



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

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### Agenda Item 16

**MEETING DATE:** October 16, 2019

**SUBJECT:** Proxy Voting Education

**SUBMITTED FOR:**  Consent  **Deliberation and Action**  **Receive and File**

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#### **RECOMMENDATION**

Staff recommends the Board receive and file the education presentation on Proxy Voting.

#### **PURPOSE**

This item supports an objective of the SCERS' 2019 Annual Investment Plan, to provide the Board with an update on proxy voting services for SCERS' investment portfolio.

#### **BACKGROUND**

SCERS has been investing in public equity securities for decades. Over that time, the market for both public equity investing and proxy voting has changed dramatically. As defined within SCERS' Strategic Asset Allocation, 40% of the SCERS portfolio is invested in public equities, split evenly between domestic and international allocations, including both passive and actively managed strategies. The SCERS public equity portfolio consists of thousands of global equity securities, with investments ranging from large capitalization domestic companies to small capitalization emerging market companies.

The market for proxy voting has also changed significantly over the years. As the public equity markets have expanded in scope and scale, the emphasis on proxy voting and corporate governance has also increased. The increased emphasis on proxy voting, including the use of proxy voting to influence corporate change, has led to increased complexity in the range of issues being considered on proxy ballots, from traditional issues such as election of Board members and ratification of auditors, to more complex issues such as executive compensation, mergers, acquisitions, and corporate citizenship issues including climate change and wage parity. Proxy voting plays an important role for shareholders to communicate their preferences to corporate board of directors and protect their economic interests as owners.

As public equity portfolios have become more diverse, including passive management portfolios with thousands of securities, and proxy voting issues more complex, the use of outside service

providers have come to serve a prominent role in the proxy voting landscape. Shareholder voting is dominated by institutional investors with recent research showing that approximately 70 percent of outstanding shares of U.S. publicly traded companies are owned by institutional investors such as pensions, index funds, mutual funds, and hedge funds. Additionally, the proxy voting process can be costly and require significant time and resources. While the largest institutional investors may have the ability to dedicate significant resources to researching company-specific issues and developing proxy voting guidelines, most small and mid-sized funds lack the resources to conduct these activities. Third-party proxy service providers satisfy the market need by centralizing these costs so they aren't duplicated across multiple investment firms. The use of third-party proxy voting firms has therefore become a cost-effective means of meeting fiduciary and regulatory voting obligations for institutional investors.

### Regulatory Requirements

The voting of proxies is required by California Government Code Sections 7450 and 7451. These code sections stipulate as follows:

#### Government Code Section 7450:

Every local agency in this state owning common stock and whose stock is by contract managed by a fiduciary shall request such fiduciary to forward any proxies for shares owned by the agency which are to be voted in a corporate election to the governing body of such local agency.

#### Government Code Section 7451:

Notwithstanding any other provision of the law, every local agency in this state owning common stock shall, when returning proxies to a corporation, vote each proxy that is returned to the corporation. Nothing in this section shall prohibit a local agency in this state owning common stock from abstaining on a corporate or shareholder proposal and notifying the corporation in writing of the local agency's desire to abstain on a corporate or shareholder proposal.

Local agency includes every county, city, city and county, district, and authority, and each department, division, bureau, board, commission, agency, instrumentality or pension or retirement system of any of the foregoing.

### **APPROACHES TO PROXY VOTING**

Investment firms, including public pension plans, take a number of approaches to voting proxies. The approaches differ based on considerations including size of the organization, ability to dedicate resources to proxy voting, and organizational view on corporate governance and shareholder activism. The different approaches to proxy voting generally fall under the following categories:

- Internal Voting by Staff
- Outsource to External Equity Managers
- Use Third-Party Service Provider

Internal voting of proxies is generally performed by the largest institutional investors who have the necessary resources to dedicate to the proxy voting process, including reviewing potentially thousands of proxy ballots and issues and the economic impact from voting decisions.

Outsourcing the voting of proxies to external equity managers delegates the voting requirement to the investment managers who are responsible for the purchase and sale of the equity securities they manage on behalf of the institutional investor (i.e. pension plan). A positive aspect of this approach is the equity manager should be well informed on the voting issues and potential impact to the underlying security from the proxy voting process. However, this approach also requires additional time and resources to reconcile and monitor the votes by the various external managers. This approach also requires the institutional investor to relinquish control over the voting process and results.

The use of third-party service providers (also known as proxy advisory firms) is a widely followed approach to voting proxies. Proxy advisory firms provide an effective and efficient way for institutional investors to meet their fiduciary and regulatory requirements. As detailed below, these firms provide a variety of services to meet the various voting requirements for a broad range of institutional investors. SCERS has employed the use of a third-party service providers to vote proxies for many years, and Staff recommends continuing with this approach, as it provides an effective way to meet regulatory requirements, with appropriate monitoring and reporting, while allowing SCERS to maintain adequate control over the process.

#### Proxy Voting Service Providers

Third-party service providers specialize in providing proxy voting advice, establishing proxy voting guidelines, providing tools and resources for institutional investors to vote proxies, casting ballots on behalf of institutional investors, and offering post-vote reporting services.

While there are a number of proxy advisory firms in the U.S., the industry is dominated by the two largest firms, Institutional Shareholder Services (ISS) and Glass, Lewis & Co (Glass Lewis). ISS is the largest proxy advisory firm in the U.S. and globally, and is the proxy advisory firm that SCERS uses to vote its proxies. ISS was founded in 1985, is based in Rockville, Maryland, and has 30 offices across 13 countries globally. ISS has over 1,600 institutional clients and executes more than 10 million proxy ballots annually, representing over 4 trillion shares, and covers over 44,000 meetings across 115 global markets. ISS will present to the Board at the October meeting, as part of this agenda item.

Glass Lewis was founded in 2003 and is the second largest proxy advisory firm. Glass Lewis serves over 1,300 clients and covers over 20,000 meetings annually across 100 global markets. While there are a number of other proxy advisory firms in the U.S. and globally, they are much smaller compared to ISS and Glass Lewis. Recent research estimates that these two firms combined have a 97% market share for proxy advisory services.

#### Proxy Voting Guidelines

Proxy advisory firms establish proxy voting guidelines that are designed to meet the needs of a broad range of institutional investors, who may have differing priorities and goals when voting

proxies. The proxy voting guidelines address a large number of issues, including governance issues such as election of directors and executive compensation, and issues of corporate citizenship such as wage parity and climate risk. The proxy advisory firms offer various proxy voting guidelines tailored to the needs of different institutional investors. Some examples include faith-based policies, public plan policies, sustainability policies, and Taft-Hartley policies.

SCERS has used the ISS Benchmark Policy as the guideline to vote proxies. As stated by ISS, their Benchmark Policy follows a “best practice” standard that promotes total shareholder value and risk mitigation. The ISS Benchmark Policy is included as an attachment for reference, and demonstrates the extensive detail that ISS considers across dozens of potential proxy issues.

### **PROXY VOTING POLICY**

The SCERS Board adopted a “Proxy Voting & Corporate Governance Policy” on October 14, 1999. The Policy was designed to provide general direction and voting guidelines to SCERS Staff, and any authorized proxy voting service provider. SCERS’ approach of using a third party service provider meets the broad goals and intent of the existing policy. However, the existing policy is outdated, references topics that have not been relevant in many years, and does not include guidance on the more current proxy voting issues. Additionally, third-party service providers, such as ISS, dedicate significant resources to research current issues and develop appropriate proxy voting guidelines.

Staff has prepared an updated Proxy Voting Policy, which will be presented as a separate agenda item at the October meeting following the education presentation. The updated policy focuses on establishing procedures designed to meet the fiduciary requirements related to proxy voting, as required by current regulatory standards.

