KINGSDALE Advisors 20 YEARS

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2024 AGM TRENDS TO WATCH FOR

Annual meetings are anything but routine. This year, more than ever, it is pertinent for board members and business leaders to be well-prepared, proactively addressing evolving governance issues, and implementing ongoing institutional and retail shareholder engagement strategies.

Key AGM Trends for Canadian Companies and Boards

Canadian companies should be prepared to be challenged on the most basic resolutions as investors are adopting their own, often stricter, policies for standard AGM resolutions and diverging from their traditional adherence to ISS and Glass Lewis benchmark policies. Voting results will be impacted across the board; routine votes on directors and auditors are declining. There is increasing scrutiny on environmental, social and governance (ESG) disclosures and a stronger focus on Say-on-Diversity. Changes in institutional voting behaviour and the opacity caused by the de-centralization of voting will create a complex situation for boards – specifically, their inability to anticipate and identify a negative vote and understand why the vote was cast that way. Companies should take a year-round approach to shareholder engagement to gain visibility into potential concerns and be ready to address any issues. Building and aligning shareholder relationships will lead to mutually beneficial results.

Key Questions Every Company Should Ask and Address Ahead of Their Meeting

1 How does pass-through voting impact your company?

A significant development was the decentralization of voting authority among major asset managers, exemplified by the "Big Three" - BlackRock, State Street Global Advisors and Vanguard. The introduction of “pass-through voting" in 2022 has shifted voting power from asset managers to their underlying holders and will become more dominant in 2024. It offers clients of asset managers the ability to choose from a menu of governance policies or to draft their own. The “Big Three” clients value their anonymity and typically do not engage. We recommend that companies develop strategies to off-set the impact and partner with a leader in this space, like us. We reach out to the “Big Three” asset managers to understand the evolving landscape and explore avenues to ensure that the issuers’ messages are at least received and undertake shareholder engagement.

2 Is your board ready for the racial and/or ethnic diversity requirements?

Beginning in February 2024, ISS will expect companies that are part of the S&P/TSX Composite Index to have at least one racially/ethnically diverse director. For S&P/TSX Composite Index constituents that have no apparent racial or ethnic diversity on the board, ISS will generally recommend voting against or withholding support from the Chair of the Nominating Committee or Chair of the committee designated with the responsibility of a nominating committee, or the Chair of the board of directors if no nominating committee has been identified. This applies in cases where the board lacks apparent racial or ethnic diversity, and the company has not issued a formal, publicly-disclosed written commitment to add at least one racially or ethnically diverse director before or at the next AGM. Case-by-case evaluation will be adopted to determine whether against/withhold recommendations are justified for additional directors at companies that persistently fail to meet this policy over two years or more. Glass Lewis does not have similar voting recommendations applicable to Canadian companies. It should be noted that many of the specialty policies available to pass-through voting clients have stricter gender and racial diversity requirements. We strongly recommend that companies equip directors with continuous board education and training and have a strategic board composition and nomination process that takes diversity into account.

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3 Is your board's accountability up to par for climate-risk related issues?

In 2024, Glass Lewis updated its climate-related issues policy to include S&P TSX 60 companies in industries identified by the Sustainability Accounting Standards Board (SASB) as having financially material risks related to GHG emissions. The assessment will include an evaluation of explicit and clearly defined board-level oversight responsibilities for climate-related issues. Absence or significant lack of these disclosures may lead to recommendations against the chair of the committee or board overseeing climate issues, or in the absence of a dedicated committee, the chair of the governance committee. Recommendations may also extend to additional committee members based on various factors, including the company's size, industry and overall governance profile. ISS' 2023 policy on climate board accountability globally remains in effect. As the impact of climate change intensifies, investors and regulators are increasingly seeking greater transparency on a climate transition plan and a robust climate governance framework. Apart from proxy advisor policies, we continue to see shareholder proposals tied to climate transition. Ensure disclosure is comprehensive and showcases board actions.

