

**Foyston, Gordon & Payne Inc.  
Proxy Voting Guidelines**

The following are guidelines only. FGP Portfolio Managers are required to use their discretion to enhance shareholder value. In cases where voting in a manner contrary to these guidelines is appropriate, the FGP Portfolio Manager must consult with members of the FGP Investment Committee, including the FGP President and Chief Compliance Officer.

**1. Tender Offers**

When acting upon a tender offer, FGP will continue to act in the best interests of the Client, within its obligations as a fiduciary.

**2. Class Actions**

When class action notices are received on behalf of FGP Clients, it is FGP's policy to determine if participation in the class action is in the Client's best interests, which must be approved by the FGP Executive Committee. If so, FGP's Operations Department, the Client's custodian, or the proxy service provider will prepare any necessary documents required to participate in the class action.

**3. Routine Corporate Administration Issues**

➤ *Appointment of Auditors.*

FGP will support the appointment of Auditors unless there is concern over the reputation of the firm being recommended.

➤ *Such other business as may properly come before the meeting.*

The voting for or against such other business will be dependent on the issue itself although typically FGP will vote in accordance with Company Management on such issues provided it does not conflict with the Guidelines.

**4. Corporate Governance Issues**

FGP is a member of the Portfolio Management Association of Canada (PMAC). The Association has published its Principles of Corporate Governance, last updated February 2012, which is supported by FGP.

The attached Principles of Corporate Governance, issued by PMAC, and its relevant recommendations are the guidelines generally followed by FGP with respect to Corporate Governance issues.

# **Portfolio Management Association of Canada Principles of Corporate Governance**

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**Introduction**

Corporate governance is the set of principles, procedures and rules that direct and control the affairs of a company. The objective of good corporate citizenship is to promote strong, viable and competitive corporations, with the purpose of enhancing shareholder value.

Some areas of corporate governance are established by legislative and regulatory framework, while other aspects are within the control of a company's board of directors, management and shareholders. This document deals with the aspect of corporate governance that is not legislated or regulated but rather, under the control of directors, management and shareholders.

The following are recommendations that PMAC views as best practice corporate governance guidelines for public companies, and would form the basis for the voting of proxies by members of PMAC.

**A. Boards of Directors****Overview**

The board of directors is a steward of a corporation's assets and represent the interests of the shareholders. The board's responsibility is to add value to those assets by engaging in a mature and constructive relationship with management to build a successful corporation and enhance shareholder value.

The board's key functions are to approve the direction of corporate strategy, supervise risk management, and evaluate performance of the company and management; concurrently, the board maintains accountability to shareholders. All directors should be nominated on the basis of experience and expertise, and are expected to act independently of management. Overall, the board is responsible for determining, implementing, and maintaining a culture of integrity and ethical behaviour.

**Recommendations****1. Voting for Directors**

One of the fundamental rights of shareholders is the election of directors to the board. Voting for each director nominees individually allows shareholders to make effective decisions regarding potential directors. PMAC recommends that all directors be proposed individually on the ballot annually.

Cumulative voting allows shareholders to apply all their director votes to one or a few board candidates. This procedure may result in a minority of shareholders skewing the votes and electing directors who see their role as representing the interest of a particular group of shareholders rather than all shareholders. PMAC recommends that cumulative voting not be used in director elections.

Shareholders should have an effective ability to vote directors both on and off the board, as it gives shareholders input into board composition. Plurality voting gives shareholders no such input. Ideally board members should be elected to the board using a majority vote standard where shareholders have the option of voting “for” and “against” individual directors, and directors must receive a majority of votes “for” to be elected to the board. PMAC strongly advocates for the elimination of plurality voting and the adoption of majority voting.

## **2. Staggered Boards**

In a staggered board only a portion of directors are elected in a given year. For example, with a three-year staggered term, one-third of the board members are elected each year for three-year terms. The advantage to this process is that staggered boards may promote continuity in corporate direction and facilitate long-term planning. However, staggered boards make it difficult to replace individual directors who are not effective, or to challenge or change board control. PMAC recommends the annual election of all directors and does not support the practice of staggered boards.

## **3. Independence of Directors**

PMAC recommends that a significant majority of a board of directors (two-thirds or more) should be independent. Ideally the only non-independent director on a board would be the CEO of the corporation. PMAC considers an independent director to be a director who is independent of management and free from any interest or business relationship that could interfere with that director’s ability to act in the best interests of the corporation. An independent director should not be a former employee of the company or a representative of a key supplier to or a key client of the company. Each director should have sufficient share ownership to align his or her interests with those of other shareholders. Remuneration of members of the board in the form of shares is strongly preferred. It is strongly favoured that directors receiving compensation in the form of shares retain those shares for the duration of their tenure. Options are not an acceptable form of compensation for directors.