### **ATTACHMENT**

- Proxy Voting Education Presentation
- ISS Benchmark Policy Proxy Voting Guidelines

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# Proxy Voting Education

October 16, 2019



**SCERS**

SACRAMENTO COUNTY  
EMPLOYEES' RETIREMENT SYSTEM

# Objectives

- Education on Proxy Voting
- Various Approaches to Voting Proxies
- SCERS' Approach to Voting Proxies
- Presentation by Proxy Advisory Firm, ISS



# SCERS Proxy Voting History and Background

- SCERS' current policy is dated October 14, 1999
- The policy is a broad “Proxy Voting & Corporate Governance Policy” designed to provide direction on how SCERS should vote specific issues
- SCERS has used a third-party proxy voting advisory firm to vote proxies for many years.
- SCERS' historical voting guidelines
  - Vote in a manner that maximizes total shareholder value



# Proxy Voting Basics

- What is proxy voting
  - A way for shareholders to vote on corporate actions when they are not able to attend a company's annual meeting (i.e. vote via proxy)
  - The primary means that shareholders, as owners of a company, can express their views and influence a company's operations.
  - Common corporate issues voted on by shareholders include
    - Electing Board of Directors
    - Ratification of Auditors
    - Executive Compensation
    - Corporate Citizenship and Governance Issues





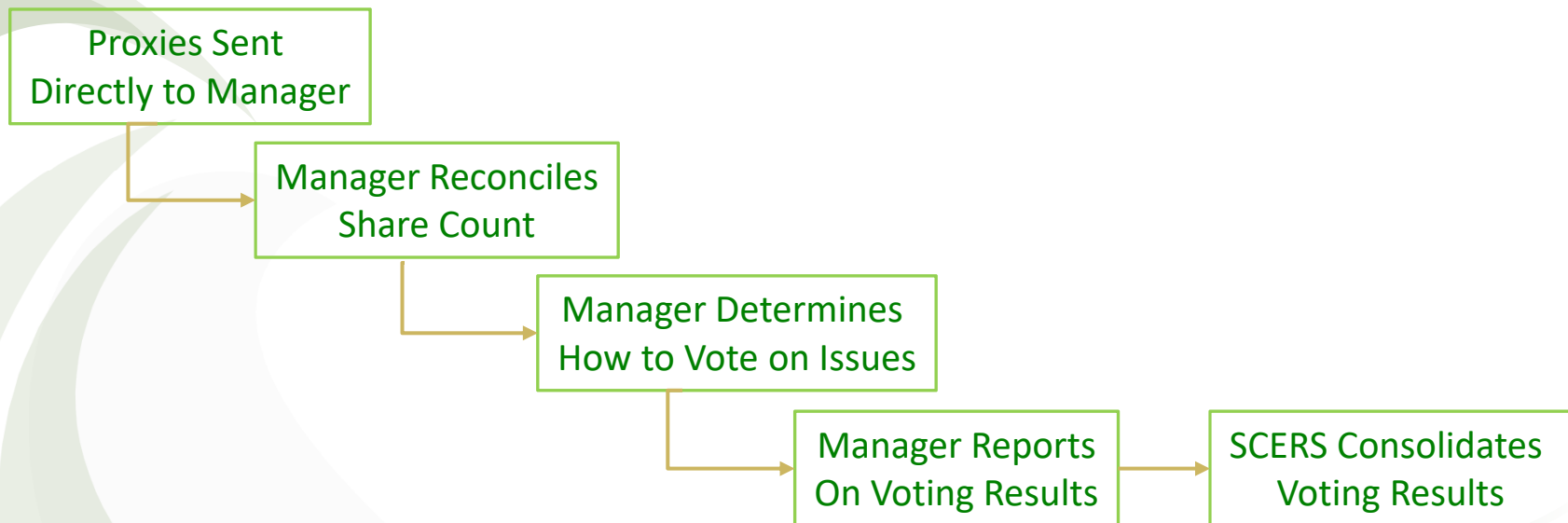
# Proxy Voting Basics

- Requirements for CA Public Plans to Vote Shareholder Ballots
  - Fiduciary Duty
    - Voting rights related to shares of stock are considered plan assets
    - Voting rights should be managed in a manner consistent with the fiduciary duties and responsibilities assigned to the management of plan assets
  - California Government Code Requirements
    - Code sections 7450 and 7451 require local agencies (including pension retirement systems) owning common stock to vote each proxy



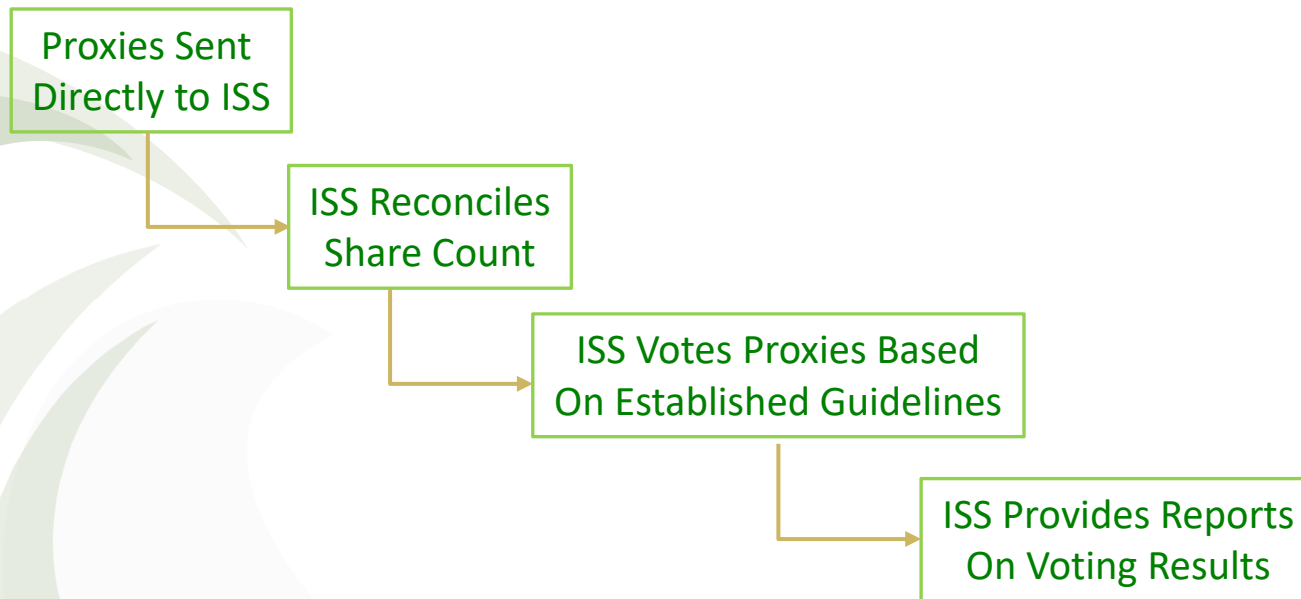
# Proxy Voting Options

- Internal Processing
  - Process followed by the largest pension plans
  - Would require significant time and additional dedicated staff resources
- Outsource to Public Equity Managers



# Proxy Voting Options

- Use Third-Party Service Provider
  - Ease of execution, monitoring, and reporting
    - Effective and efficient way to meet regulatory requirements



# SCERS Voting Approach

- SCERS has used third—party service provider approach to vote proxies for many years
- Have used the “Benchmark Guidelines” from ISS as primary proxy voting guidelines
- SCERS voting has emphasized maximizing shareholder return





# INNOVATING TO SUPPORT & ACTION

Your Governance & Responsible  
Investment Strategies



Data. Analytics. Insight.  
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## R O L E O F I S S

Empowering investors to effectively manage governance risks and opportunities to realize long-term value.



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## What are the goals of ISS' Benchmark Voting Policy?

**“ISS' voting recommendations...are intended to assist institutional investors in meeting their fiduciary requirements with respect to voting by promoting long-term shareholder value creation and risk mitigation at their portfolio firms through support of responsible global corporate governance practices. These practices should respect shareholder rights and provide appropriate transparency, taking into account relevant laws, customs, and best practice codes of each market and region, as well as the right and responsibility of shareholders to make informed voting decisions.”** – ISS Voting Manual (emphasis added)

## What core principles drive the ISS Benchmark Voting Policy?

### Four Pillars: Accountability, Stewardship, Independence & Transparency

- **Accountability**—Boards should be accountable to shareholders...by **holding regular board elections**, by **providing sufficient information for shareholders to be able to assess directors and board composition**, and by **providing shareholders with the ability to remove directors**. Directors should **respond to investor input** such as that expressed through vote results.... Shareholders should have **meaningful rights on structural provisions**, such as approval of amendments to the corporate governing documents and a vote on takeover defenses. In addition, **shareholders' voting rights should be proportional to their economic interest in the company**; each share should have one vote. In general, a **simple majority vote** should be required to change a company's governance provisions or to approve transactions.