4 Are you actively engaging with your retail shareholders - do they know you?

Historically, the outcome of proxy voting has been influenced by institutional investors while retail shareholders have been overlooked. Retail shareholders are becoming more active participants and this diverse group encompasses individual shareholders, investment clubs, and online communities. With online platforms and social media democratizing investment opportunities, retail shareholders are empowered to engage in information sharing, and, at times, unite to vote against management. The rise of pass-through voting also underlines the importance of reaching out and engaging with retail shareholders. In this era of digital transformation, companies should recognize the shifting dynamics and look for ways to mobilize retail shareholders. Kingsdale has rolled out full-service digital solutions to help companies better tap into their retail base and provide greater visibility into the shareholder universe.

5 Are you prepared if your directors are being targeted?

An increasing trend in AGMs across all sectors is the decline in overall support levels. A key driver is that institutional investors have developed customized and more restrictive in-house proxy voting policies. These include policies around director over-boarding, tenure, independence concerns, environmental commitment, impact or performance, board diversity, and accountability when "things go wrong". We recommend a year-round approach to investor engagement with top holders and the majority of the largest investors to gain better visibility into any issues and to anticipate and address any comments or concerns in real time. Companies should also look inward and perform an internal vulnerability assessment on their proposed board for 2024 and, in addition to protecting the current board, build a strategic approach to refreshment, ensuring a strong pipeline of qualified candidates.

6 Think your auditor appointment is a formality? Your investors don't.

Until recently, absent major accounting issues, boards were able to bank on 99% support for their auditor appointment. The landscape has changed: in the last two years, the number of Canadian companies receiving less than 90% of investor support for auditor ratification resolutions has escalated and we expect the decrease in support for auditors will continue, absent a better understanding of the North American framework for ensuring auditor independence and the quality of audit work. European policies, formed in response to local accounting scandals, have equated long auditor tenure to a lack of independence. Institutional investors are adopting their in-house voting policies to promote more frequent audit firm rotation and putting audit contracts out to tender. We suggest that companies engage investors in their auditor selection and be prepared to explain the regulatory framework and how their board operates within that framework.

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7 Does your board have a designated "Audit Financial Expert"?

Glass Lewis believes that audit committees should have at least one member designated as an "audit financial expert" with demonstrable audit experience. Revised criteria for the designation of an "audit financial expert" include experience as a chartered accountant, certified public accountant, former or current CFO of a public company or corporate controller of similar experience, current or former partner of an audit company or possessing demonstrably meaningful audit experience. We recommend that boards must carefully review the existing disclosure related to audit committees and "financial experts" to ensure that committees and directors are compliant with Glass Lewis' new designation of "audit financial expert".

8 Are you prepared for shareholder proposals with a specific interest in ESG?

In 2023, 52 shareholder proposals were opposed by management compared to 69 in 2022, and does not include proposals that were rejected on technical grounds or negotiated away. Yet, average investor support for these 2023 shareholder proposals increased – in contrast to the decrease seen south of the border - indicating that ESG needs to remain on the radar for companies. Among those that have been subject to shareholder proposals are the banking and energy sectors, specifically related to environmental shareholder proposals which were up year over year and centered around those companies' investments in traditional energy and environmental performance. Investor interest in ESG is here to stay – and scrutiny is going further into all corners of the business. The second most prevalent are "social" proposals that include pay diversity, racial equity audits, workers' safety, and human capital management. Companies should carefully evaluate their disclosures, detailing how their ESG initiatives drive long-term sustainable shareholder value. Every shareholder base is different. Companies must understand who their shareholders are, the specifics of their voting policies and how best to engage with those shareholders to ensure that the company's ESG strategies are aligned with shareholder sentiment.