In-camera board meetings of independent board members only give an opportunity for more candid discussions than at formal board meetings. These meetings will help to facilitate and enhance overall board independence..

PMAC also recommends that interlinking directorships with related companies be avoided.

## **4. Board Performance Assessments**

It is recommended that all boards of directors should have a means of evaluating their own performance, as a board and individually. This evaluation should assess the knowledge and skills of directors individually, and identify any skill gaps that the

board may have a whole. This procedure should be described to shareholders in the proxy circular.

## **5. Separation of Chair and CEO**

It is a matter of good governance practice that an independent director be appointed to the position of chair. An independent chair is one of the primary mechanisms by which board independence is maintained.

PMAC strongly recommends that the roles of Chair of the board and Chief Executive Officer be separated without exception.

## **6. Board Committees**

Committees have become accepted mechanisms for corporate governance. Corporations of a sufficient size should, at a minimum, count the following among the committees of the board:

- **Audit Committee** – Responsible for accurate accounting and reporting of the company's financial performance. Also responsible for internal controls and management information systems as well as all reporting of findings to shareholders. Members on this committee must possess relevant accounting expertise to fulfill their role on this committee.
- **Corporate Governance Committee** – While the entire board is ultimately responsible for corporate governance, it is this committee's responsibility to focus full attention on such issues and make the board aware of them as they arise, and develop appropriate policies.
- **Compensation Committee** – Responsible for assessment and compensation of senior management.
- **Nominating Committee** - Responsible for assessment of existing directors, identification of needs, and identification, recruitment, nomination and orientation of new directors.

PMAC recommends that the chair and committee members should all be independent directors, and that each committee have a written mandate. It is also strongly recommended that CEO's of other listed companies do not sit on the Compensation Committees.

## **7. Risk Management**

One of the primary functions of the board is the oversight and management of risk. The board should ensure that it fully understands the risks being assumed by management and the corporation under all eventualities and contingencies, and that these risks are being appropriately managed and/or mitigated. The board should explicitly assume responsibility of this function, either by forming a committee of

the board or by some other mechanism the board deems appropriate. Regardless, the board should disclose what mechanism it has adopted to address risk management.

#### **8. Size of Board of Directors**

The number of directors on a board is important to board effectiveness. The board should be large enough to adequately perform its responsibilities without being so large that it becomes cumbersome. PMAC recommends that an appropriate board size is between nine and 20 directors for a large company, and between five and 12 directors for a small company. A key priority of the board should be to ensure that it has enough competent and independent members, regardless of size.

#### **9. Overboarding**

Overboarding is the term that is used to describe a situation where a director sits on too many boards to be effective. Being a director of a public company requires a significant commitment of time in order to do the job well. Any director who has significant other commitments in the form of other directorships and/or is a CEO or senior executive of a listed company may not be able to perform their board duties to the standard required. It is recommended that a director sit on no more than six public company boards, and in the case of a current CEO, no more than two boards.

#### **10. Director Attendance**

Directors should be able to commit sufficient time and energy to their duties to carry them out in an effective manner. Attendance at board and committee meetings is not the only measure of a director's performance, but poor attendance makes it difficult for a director to carry out his or her responsibilities effectively. All board members should attend a minimum of 75% of board and committee meetings in person. PMAC recommends voting against or withhold voting for those directors who have a poor attendance record.

#### **11. Audit Process**

The audit plays a vital role in the corporate governance process. Not only does it give credibility to the company's financial information, but it also gives shareholders comfort that the financial information has been presented in accordance with established accounting standards.

The audit process should involve the establishment of an independent audit committee and the appointment of an independent auditor by that committee. The auditor should report directly to the Audit Committee, and not to management.

Auditors and/or the audit partner should be rotated on a regular basis.

#### **12. Audit Fees**

The amount and composition of total fees paid to an auditor can compromise an auditor's ability to act independently and perform an audit that is free from undue influence by management. Requiring that a substantial majority of the fees paid to

the auditor is for audit and audit-related services will help to ensure auditor independence.

Ideally the audit firm should provide only audit services to the company.

## ***B. Management & Director Compensation***

### ***Overview***

Executive compensation and incentives are the costs that shareholders are prepared to pay for having people with relevant expertise and experience manage the company for them and enhance long-term shareholder value. Well-designed compensation structures can serve to align the interests of directors, management and shareholders.