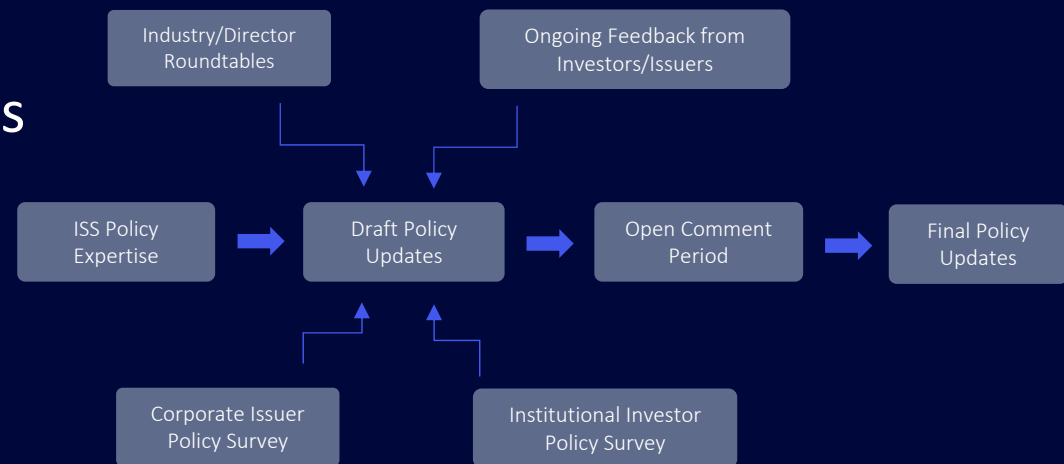
## What core principles drive the ISS Benchmark Voting Policy?

- **Stewardship**—A company's ESG practices should **meet or exceed the standards of its market regulations** and general practices and should take into account relevant factors that may impact significantly the company's long-term value creation. Issuers and investors should **recognize constructive engagement as both a right and responsibility**.
- **Independence**—Boards should be **sufficiently independent** so as to ensure that directors are able and motivated to effectively supervise management's performance and remuneration, for the benefit of all shareholders. Boards should include **an effective independent leadership position** and **sufficiently independent committees** that focus on key governance concerns such as audit, compensation, and the selection and evaluation of directors.
- **Transparency**—Companies should **provide sufficient and timely information** that enables shareholders to understand key issues, make informed vote decisions, and effectively engage...on substantive matters that impact shareholders' long-term interests in the company.

## How does ISS evolve its Benchmark Policy?

- Rigorous Review
  - annual, nine-month iterative process
  - identify, study, discuss, propose, back test, repeat
- Inclusive Input
  - open survey, roundtables, one-on-ones
- Transparent Communications
  - publish survey results, hold open comment period (searching for unintended consequences)

# ISS Policy Development Process – Key Strengths



**Industry-Leading Transparency:** ISS promotes openness and transparency in the development of its proxy voting policies. A description of the policy development and application process, and copies of all ISS guidelines and a number of FAQ documents, appears on our website under the Policy Gateway section.

**Robust Engagement with Market Constituents:** Listening to diverse viewpoints is critical to effective policy review, development and application processes. ISS' analysts regularly interact with institutional investors, company directors and other issuer representatives, shareholder proposal proponents, and other parties to gain deeper insight into critical issues.

**Global Expertise:** ISS' policy development process is rooted in global expertise. ISS' network of global offices provides access to regional and local market experts for the Americas, Europe/Middle East/Africa (EMEA), and Asia-Pacific regions.

## FIDUCIARY RESPONSIBILITY

# TURNKEY RESEARCH TO SUPPORT YOUR INVESTMENT PHILOSOPHIES



### TAFT-HARTLEY POLICY

Taft-Hartley pension funds & investment managers (ERISA).

Worker-owner view of long-term corporate value based on the AFL-CIO proxy voting guidelines. Greater focus on board independence & executive compensation.

### SUSTAINABILITY POLICY

Signatories to the UN Principles for Responsible Investment (UN PRI) or similarly aligned investment managers & asset owners.

Supportive of greater ESG disclosure and policies and practices that are consistent with related globally accepted norms.

### SRI POLICY

SRI investment firms, religious groups, charitable foundations & university endowments.

Traditional SRI investor perspective on social, environmental, and economic issues. The “triple bottom line” value creation.

### FAITH BASED POLICY

Catholic faith-based socially responsible investors. Including individuals and organizations.

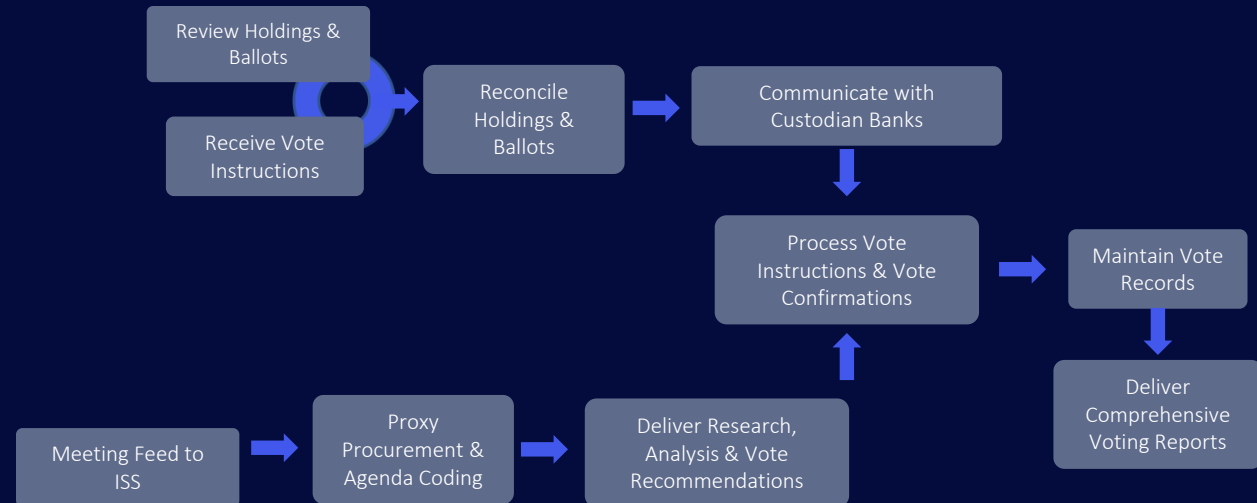
Based on the ethical perspective & teachings of the Catholic Church (USCCB). Attention to economic, environmental, and social justice concerns.

### PUBLIC FUND POLICY

Public pension fund managers & public plan sponsors and trustees.

Long-term best interests of public plan participants & beneficiaries. Greater focus on board independence and executive compensation.

## ISS Voting Process – A step-by-step overview of the proxy voting workflow



ISS provides leading technology and business intelligence to facilitate accurate and efficient vote execution and reporting.

- ISS has robust processes around account setup, validation, and ballot reconciliation with custodians and ballot distributors.
- The voting process allows clients to control their voting policy and final vote decisions while outsourcing the processing and management portions of the proxy voting process to a reliable partner.
- ISS' straight-through-processing system handles approximately 10 million ballots and 300,000 holdings files annually for our clients backed by rigorous information security controls

# Reporting: Supporting your fiduciary responsibilities

## ProxyExchange Voting Reports

- **Transparency and control** by leveraging ISS' library of pre-built, customizable templates
- **Flexibility** to include vote history and statistical summary data
- **Meet internal, compliance, and client requests**

## Vote Disclosure Service

- **Efficient and cost-effective** solution in global markets where vote disclosure is a regulatory or best practice standard
- **Turnkey solution** includes record-keeping, reporting, and hosted websites
- **Report creation for SEC's Form N-PX** offered for U.S. domiciled funds

## Global Stewardship Codes

- **Fulfill stewardship responsibilities** through comprehensive reporting solutions
- **Support engagement and vote disclosure**, including PRI Reporting User Guide

## Meet regulatory and best practice standards for:

- US Securities and Exchange Commission Form N-PX
- National Instrument (NI) 81-106 website disclosure in Canada
- PRI Signatories
- UCITS Directive in Europe
- UK Stewardship Code
- EC Action Plan for Corporate Governance
- EU Shareholder Rights Directive
- EFAMA Code for External Governance
- Minder Swiss Ordinance for Pension Fund Voting
- BVI Code of Conduct in Germany
- Eumedion Best Practices in Netherlands
- Assogestioni Principi in Italy
- Japan Stewardship Code
- Financial Service Council (FSC) Standard No. 13 and Standard No. 20
- Stronger Super Reforms (RG 252) in Australia
- SEBI vote disclosure requirements in India