9 How does Artificial Intelligence impact your boardroom?

Boards are identifying Artificial Intelligence (AI) as one of their top priorities and risks as they are accountable legally and ethically for the use of AI within the company and its impact on employees, customers, and shareholders including third-party products which may embed AI technologies. The use of "artificial governance intelligence" is already actively applied in boardrooms and the corporate decision-making processes, such as due diligence of mergers and acquisitions, profiling investors, auditing annual reports, validating new business opportunities, analyzing and optimizing procurement, sales, marketing, and other corporate matters. In Canada, several upcoming federal and provincial privacy law reforms will affect the use of AI in business operations. If passed, the proposed federal Bill C-27, would implement Canada's first artificial intelligence legislation the Artificial Intelligence and Data Act (AIDA) and could come into effect in 2025. The use of AI requires strong risk and governance frameworks and companies should proactively develop strategies and policies that seamlessly integrate with the organizations' ESG strategy, and enhance accountability, and ethical behaviour.

10 Do you have cybersecurity governance in place?

Recent cyber-attacks at major companies have sounded the alarm for boards to reassess their cybersecurity governance. Such incidents can result in the loss of revenue, reputational risk, and expose the company to potential litigation. In response to the growing risk of cyber-attacks, Glass Lewis now expects periodic updates for shareholders following a material cyber-attack. Glass Lewis generally refrains from making voting recommendations on cyber-related issues in the absence of material incidents. Recommendations against relevant directors may be made if the board's oversight, responses or disclosures concerning cybersecurity issues are deemed insufficient or not provided to shareholders. Companies should consider aligning cybersecurity governance policies and practices with strategic business plans, enterprise-risk management programs, AI and IT applications, business culture, and brand reputation.

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Companies should also ensure that the boards receive regular and proactive reports on cybersecurity and cyber resilience issues, maintain thorough cybersecurity oversight, allocate proper resources to cybersecurity risks, benchmark company policies and procedures against industry peers and best practices. Companies should also continue refreshing their board and upskilling the current board and/or committee responsible to understand and address cyber risks.

11 Is your compensation performance design and executive compensation in line with your company's performance?

The 2023 proxy season saw increased opposition to Say-on-Pay (SOP) proposals in Canada and continues to be a challenge. The opposition in some cases was prompted by poor results in ISS and Glass Lewis's pay-for-performance models. Glass Lewis has shown more propensity to rely on qualitative factors, such as compensation design, in reaching its conclusions. Retail investors are taking notice and increasingly putting their collective weight behind their ballots in addition to the proxy advisors and the typically high turnout of institutional investors. However, unlike proxy advisors, retail investors are less likely to consider peer groups. They will look at more rudimentary metrics, such as the stock's performance over the past year and other peer-share measures. Institutional investors are exerting their own views on executive compensation with distinctive views about overall compensation program design, setting of target objectives, and financial performance measures.

12 Do you know if you are a target for activism?

Activism is on the rise and is sector and market-cap-agnostic. What has changed in activism is that it's no longer the brand name, "capital A" activists who are driving proxy contests. In 2023, only seven of the 69 proxy fights in Canada were initiated by a brand name activist fund. The vast majority of campaigns were initiated by long-term investors, institutional investors, and company insiders. The 2023 proxy season also saw various activist demands, including changes to capital allocation, changes to boards and management, a reduction in operational expenses, shifts in business focus, ESG-related issues, and requests for spin-offs or sales of specific business divisions.

There were notable instances where activists swarmed the same target group. Unlike a traditional wolfpack approach, where like-minded activists rally behind a lead, a swarm is different activists with their own agendas targeting the same company, often unbeknown to one another. Companies that suspect they may be a target should conduct an internal vulnerability analysis from the shareholders' point of view, engage meaningfully with their investors, and put defences in place.

13 Is your defence playbook up-to-date and do you have the right response team in your place?

Canadian companies found themselves in the crosshairs of a record-breaking 69 shareholder activist campaigns, marking an unprecedented high for the market and a dramatic increase over last year. There were notable instances where activists swarmed the same target company. Companies should take advantage of every opportunity to communicate with their investors and have a story to tell. Also, we recommend that companies get their defences in place and have a response plan prepared. Just because your company or sector hasn't faced activism in the past doesn't mean you won't be on the radar this year.

Kingsdale Advisors is North America's leading strategic shareholder advisory firm, trusted by hundreds of management teams and boards for their annual meeting needs. For advice on your AGM, please contact:

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