Management favours compensation where there is limited downside, whereas shareholders prefer it to be tied to company performance. Companies must strike a balance between compensation practices that are generous enough to attract and retain qualified executives, while not being excessive.

In addressing compensation issues, the board is best served by establishing a Compensation Committee whose task is to ensure that compensation arrangements are structured in such a way as to ensure that this balance is achieved.

### ***Recommendations***

#### **1. Management Compensation**

The principal interest of shareholders is to build long-term shareholder value. Compensation packages should induce management to become owners of enough stock such that their interests are aligned with those of shareholders. There should be a positive and significant correlation over a reasonable period of time between compensation and the enhancement of shareholder value. Compensation must be high enough to attract and retain qualified management and be competitive within the company's respective industry, but should not reward failure or mediocrity. PMAC believes that executive compensation should be competitive without being excessive. A significant portion of the total compensation arrangements for senior management should be linked to the company's performance.

#### **2. Stock Option and Incentive Compensation Plans**

PMAC supports compensation and option packages that encourage management to own stock so as to align their financial interests with those of the shareholders. It is important that option plans and the cost of those plans should be clearly disclosed to all shareholders. PMAC views unrestricted stock options, options priced below current market value, and lowering the exercise price on previously granted options as unacceptable practices. In PMAC's opinion, options should expire within 5 years of being granted. Furthermore, the total of all stock option plans should be capped at a maximum of 5 percent of outstanding shares for large mature companies, and 10

percent of outstanding shares for all other companies, to prevent excessive dilution. PMAC is generally opposed to large option grants to one individual or a small group. If a company chooses to grant restricted stock, or stock that has holding period restrictions, it should not be 100 percent vested when granted; rather it should vest over a specified period of time. Similarly, options should have a minimum holding period of at least three years before they can be exercised or sold. Stock options are an expense to a company and should be duly expensed on the income statement of the company's financial documents and disclosed to shareholders.

### **3. Golden Parachutes**

Golden parachutes are severance arrangements for senior executives who are terminated or demoted following a takeover or merger. Golden parachutes are used as a means to attract or retain qualified executives by providing financial security in the case of an unexpected change in control. These arrangements help to ensure that management makes decisions in the best interest of a company and its shareholders regardless of management's own welfare. However, golden parachutes can be excessive and can entrench management. PMAC recommends that golden parachutes should be reasonable, fully disclosed, and approved by shareholders at the earliest possible opportunity once the plan has been put in place by the board. Plans that use a single trigger are not acceptable under any conditions, and it is recommended that such plans not be approved by shareholders.

### **4. Corporate Loans**

Loans to senior management or the guaranteeing of loans for the purpose of exercising options should be avoided. These types of arrangements expose the company to the risk of not being able to recover the loan if the borrower is terminated.

Generally, loans that are reasonable in amount, are charged a market rate of interest, are secured against shares in the company or some other real asset, and are unforfeitable are acceptable provided they are fully disclosed to shareholders

### **5. Disclosure of Compensation Practices**

PMAC believes that executive compensation should be performance based, and align the interests of executives with the long-term interests of shareholders. We would like to see performance criteria clearly disclosed and defined, and if and how those criteria are met.

This information should be included in the Compensation Report in the proxy circular. The performance criteria and if they have been met should be determined by the Compensation Committee.

PMAC recommends that shareholders should be allowed an advisory vote on the annual proxy to approve the Compensation Report.

Where compensation disclosure is inadequate, or the link between pay and performance is not adequately demonstrated, it is recommended that shareholders



vote against the approval of the compensation report, or if this option is not available to withhold votes from the compensation committee.

## **6. Aggregate Dilution from Equity-Based Compensation**

There are many types of stock based compensation plans, and some of these types of plans can dilute the holdings of current shareholders. For example, performance stock will result in dilution, where phantom stock will not. It is easy to focus on the dilution from stock option plans but ignore the dilution from other types of stock based plans. As such it is important to assess the dilution of these plans individually and in aggregate. It is recommended that the aggregate potential dilution from all stock based compensation plans not exceed 10% of outstanding shares.

## ***C. Shareholder Rights***

### ***Overview***

Shareholders can influence the affairs of a corporation in which they invest. This can be done by directly communicating with the management and directors of the company and/or by exercising proxy voting rights. Share ownership rights are assets that should be protected and therefore shareholders should keep themselves informed about market and corporate governance issues that may affect the company. Effective shareholders must manage their proxy votes to protect their ownership in such corporations.