**ISS**



**Data. Analytics. Insight.**  
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# Conclusion

- Recommend continued approach of using third—party provider to vote proxies
- Staff has prepared an updated Proxy Voting Policy for Board consideration
- Updated policy focuses on proxy voting process, including monitoring and Board reporting
- Will return to the Board in the first half of 2020 to confirm approval of third—party provider and applicable proxy voting guidelines





# Appendix

## ISS MANAGES MULTIPLE POLICY PERSPECTIVES ON BEHALF OF ITS CLIENTS

	ISS Policy	Sustainability Policy	SRI Policy	Catholic Policy	Public Fund Policy	Taft-Hartley Policy
<b>Policy Focus</b>	Investment firms and large institutional investors	UN PRI Signatories or similarly aligned investment managers & asset owners	SRI investment firms, religious groups, charitable foundations & university endowments	Catholic faith-based investors, including dioceses & Catholic healthcare systems	Public pension fund managers & public plan sponsors/trustees	Taft-Hartley pension funds & investment managers (ERISA)
<b>Orientation</b>	"Best practice" standards that promote total shareholder value & risk mitigation	United Nations Principles for Responsible Investment (UN PRI)	The "triple bottom line" value creation	Economic gain, social justice, environmental stewardship, ethical conduct & teachings of the Catholic Church (USCCB)	Long-term best interests of public plan participants & beneficiaries	Worker-owner view of long-term corporate value based on the AFL-CIO proxy voting guidelines
<b>Key Policy Highlights:</b>						
<b>1. <u>Board</u></b>	Board competence, performance, and independence (50%)	Board competence, performance - including on ESG topics, and independence (50%)	Board competence, performance - including on ESG topics, diversity, and independence (50%)	Board competence, performance - including on ESG topics, diversity and independence (50%)	Board competence, performance, & independence (50%)	Board competence, performance, & independence (67%)
<b>2. <u>Compensation</u></b>	Alignment of pay and performance, presence of problematic compensation practices, shareholder value transfer (SVT)	Alignment of pay and performance, presence of problematic compensation practices, shareholder value transfer (SVT)	Alignment of pay and performance including on ESG topics, presence of problematic compensation practices, shareholder value transfer (SVT)	Alignment of pay and performance - including on ESG topics, presence of problematic compensation practices, shareholder value transfer (SVT)	Alignment of pay & performance, presence of problematic compensation practices, voting power dilution (15%)	Alignment of pay & performance, presence of problematic compensation practices, voting power dilution (10%)
<b>3. <u>Social &amp; Environmental</u></b>	Consider shareholder proposals on social, environmental and labor/human rights issues on a case-by-case basis	Generally support shareholder proposals advocating ESG disclosure or universal norms/codes of conduct	Generally support shareholder proposals on social, environmental and labor/human rights issues	Generally support shareholder proposals on social, environmental and labor/human rights issues	Generally support shareholder proposals on social, environmental & labor/human rights issues	Generally support shareholder proposals on social, environmental & labor/human rights issues
<b>Board Opposition</b>	12%	11%	33%	57%	38%	45%
<b>Auditor Ratification Opposition</b>	0%	0%	6%	6%	71%	70%
<b>Equity Pay Plans</b>	22%	22%	21%	17%	86%	88%
<b>Say on Pay Opposition</b>	14%	14%	21%	20%	28%	29%
<b>Gov. Shareholder Proposal Support</b>	82%	81%	87%	87%	91%	90%
<b>E&amp;S Shareholder Proposal Support</b>	72%	80%	97%	97%	97%	97%

\* Recommendations for shareholder meetings in the Russell 3000 (1H 2019)





# United States

## Proxy Voting Guidelines

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Benchmark Policy Recommendations

**Effective for Meetings on or after February 1, 2019**

**Published December 6, 2018**

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## COVERAGE

The U.S. research team provides proxy analyses and voting recommendations for common shareholder meetings of publicly - traded U.S. - incorporated companies that are held in our institutional investor clients' portfolios and includes all S&P 1500 and Russell 3000 companies that are considered U.S. Domestic Issuers by the SEC. Coverage generally includes corporate actions for common equity holders, such as written consents and bankruptcies. ISS' U.S. coverage includes investment companies (including open-end funds, closed-end funds, exchange-traded funds, and unit investment trusts), limited partnerships ("LPs"), master limited partnerships ("MLPs"), limited liability companies ("LLCs"), and business development companies. ISS reviews its universe of coverage on an annual basis, and the coverage is subject to change based on client need and industry trends.

The U.S. research team also produces, for subscribing clients, research and recommendations for fixed income meetings, and meetings of certain preferred securities, including Auction Rate Preferred Securities ("ARPS") and Variable Rate Municipal Term Preferred securities ("VMTPs").

### Foreign-incorporated companies

In addition to U.S. - incorporated companies, U.S. policies are applied to certain foreign-incorporated company analyses. Like the SEC, ISS distinguishes two types of companies that list but are not incorporated in the U.S.:

- › U.S. Domestic Issuers – which have a majority of outstanding shares held in the U.S. and meet other criteria, as determined by the SEC, and are subject to the same disclosure and listing standards as U.S. incorporated companies – are generally covered under standard U.S. policy guidelines.
- › Foreign Private Issuers (FPIs) – which do not meet the Domestic Issuer criteria and are exempt from most disclosure requirements (e.g., they do not file DEF14A reports) and listing standards (e.g., for required levels of board and committee independence) – are covered under a combination of policy guidelines:
  - › FPI Guidelines (see the [Americas Regional Proxy Voting Guidelines](#)), which apply certain minimum independence and disclosure standards in the evaluation of key proxy ballot items, such as the election of directors and approval of financial reports; and
  - › For other issues, guidelines for the market that is responsible for, or most relevant to, the item on the ballot.

In all cases – including with respect to other companies with cross-market features that may lead to ballot items related to multiple markets – items that are on the ballot solely due to the requirements of another market (listing, incorporation, or national code) may be evaluated under the policy of the relevant market, regardless of the "assigned" market coverage.

## 1. BOARD OF DIRECTORS

### Voting on Director Nominees in Uncontested Elections


Four fundamental principles apply when determining votes on director nominees:

**Independence:** Boards should be sufficiently independent from management (and significant shareholders) to ensure that they are able and motivated to effectively supervise management's performance for the benefit of all shareholders, including in setting and monitoring the execution of corporate strategy, with appropriate use of shareholder capital, and in setting and monitoring executive compensation programs that support that strategy. The chair of the board should ideally be an independent director, and all boards should have an independent leadership position or a similar role in order to help provide appropriate counterbalance to executive management, as well as having sufficiently independent committees that focus on key governance concerns such as audit, compensation, and nomination of directors.

**Composition:** Companies should ensure that directors add value to the board through their specific skills and expertise and by having sufficient time and commitment to serve effectively. Boards should be of a size appropriate to accommodate diversity, expertise, and independence, while ensuring active and collaborative participation by all members. Boards should be sufficiently diverse to ensure consideration of a wide range of perspectives.

**Responsiveness:** Directors should respond to investor input, such as that expressed through significant opposition to management proposals, significant support for shareholder proposals (whether binding or non-binding), and tender offers where a majority of shares are tendered.

**Accountability:** Boards should be sufficiently accountable to shareholders, including through transparency of the company's governance practices and regular board elections, by the provision of sufficient information for shareholders to be able to assess directors and board composition, and through the ability of shareholders to remove directors.

 **General Recommendation:** Generally vote for director nominees, except under the following circumstances:

#### Independence

Vote against<sup>1</sup> or withhold from non-independent directors (Executive Directors and Non-Independent Non-Executive Directors per [ISS' Classification of Directors](#)) when:

- › Independent directors comprise 50 percent or less of the board;
- › The non-independent director serves on the audit, compensation, or nominating committee;
- › The company lacks an audit, compensation, or nominating committee so that the full board functions as that committee; or
- › The company lacks a formal nominating committee, even if the board attests that the independent directors fulfill the functions of such a committee.

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<sup>1</sup> In general, companies with a plurality vote standard use "Withhold" as the contrary vote option in director elections; companies with a majority vote standard use "Against". However, it will vary by company and the proxy must be checked to determine the valid contrary vote option for the particular company.

