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Proxy Alert

Recommendation: FOR shareholder proposal at Linamar Corporation

April 2, 2019

Linamar Corporation
Symbol: LNR.TO
Annual Meeting Date: May 30, 2019

Filers: ECHO Foundation (represented by SHARE), Alberta Investment Management Corporation (AIMCo), British Columbia Investment Management Corporation (BCI) and the Public Sector Pension Investment Board (PSP).

Shareholder proposal: Adopt a "say on pay" vote

A group of pension plans and other institutional investors have filed a formal shareholder proposal with Linamar Corporation asking that the company offer an annual shareholder advisory vote on executive compensation ("Say on Pay"). The proponents sought assurances that directors are making serious efforts to link executive compensation to corporate performance. They argue that "Say on Pay" votes provide shareholders with an opportunity to register their approval or disapproval on executive compensation and that "Say on Pay" has been found to improve communication between shareholders and issuers on executive compensation.

The resolution reads:

> *Shareholders request that the Board of Directors adopt a policy that the Company's shareholders be permitted to vote, on an annual and advisory basis, on a management resolution to ratify the compensation of Named Executive Officers set forth in the proxy statement.*

The company's response, issued in its proxy circular, suggests four main points of argument:

- ***Executive compensation is complex**: "Executive compensation is an increasingly complex area, requiring expertise and thoughtful deliberation over time and circumstances, to arrive at the right mix or balance to attract and retain effective senior executives and align their incentives and efforts with the Corporation's success. Boards and compensation committees are faced with a multitude of potential forms of compensation to be considered, including cash (e.g. salary, annual bonus, long-term non-equity plans and pensions) and equity-based compensation (e.g. stock options, restricted share units, performance share units and stock appreciation rights), each with its own particular incentives and pay-out profile, which can be contingent on the achievement of outcomes across an extensive array of performance-based triggers (e.g. earnings per share, return on invested capital, stock price levels and any number of appropriately-crafted non-GAAP measures) which can vary as between industries, issuer growth profiles and even executive titles."*
- ***Executive compensation is the board's responsibility**: "In the Board's view, it is also important to maintain clarity regarding the role of the Board as distinct from the role of shareholders …. Executive compensation is one of the Board's most important responsibilities and the Board's authority to determine executive compensation is vital to the Board's performance of its overall duties."*
- ***The vote is a blunt instrument**: "A 'say on pay' 'for' or 'against' advisory vote would be an ambiguous, public and inferior form of communication that would not be in Linamar's best interests. The Board believes that the process of shareholder feedback on executive compensation can be better addressed through direct shareholder communications with the Board and the Corporation rather than through a blunt voting processes which is both administratively burdensome and not issue specific."*

- ***Pay at Linamar is already aligned with performance****: "It is notable that this Proposal is being brought in a year where executive compensation is down, overall, as a reflection of the year over year performance of the Company's share price. CEO compensation, for instance, decreased by approximately 7.7% in 2018 in view of a reduced award of share grants during the fiscal year. The Board believes this key point underscores the successful operation of the compensation philosophy and demonstrates that compensation is very much aligned with shareholder value."*

Background on "Say on Pay" in Canada

"Say on Pay" is not a regulatory requirement for Canadian issuers. However, as a result of years of continual shareholder engagement more than 71% of companies in the TSX Composite Index have now adopted "Say on Pay" votes and 52 of the TSX60 Index companies have adopted the practice. Another 52 Canadian publicly-traded companies that are not on the TSX Composite Index have adopted the practice, making a total of 220 companies in Canada offering an annual "Say on Pay" vote.

Arguably, this high uptake makes "Say on Pay" the norm in Canadian markets, and is already the practice at many of Imperial Oil's competitors.

It is also a regulatory requirement in other jurisdictions including the USA and the UK.

Vote Recommendation and rationale

It is true that executive compensation has become a complex and multi-faceted endeavour, however this complexity does not preclude a shareholder from either understanding the approach the company has taken nor expressing a view as to the adequacy of the approach. If the company is not able to communicate its approach effectively to its shareholders, that alone may be cause for concern with the board's management of executive compensation and incentive programs. An effective executive compensation plan should be easily understood and reflect clear performance objectives.

As a general rule, suggestions that shareholders cannot be trusted to evaluate a company's plan in context and make unique decisions based on the merit of the proposed plan at the specific company are not an adequate argument against allowing shareholders an advisory – and we stress "advisory" vote – on the issue at hand.

That said, the proponents express that neither the intent nor the effect of their proposal is to supplant the board's decision-making power over executive compensation. The proposed vote is a non-binding, advisory vote. As the proponents write, *"the philosophy underpinning Say on Pay acknowledges that directors are charged with making decisions regarding executive compensation while allowing shareholders to provide their views of those decisions."*

SHARE's long-standing view is that "Say on Pay" votes create a critical accountability mechanism for shareholders, providing them with an opportunity to voice concerns with executive compensation practices in a focused, effective and appropriate manner. Adopting Say on Pay has been a way for boards to demonstrate their willingness to communicate and discuss their approach to compensation in open dialogue with shareholders, both before and after the annual vote. It provides the right balance between accountability to a company's owners and the board's discretion to oversee the company's overall health and success.

It is true that "Say on Pay" votes are a binary proposition, and cannot deliver detailed criticism or praise of any specific aspect of a given company's approach to compensation. Further, the large holdings by Frank and (Linamar CEO) Linda Hasenfratz suggest that in any given "Say on Pay" vote the board's recommendation will receive majority approval.

However, a high "no" vote amongst independent shareholders will still provide an important signal to the board about its approach. It surfaces a level of concern that may not otherwise have been brought to the board's attention by other means.

These concerns are best raised in the context of a "Say on Pay" vote rather than through other vote results, as the proponents argue:

> *In the absence of a Say on Pay vote at Linamar Corporation, shareholders who do not support some or all aspects of the company's executive compensation practices can only register this view indirectly, by withholding their votes to re-elect directors on the compensation committee. Say on Pay will allow shareholders to clearly and unambiguously express their views of executive compensation by voting on the matter directly.*

Low votes for otherwise competent directors would be a confusing signal for the board and a much less effective means of delivering a message regarding executive compensation.

It is also true that larger institutions may be able to avail themselves of other means of communication with the board of directors (as suggested by the company). Smaller institutions and retail investors, however, rarely have this capacity on their own and would benefit from the ability to register a simple vote with minimal transaction costs. Nor is it easy for the board to accurately determine the extent of shareholder agreement with opinions expressed by any one large shareholder without a democratic means of testing for agreement, as may be done with a "Say on Pay" vote. The vote is a valuable supplement, not a replacement, for shareholder/board engagement.

Lastly, the shareholders' request to make an advisory "say on pay" vote available to shareholders is not in itself a verdict on the appropriateness of the Linamar board's approach to executive compensation in a given year, and therefore current or past corporate performance is not relevant to the question of *whether* to offer a vote. The availability of a vote provides an accountability mechanism for shareholders should they, *at any point in the future*, have concerns about the board's approach.

SHARE's Recommendation:
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Link to full proposal:

https://share.ca/share-proposals/2019-say-on-pay-linamar/

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