PMAC Members believe it is in the best interest of their clients that shareholder rights are exercised with the aim of enhancing long-term investment returns. The following sections address some specific issues that impact shareholders' rights.

### ***Recommendations***

#### **1. Confidential Voting by Shareholders**

Voting at annual and special meetings should be subject to the same safeguards as voting in any other election and should be free of any potential coercion and/or impropriety. With this in mind, PMAC supports confidential voting processes.

#### **2. Takeover Protection – Shareholder Rights Plans**

The takeover protection measures that are available to boards and management can be a double-edged sword for the shareholder. They can be used to protect shareholder value by defending the company from hostile takeover bids that do not represent a fair value for the assets of the company. However, they can also be used to entrench a board and management who may ultimately undermine shareholder rights and shareholder value.

Shareholder rights plans, sometimes referred to as “poison pills”, are the most common form of takeover protection. There are two main purposes for a shareholders rights plan. Firstly, to ensure that all shareholders are treated equally, and secondly, to give the board time to consider other options. Many shareholder rights plans go well beyond these two aims and may be used to prevent bids that are, in fact, worthy of shareholder consideration.

The plan should allow a takeover offer to stand for no longer than 60 days before the board responds. This gives management and the board ample time to consider the bid, and assess alternatives. In addition, the plan should be subject to shareholder approval at least every three years, and any significant changes to the plan should also be subject to shareholder approval.

### **3. Dual Class Shares**

Dual-class shares refer to unequal voting rights between classes of shares. This violates the principle of one share, one vote. This means that a minority of shareholders has the ability to make decisions that may not be in the interests of all shareholders, or may not be supported by the majority of shareholders.

PMAC takes the view that all shares should have equal voting rights, and control should only be gained through the ownership of a majority of the shares in a corporation. PMAC opposes the creation of shares with unequal or multiple-voting rights, and encourages the elimination of them where they currently exist.

### **4. Super-majority Approval of Business Transactions**

We believe that supermajority requirements do have a legitimate purpose, but can be subject to abuse. They should not be used for votes regarding takeovers or control of a company, and the approval proportion should not be set too high. A two-thirds majority is most common, and anything above this would be considered unreasonable.

### **5. Linked Proposals**

Linked proposals combine two separate issues into one for the purposes of a proxy vote. Often, linked proposals are designed to make an issue more acceptable to shareholders than it would be separately, thereby causing confusion or having the result of coercing shareholders into voting for it.

PMAC opposes linked proposals.

### **6. Unlimited Authorised Shares**

A company may ask shareholders to authorize additional common shares that may be used to implement a stock split, to support an acquisition or restructuring plan, to use in a stock option plan or to implement an anti-takeover plan.

Although the additional authorised shares may in some cases be in the best interest of shareholders, in other cases the shares may be used to dilute the value of existing shareholders' holdings and not be in their best interests.

PMAC opposes unlimited authorised shares. PMAC supports the approval of additional authorised shares if the amount of stock is limited in number and the purpose of potential issuance is identified and in the shareholders' interest.

## **7. Shareholder Proposals**

Shareholder proposals give shareholders an opportunity to raise concerns or issues and be heard by management and the board. These proposals give corporations the insight and knowledge of shareholders on particular issues.

PMAC supports proposals that respect the fiduciary responsibilities of management and the board. PMAC does not support proposals submitted for the purposes of enforcing personal grievances or obtaining publicity or do not pertain to the business of the corporation.

Generally, PMAC supports proposals that call for enhanced disclosure where the proposal relates to an area that represents a real risk to the corporation and those risks are not adequately disclosed.

## **8. Reporting of the Results of Proxy Voting**

PMAC takes the view that reporting of proxy voting results at annual and special meetings should be timely and include at a minimum the number and percentage of votes for, against and withheld.

Additionally, all voting should be conducted by ballot rather than a show of hands, as this will ensure that all shareholders, whether present at the meeting or not, will be treated equally. In order to maintain the integrity of the proxy voting process, it is recommended that vote results be subject to independent verification.

## **9. Income Trust Governance**

Unitholders of income trusts should enjoy the equivalent rights and protections as those of shareholders of a corporation. The trust and associated entities should take steps to ensure that appropriate corporate governance practices are adopted to achieve this end.

## **D. Conclusion**

Corporate governance practices are constantly changing, and as such best practices will continue to evolve. PMAC commits to reviewing the Principles of Corporate Governance annually and as part of this review process, any comments or feedback on the principles from Members would be appreciated. Any comments on these principles can be directed to the chair of PMAC's Investment & Corporate Governance Committee.