**ISS Classification of Directors – U.S.**

1. **Executive Director**
  - 1.1. Current employee or current officer<sup>1</sup> of the company or one of its affiliates<sup>2</sup>.
2. **Non-Independent Non-Executive Director**

Board Identification

  - 2.1. Director identified as not independent by the board.

Controlling/Significant Shareholder

  - 2.2. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a group).

Former CEO/Interim Officer

  - 2.3. Former CEO of the company.<sup>3,4</sup>
  - 2.4. Former CEO of an acquired company within the past five years.<sup>4</sup>
  - 2.5. Former interim officer if the service was longer than 18 months. If the service was between 12 and 18 months an assessment of the interim officer's employment agreement will be made.<sup>5</sup>

Non-CEO Executives

  - 2.6. Former officer<sup>1</sup> of the company, an affiliate<sup>2</sup>, or an acquired firm within the past five years.
  - 2.7. Officer<sup>1</sup> of a former parent or predecessor firm at the time the company was sold or split off from the parent/predecessor within the past five years.
  - 2.8. Officer<sup>1</sup>, former officer, or general or limited partner of a joint venture or partnership with the company.

Family Members

  - 2.9. Immediate family member<sup>6</sup> of a current or former officer<sup>1</sup> of the company or its affiliates<sup>2</sup> within the last five years.
  - 2.10. Immediate family member<sup>6</sup> of a current employee of company or its affiliates<sup>2</sup> where additional factors raise concern (which may include, but are not limited to, the following: a director related to numerous employees; the company or its affiliates employ relatives of numerous board members; or a non-Section 16 officer in a key strategic role).

Transactional, Professional, Financial, and Charitable Relationships

  - 2.11. Currently provides (or an immediate family member<sup>6</sup> provides) professional services<sup>7</sup> to the company, to an affiliate<sup>2</sup> of the company or an individual officer of the company or one of its affiliates in excess of \$10,000 per year.
  - 2.12. Is (or an immediate family member<sup>6</sup> is) a partner in, or a controlling shareholder or an employee of, an organization which provides professional services<sup>7</sup> to the company, to an affiliate<sup>2</sup> of the company, or an individual officer of the company or one of its affiliates in excess of \$10,000 per year.
  - 2.13. Has (or an immediate family member<sup>6</sup> has) any material transactional relationship<sup>8</sup> with the company or its affiliates<sup>2</sup> (excluding investments in the company through a private placement).
  - 2.14. Is (or an immediate family member<sup>6</sup> is) a partner in, or a controlling shareholder or an executive officer of, an organization which has any material transactional relationship<sup>8</sup> with the company or its affiliates<sup>2</sup> (excluding investments in the company through a private placement).
  - 2.15. Is (or an immediate family member<sup>6</sup> is) a trustee, director, or employee of a charitable or non-profit organization that receives material grants or endowments<sup>8</sup> from the company or its affiliates<sup>2</sup>.

Other Relationships

  - 2.16. Party to a voting agreement<sup>9</sup> to vote in line with management on proposals being brought to shareholder vote.
  - 2.17. Has (or an immediate family member<sup>6</sup> has) an interlocking relationship as defined by the SEC involving members of the board of directors or its Compensation Committee.<sup>10</sup>
  - 2.18. Founder<sup>11</sup> of the company but not currently an employee.
  - 2.19. Any material<sup>12</sup> relationship with the company.
3. **Independent Director**
  - 3.1. No material<sup>12</sup> connection to the company other than a board seat.

**Footnotes:**

1. The definition of officer will generally follow that of a “Section 16 officer” (officers subject to Section 16 of the Securities and Exchange Act of 1934) and includes the chief executive, operating, financial, legal, technology, and accounting officers of a company (including the president, treasurer, secretary, controller, or any vice president in charge of a principal business unit, division, or policy function). Current interim officers are included in this category. For private companies, the equivalent positions are applicable. A non-employee director serving as an officer due to statutory requirements (e.g. corporate secretary) will generally be classified as a Non-Independent Non-Executive Director under 2.19: “Any material relationship with the company.” However, if the company provides explicit disclosure that the director is not receiving additional compensation exceeding \$10,000 per year for serving in that capacity, then the director will be classified as an Independent Director.
2. “Affiliate” includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.
3. Includes any former CEO of the company prior to the company’s initial public offering (IPO).
4. When there is a former CEO of a special purpose acquisition company (SPAC) serving on the board of an acquired company, ISS will generally classify such directors as independent unless determined otherwise taking into account the following factors: the applicable listing standards determination of such director’s independence; any operating ties to the firm; and the existence of any other conflicting relationships or related party transactions.
5. ISS will look at the terms of the interim officer’s employment contract to determine if it contains severance pay, long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was under way for a full-time officer at the time.
6. “Immediate family member” follows the SEC’s definition of such and covers spouses, parents, children, step-parents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.
7. Professional services can be characterized as advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically have a commission- or fee-based payment structure. Professional services generally include but are not limited to the following: investment banking/financial advisory services, commercial banking (beyond deposit services), investment services, insurance services, accounting/audit services, consulting services, marketing services, legal services, property management services, realtor services, lobbying services, executive search services, and IT consulting services. The following would generally be considered transactional relationships and not professional services: deposit services, IT tech support services, educational services, and construction services. The case of participation in a banking syndicate by a non-lead bank should be considered a transactional (and hence subject to the associated materiality test) rather than a professional relationship. “Of Counsel” relationships are only considered immaterial if the individual does not receive any form of compensation (in excess of \$10,000 per year) from, or is a retired partner of, the firm providing the professional service. The case of a company providing a professional service to one of its directors or to an entity with which one of its directors is affiliated, will be considered a transactional rather than a professional relationship. Insurance services and marketing services are assumed to be professional services unless the company explains why such services are not advisory.
8. A material transactional relationship, including grants to non-profit organizations, exists if the company makes annual payments to, or receives annual payments from, another entity, exceeding the greater of: \$200,000 or 5 percent of the recipient’s gross revenues, for a company that follows NASDAQ listing standards; or the greater of \$1,000,000 or 2 percent of the recipient’s gross revenues, for a company that follows NYSE listing standards. For a company that follows neither of the preceding standards, ISS will apply the NASDAQ-based materiality test. (The recipient is the party receiving the financial proceeds from the transaction).
9. Dissident directors who are parties to a voting agreement pursuant to a settlement or similar arrangement may be classified as Independent Directors if an analysis of the following factors indicates that the voting agreement does not compromise their alignment with all shareholders’ interests: the terms of the agreement; the duration of the standstill provision in the agreement; the limitations and requirements of actions that are agreed upon; if the dissident director nominee(s) is subject to the standstill; and if there any conflicting relationships or related party transactions.
10. Interlocks include: executive officers serving as directors on each other’s compensation or similar committees (or, in the absence of such a committee, on the board); or executive officers sitting on each other’s boards and at least one serves on the other’s compensation or similar committees (or, in the absence of such a committee, on the board).

11. The operating involvement of the founder with the company will be considered; if the founder was never employed by the company, ISS may deem him or her an Independent Director.

12. For purposes of ISS's director independence classification, "material" will be defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

## Composition

**Attendance at Board and Committee Meetings:** Generally vote against or withhold from directors (except new nominees, who should be considered case-by-case<sup>2</sup>) who attend less than 75 percent of the aggregate of their board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed in the proxy or another SEC filing. Acceptable reasons for director absences are generally limited to the following:

- › Medical issues/illness;
- › Family emergencies; and
- › Missing only one meeting (when the total of all meetings is three or fewer).

In cases of chronic poor attendance without reasonable justification, in addition to voting against the director(s) with poor attendance, generally vote against or withhold from appropriate members of the nominating/governance committees or the full board.

If the proxy disclosure is unclear and insufficient to determine whether a director attended at least 75 percent of the aggregate of his/her board and committee meetings during his/her period of service, vote against or withhold from the director(s) in question.

**Overboarded Directors:** Generally vote against or withhold from individual directors who:

- › Sit on more than five public company boards; or
- › Are CEOs of public companies who sit on the boards of more than two public companies besides their own— withhold only at their outside boards<sup>3</sup>.

**Diversity:** Highlight boards with no gender diversity. For 2019 meetings, no adverse vote recommendations will be made due to a lack of gender diversity.

For companies in the Russell 3000 or S&P 1500 indices, effective for meetings on or after Feb. 1, 2020, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies when there are no women on the company's board. Mitigating factors include:

- › A firm commitment, as stated in the proxy statement, to appoint at least one female to the board in the near term;
- › The presence of a female on the board at the preceding annual meeting; or
- › Other relevant factors as applicable.

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<sup>2</sup> New nominees who served for only part of the fiscal year are generally exempted from the attendance policy.

<sup>3</sup> Although all of a CEO's subsidiary boards with publicly-traded common stock will be counted as separate boards, ISS will not recommend a withhold vote for the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships.

## Responsiveness

Vote case-by-case on individual directors, committee members, or the entire board of directors as appropriate if:

- › The board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year or failed to act on a management proposal seeking to ratify an existing charter/bylaw provision that received opposition of a majority of the shares cast in the previous year. Factors that will be considered are:
  - › Disclosed outreach efforts by the board to shareholders in the wake of the vote;
  - › Rationale provided in the proxy statement for the level of implementation;
  - › The subject matter of the proposal;
  - › The level of support for and opposition to the resolution in past meetings;
  - › Actions taken by the board in response to the majority vote and its engagement with shareholders;
  - › The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
  - › Other factors as appropriate.
- › The board failed to act on takeover offers where the majority of shares are tendered;
- › At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote.

Vote case-by-case on Compensation Committee members (or, in exceptional cases, the full board) and the Say on Pay proposal if:

- › The company's previous say-on-pay received the support of less than 70 percent of votes cast. Factors that will be considered are:
  - › The company's response, including:
    - › Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);
    - › Disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;
    - › Disclosure of specific and meaningful actions taken to address shareholders' concerns;
  - › Other recent compensation actions taken by the company;
  - › Whether the issues raised are recurring or isolated;
  - › The company's ownership structure; and
  - › Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.
- › The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the plurality of votes cast.

## Accountability

Vote against or withhold from the entire board of directors (except new nominees<sup>4</sup>, who should be considered case-by-case) for the following:

### *Problematic Takeover Defenses/Governance Structure*

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<sup>4</sup> A "new nominee" is any current nominee who has not already been elected by shareholders and who joined the board after the problematic action in question transpired. If ISS cannot determine whether the nominee joined the board before or after the problematic action transpired, the nominee will be considered a "new nominee" if he or she joined the board within the 12 months prior to the upcoming shareholder meeting.

**Poison Pills:** Vote against or withhold from all nominees (except new nominees, who should be considered case-by-case) if:

- › The company has a poison pill that was not approved by shareholders<sup>5</sup>. However, vote case-by-case on nominees if the board adopts an initial pill with a term of one year or less, depending on the disclosed rationale for the adoption, and other factors as relevant (such as a commitment to put any renewal to a shareholder vote).
- › The board makes a material adverse modification to an existing pill, including, but not limited to, extension, renewal, or lowering the trigger, without shareholder approval.

**Classified Board Structure:** The board is classified, and a continuing director responsible for a problematic governance issue at the board/committee level that would warrant a withhold/against vote recommendation is not up for election. All appropriate nominees (except new) may be held accountable.

**Removal of Shareholder Discretion on Classified Boards:** The company has opted into, or failed to opt out of, state laws requiring a classified board structure.

**Director Performance Evaluation:** The board lacks mechanisms to promote accountability and oversight, coupled with sustained poor performance relative to peers. Sustained poor performance is measured by one-, three-, and five-year total shareholder returns in the bottom half of a company's four-digit GICS industry group (Russell 3000 companies only). Take into consideration the company's operational metrics and other factors as warranted. Problematic provisions include but are not limited to:

- › A classified board structure;
- › A supermajority vote requirement;
- › Either a plurality vote standard in uncontested director elections, or a majority vote standard in contested elections;
- › The inability of shareholders to call special meetings;
- › The inability of shareholders to act by written consent;
- › A multi-class capital structure; and/or
- › A non-shareholder-approved poison pill.

**Unilateral Bylaw/Charter Amendments and Problematic Capital Structures:** Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors:

- › The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- › Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- › The level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter;
- › The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- › The company's ownership structure;
- › The company's existing governance provisions;
- › The timing of the board's amendment to the bylaws/charter in connection with a significant business development; and
- › Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders.

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<sup>5</sup> Public shareholders only, approval prior to a company's becoming public is insufficient.

Unless the adverse amendment is reversed or submitted to a binding shareholder vote, in subsequent years vote case-by-case on director nominees. Generally vote against (except new nominees, who should be considered case-by-case) if the directors:

- › Classified the board;
- › Adopted supermajority vote requirements to amend the bylaws or charter; or
- › Eliminated shareholders' ability to amend bylaws.

**Problematic Governance Structure - Newly public companies:** For newly public companies, generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopted bylaw or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights considering the following factors:

- › The level of impairment of shareholders' rights;
- › The disclosed rationale;
- › The ability to change the governance structure (e.g., limitations on shareholders' right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- › The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure;
- › Any reasonable sunset provision; and
- › Other relevant factors.

Unless the adverse provision and/or problematic capital structure is reversed or removed, vote case-by-case on director nominees in subsequent years.

**Management Proposals to Ratify Existing Charter or Bylaw Provisions:** Vote against/withhold from individual directors, members of the governance committee, or the full board, where boards ask shareholders to ratify existing charter or bylaw provisions considering the following factors:

- › The presence of a shareholder proposal addressing the same issue on the same ballot;
- › The board's rationale for seeking ratification;
- › Disclosure of actions to be taken by the board should the ratification proposal fail;
- › Disclosure of shareholder engagement regarding the board's ratification request;
- › The level of impairment to shareholders' rights caused by the existing provision;
- › The history of management and shareholder proposals on the provision at the company's past meetings;
- › Whether the current provision was adopted in response to the shareholder proposal;
- › The company's ownership structure; and
- › Previous use of ratification proposals to exclude shareholder proposals.

### ***Restrictions on Shareholders' Rights***

**Restricting Binding Shareholder Proposals:** Generally vote against or withhold from the members of the governance committee if:

- › The company's governing documents impose undue restrictions on shareholders' ability to amend the bylaws. Such restrictions include but are not limited to: outright prohibition on the submission of binding shareholder proposals or share ownership requirements or time holding requirements in excess of SEC Rule 14a-8. Vote against on an ongoing basis.

### ***Problematic Audit-Related Practices***

Generally vote against or withhold from the members of the Audit Committee if:



- › The non-audit fees paid to the auditor are [excessive](#);
- › The company receives an adverse opinion on the company's financial statements from its auditor; or
- › There is persuasive evidence that the Audit Committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

Vote case-by-case on members of the Audit Committee and potentially the full board if:

- › Poor accounting practices are identified that rise to a level of serious concern, such as: fraud; misapplication of GAAP; and material weaknesses identified in Section 404 disclosures. Examine the severity, breadth, chronological sequence, and duration, as well as the company's efforts at remediation or corrective actions, in determining whether withhold/against votes are warranted.

### ***Problematic Compensation Practices***

In the absence of an Advisory Vote on Executive Compensation (Say on Pay) ballot item or in egregious situations, vote against or withhold from the members of the Compensation Committee and potentially the full board if:

- › There is an unmitigated misalignment between CEO pay and company performance ([pay for performance](#));
- › The company maintains significant [problematic pay practices](#); or
- › The board exhibits a significant level of [poor communication and responsiveness](#) to shareholders.

Generally vote against or withhold from the Compensation Committee chair, other committee members, or potentially the full board if:

- › The company fails to include a Say on Pay ballot item when required under SEC provisions, or under the company's declared frequency of say on pay; or
- › The company fails to include a Frequency of Say on Pay ballot item when required under SEC provisions.

Generally vote against members of the board committee responsible for approving/setting non-employee director compensation if there is a pattern (i.e. two or more years) of awarding excessive non-employee director compensation without disclosing a compelling rationale or other mitigating factors.

### ***Problematic Pledging of Company Stock:***

Vote against the members of the committee that oversees risks related to pledging, or the full board, where a significant level of pledged company stock by executives or directors raises concerns. The following factors will be considered:

- › The presence of an anti-pledging policy, disclosed in the proxy statement, that prohibits future pledging activity;
- › The magnitude of aggregate pledged shares in terms of total common shares outstanding, market value, and trading volume;
- › Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
- › Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- › Any other relevant factors.

### ***Governance Failures***

Under extraordinary circumstances, vote against or withhold from directors individually, committee members, or the entire board, due to:

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- › Material failures of governance, stewardship, risk oversight<sup>6</sup>, or fiduciary responsibilities at the company;
- › Failure to replace management as appropriate; or
- › Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

## Voting on Director Nominees in Contested Elections

### Vote-No Campaigns

- ▶ **General Recommendation:** In cases where companies are targeted in connection with public “vote-no” campaigns, evaluate director nominees under the existing governance policies for voting on director nominees in uncontested elections. Take into consideration the arguments submitted by shareholders and other publicly available information.

### Proxy Contests/Proxy Access — Voting for Director Nominees in Contested Elections

- ▶ **General Recommendation:** Vote case-by-case on the election of directors in contested elections, considering the following factors:
  - › Long-term financial performance of the company relative to its industry;
  - › Management's track record;
  - › Background to the contested election;
  - › Nominee qualifications and any compensatory arrangements;
  - › Strategic plan of dissident slate and quality of the critique against management;
  - › Likelihood that the proposed goals and objectives can be achieved (both slates); and
  - › Stock ownership positions.

In the case of candidates nominated pursuant to proxy access, vote case-by-case considering any applicable factors listed above or additional factors which may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether there are more candidates than board seats).

## Other Board-Related Proposals

### Adopt Anti-Hedging/Pledging/Speculative Investments Policy

- ▶ **General Recommendation:** Generally vote for proposals seeking a policy that prohibits named executive officers from engaging in derivative or speculative transactions involving company stock, including hedging, holding stock in a margin account, or pledging stock as collateral for a loan. However, the company's existing policies regarding responsible use of company stock will be considered.

### Age/Term Limits

- ▶ **General Recommendation:** Vote against management and shareholder proposals to limit the tenure of outside directors through mandatory retirement ages.

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<sup>6</sup> Examples of failure of risk oversight include but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; significant adverse legal judgments or settlement; or hedging of company stock.

Vote against management proposals to limit the tenure of outside directors through term limits. However, scrutinize boards where the average tenure of all directors exceeds 15 years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board.

### Board Size

- ▶ **General Recommendation:** Vote for proposals seeking to fix the board size or designate a range for the board size.

Vote against proposals that give management the ability to alter the size of the board outside of a specified range without shareholder approval.

### Classification/Declassification of the Board

- ▶ **General Recommendation:** Vote against proposals to classify (stagger) the board. Vote for proposals to repeal classified boards and to elect all directors annually.

### CEO Succession Planning

- ▶ **General Recommendation:** Generally vote for proposals seeking disclosure on a CEO succession planning policy, considering, at a minimum, the following factors:
  - › The reasonableness/scope of the request; and
  - › The company's existing disclosure on its current CEO succession planning process.

### Cumulative Voting

- ▶ **General Recommendation:** Generally vote against management proposals to eliminate cumulate voting, and for shareholder proposals to restore or provide for cumulative voting, unless:
  - › The company has proxy access<sup>7</sup>, thereby allowing shareholders to nominate directors to the company's ballot; and
  - › The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.

Vote for proposals for cumulative voting at controlled companies (insider voting power > 50%).

### Director and Officer Indemnification and Liability Protection

- ▶ **General Recommendation:** Vote case-by-case on proposals on director and officer indemnification and liability protection.

Vote against proposals that would:

- › Eliminate entirely directors' and officers' liability for monetary damages for violating the duty of care.
- › Expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness.
- › Expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts that previously the company was permitted to provide indemnification for, at the discretion of the company's board (*i.e.*, "permissive indemnification"), but that previously the company was not required to indemnify.


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<sup>7</sup> A proxy access right that meets the [recommended guidelines](#).

Vote for only those proposals providing such expanded coverage in cases when a director's or officer's legal defense was unsuccessful if both of the following apply:

- › If the director was found to have acted in good faith and in a manner that s/he reasonably believed was in the best interests of the company; and
- › If only the director's legal expenses would be covered.


### Establish/Amend Nominee Qualifications

 **General Recommendation:** Vote case-by-case on proposals that establish or amend director qualifications. Votes should be based on the reasonableness of the criteria and the degree to which they may preclude dissident nominees from joining the board.

Vote case-by-case on shareholder resolutions seeking a director nominee who possesses a particular subject matter expertise, considering:


- › The company's board committee structure, existing subject matter expertise, and board nomination provisions relative to that of its peers;
- › The company's existing board and management oversight mechanisms regarding the issue for which board oversight is sought;
- › The company's disclosure and performance relating to the issue for which board oversight is sought and any significant related controversies; and
- › The scope and structure of the proposal.

### Establish Other Board Committee Proposals


 **General Recommendation:** Generally vote against shareholder proposals to establish a new board committee, as such proposals seek a specific oversight mechanism/structure that potentially limits a company's flexibility to determine an appropriate oversight mechanism for itself. However, the following factors will be considered:

- › Existing oversight mechanisms (including current committee structure) regarding the issue for which board oversight is sought;
- › Level of disclosure regarding the issue for which board oversight is sought;
- › Company performance related to the issue for which board oversight is sought;
- › Board committee structure compared to that of other companies in its industry sector; and
- › The scope and structure of the proposal.

### Filling Vacancies/Removal of Directors

 **General Recommendation:** Vote against proposals that provide that directors may be removed only for cause. Vote for proposals to restore shareholders' ability to remove directors with or without cause. Vote against proposals that provide that only continuing directors may elect replacements to fill board vacancies. Vote for proposals that permit shareholders to elect directors to fill board vacancies.

### Independent Chair (Separate Chair/CEO)

 **General Recommendation:** Generally vote for shareholder proposals requiring that the chairman's position be filled by an independent director, taking into consideration the following:

- › The scope of the proposal;
- › The company's current board leadership structure;
- › The company's governance structure and practices;

- › Company performance; and
- › Any other relevant factors that may be applicable.

Regarding the scope of the proposal, consider whether the proposal is precatory or binding and whether the proposal is seeking an immediate change in the chairman role or the policy can be implemented at the next CEO transition.

Under the review of the company's board leadership structure, ISS may support the proposal under the following scenarios absent a compelling rationale: the presence of an executive or non-independent chair in addition to the CEO; a recent recombination of the role of CEO and chair; and/or departure from a structure with an independent chair. ISS will also consider any recent transitions in board leadership and the effect such transitions may have on independent board leadership as well as the designation of a lead director role.

When considering the governance structure, ISS will consider the overall independence of the board, the independence of key committees, the establishment of governance guidelines, board tenure and its relationship to CEO tenure, and any other factors that may be relevant. Any concerns about a company's governance structure will weigh in favor of support for the proposal.

The review of the company's governance practices may include, but is not limited to, poor compensation practices, material failures of governance and risk oversight, related-party transactions or other issues putting director independence at risk, corporate or management scandals, and actions by management or the board with potential or realized negative impact on shareholders. Any such practices may suggest a need for more independent oversight at the company thus warranting support of the proposal.

ISS' performance assessment will generally consider one-, three-, and five-year TSR compared to the company's peers and the market as a whole. While poor performance will weigh in favor of the adoption of an independent chair policy, strong performance over the long term will be considered a mitigating factor when determining whether the proposed leadership change warrants support.

### Majority of Independent Directors/Establishment of Independent Committees

- ▶ **General Recommendation:** Vote for shareholder proposals asking that a majority or more of directors be independent unless the board composition already meets the proposed threshold by ISS' definition of Independent Director (See [ISS' Classification of Directors.](#))

Vote for shareholder proposals asking that board audit, compensation, and/or nominating committees be composed exclusively of independent directors unless they currently meet that standard.

### Majority Vote Standard for the Election of Directors

- ▶ **General Recommendation:** Generally vote for management proposals to adopt a majority of votes cast standard for directors in uncontested elections. Vote against if no carve-out for a plurality vote standard in contested elections is included.

Generally vote for precatory and binding shareholder resolutions requesting that the board change the company's bylaws to stipulate that directors need to be elected with an affirmative majority of votes cast, provided it does not conflict with the state law where the company is incorporated. Binding resolutions need to allow for a carve-out for a plurality vote standard when there are more nominees than board seats.

Companies are strongly encouraged to also adopt a post-election policy (also known as a director resignation policy) that will provide guidelines so that the company will promptly address the situation of a holdover director.

## Proxy Access

▶ **General Recommendation:** Generally vote for management and shareholder proposals for proxy access with the following provisions:

- › **Ownership threshold:** maximum requirement not more than three percent (3%) of the voting power;
- › **Ownership duration:** maximum requirement not longer than three (3) years of continuous ownership for each member of the nominating group;
- › **Aggregation:** minimal or no limits on the number of shareholders permitted to form a nominating group;
- › **Cap:** cap on nominees of generally twenty-five percent (25%) of the board.

Review for reasonableness any other restrictions on the right of proxy access.  
Generally vote against proposals that are more restrictive than these guidelines.

## Require More Nominees than Open Seats

▶ **General Recommendation:** Vote against shareholder proposals that would require a company to nominate more candidates than the number of open board seats.

## Shareholder Engagement Policy (Shareholder Advisory Committee)

▶ **General Recommendation:** Generally vote for shareholder proposals requesting that the board establish an internal mechanism/process, which may include a committee, in order to improve communications between directors and shareholders, unless the company has the following features, as appropriate:

- › Established a communication structure that goes beyond the exchange requirements to facilitate the exchange of information between shareholders and members of the board;
- › Effectively disclosed information with respect to this structure to its shareholders;
- › Company has not ignored majority-supported shareholder proposals or a majority withhold vote on a director nominee; and
- › The company has an independent chairman or a lead director, according to ISS' definition. This individual must be made available for periodic consultation and direct communication with major shareholders.

## 2. AUDIT-RELATED

### Auditor Indemnification and Limitation of Liability

▶ **General Recommendation:** Vote case-by-case on the issue of auditor indemnification and limitation of liability. Factors to be assessed include, but are not limited to:

- › The terms of the auditor agreement—the degree to which these agreements impact shareholders' rights;
- › The motivation and rationale for establishing the agreements;
- › The quality of the company's disclosure; and
- › The company's historical practices in the audit area.

Vote against or withhold from members of an audit committee in situations where there is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

### Auditor Ratification

▶ **General Recommendation:** Vote for proposals to ratify auditors unless any of the following apply:

- › An auditor has a financial interest in or association with the company, and is therefore not independent;
- › There is reason to believe that the independent auditor has rendered an opinion that is neither accurate nor indicative of the company's financial position;
- › Poor accounting practices are identified that rise to a serious level of concern, such as fraud or misapplication of GAAP; or
- › Fees for non-audit services ("Other" fees) are excessive.

Non-audit fees are excessive if:

- › Non-audit ("other") fees > audit fees + audit-related fees + tax compliance/preparation fees


Tax compliance and preparation include the preparation of original and amended tax returns and refund claims, and tax payment planning. All other services in the tax category, such as tax advice, planning, or consulting, should be added to "Other" fees. If the breakout of tax fees cannot be determined, add all tax fees to "Other" fees.

In circumstances where "Other" fees include fees related to significant one-time capital structure events (such as initial public offerings, bankruptcy emergence, and spin-offs) and the company makes public disclosure of the amount and nature of those fees that are an exception to the standard "non-audit fee" category, then such fees may be excluded from the non-audit fees considered in determining the ratio of non-audit to audit/audit-related fees/tax compliance and preparation for purposes of determining whether non-audit fees are excessive.

### Shareholder Proposals Limiting Non-Audit Services

▶ **General Recommendation:** Vote case-by-case on shareholder proposals asking companies to prohibit or limit their auditors from engaging in non-audit services.

## Shareholder Proposals on Audit Firm Rotation

 **General Recommendation:** Vote case-by-case on shareholder proposals asking for audit firm rotation, taking into account:

- › The tenure of the audit firm;
- › The length of rotation specified in the proposal;
- › Any significant audit-related issues at the company;
- › The number of Audit Committee meetings held each year;
- › The number of financial experts serving on the committee; and
- › Whether the company has a periodic renewal process where the auditor is evaluated for both audit quality and competitive price.



### 3. SHAREHOLDER RIGHTS & DEFENSES

#### Advance Notice Requirements for Shareholder Proposals/Nominations

- ▶ **General Recommendation:** Vote case-by-case on advance notice proposals, giving support to those proposals which allow shareholders to submit proposals/nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review.

To be reasonable, the company's deadline for shareholder notice of a proposal/nominations must not be more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline. The submittal window is the period under which a shareholder must file his proposal/nominations prior to the deadline.

In general, support additional efforts by companies to ensure full disclosure in regard to a proponent's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review such proposals.

#### Amend Bylaws without Shareholder Consent

- ▶ **General Recommendation:** Vote against proposals giving the board exclusive authority to amend the bylaws.

Vote case-by-case on proposals giving the board the ability to amend the bylaws in addition to shareholders, taking into account the following:

- › Any impediments to shareholders' ability to amend the bylaws (i.e. supermajority voting requirements);
- › The company's ownership structure and historical voting turnout;
- › Whether the board could amend bylaws adopted by shareholders; and
- › Whether shareholders would retain the ability to ratify any board-initiated amendments.

#### Control Share Acquisition Provisions

Control share acquisition statutes function by denying shares their voting rights when they contribute to ownership in excess of certain thresholds. Voting rights for those shares exceeding ownership limits may only be restored by approval of either a majority or supermajority of disinterested shares. Thus, control share acquisition statutes effectively require a hostile bidder to put its offer to a shareholder vote or risk voting disenfranchisement if the bidder continues buying up a large block of shares.

- ▶ **General Recommendation:** Vote for proposals to opt out of control share acquisition statutes unless doing so would enable the completion of a takeover that would be detrimental to shareholders.

Vote against proposals to amend the charter to include control share acquisition provisions.

Vote for proposals to restore voting rights to the control shares.

#### Control Share Cash-Out Provisions

Control share cash-out statutes give dissident shareholders the right to "cash-out" of their position in a company at the expense of the shareholder who has taken a control position. In other words, when an investor crosses a preset threshold level, remaining shareholders are given the right to sell their shares to the acquirer, who must buy them at the highest acquiring price.

- ▶ **General Recommendation:** Vote for proposals to opt out of control share cash-out statutes.

### Disgorgement Provisions

Disgorgement provisions require an acquirer or potential acquirer of more than a certain percentage of a company's stock to disgorge, or pay back, to the company any profits realized from the sale of that company's stock purchased 24 months before achieving control status. All sales of company stock by the acquirer occurring within a certain period of time (between 18 months and 24 months) prior to the investor's gaining control status are subject to these recapture-of-profits provisions.

- ▶ **General Recommendation:** Vote for proposals to opt out of state disgorgement provisions.

### Fair Price Provisions

- ▶ **General Recommendation:** Vote case-by-case on proposals to adopt fair price provisions (provisions that stipulate that an acquirer must pay the same price to acquire all shares as it paid to acquire the control shares), evaluating factors such as the vote required to approve the proposed acquisition, the vote required to repeal the fair price provision, and the mechanism for determining the fair price.

Generally vote against fair price provisions with shareholder vote requirements greater than a majority of disinterested shares.

### Freeze-Out Provisions

- ▶ **General Recommendation:** Vote for proposals to opt out of state freeze-out provisions. Freeze-out provisions force an investor who surpasses a certain ownership threshold in a company to wait a specified period of time before gaining control of the company.

### Greenmail

Greenmail payments are targeted share repurchases by management of company stock from individuals or groups seeking control of the company. Since only the hostile party receives payment, usually at a substantial premium over the market value of its shares, the practice discriminates against all other shareholders.

- ▶ **General Recommendation:** Vote for proposals to adopt anti-greenmail charter or bylaw amendments or otherwise restrict a company's ability to make greenmail payments.

Vote case-by-case on anti-greenmail proposals when they are bundled with other charter or bylaw amendments.

### Litigation Rights (including Exclusive Venue and Fee-Shifting Bylaw Provisions)

Bylaw provisions impacting shareholders' ability to bring suit against the company may include exclusive venue provisions, which provide that the state of incorporation shall be the sole venue for certain types of litigation, and fee-shifting provisions that require a shareholder who sues a company unsuccessfully to pay all litigation expenses of the defendant corporation.

- ▶ **General Recommendation:** Vote case-by-case on bylaws which impact shareholders' litigation rights, taking into account factors such as:

- › The company's stated rationale for adopting such a provision;
- › Disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or shareholder lawsuits outside the jurisdiction of incorporation;
- › The breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms; and
- › Governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections.

Generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., in cases where the plaintiffs are partially successful).

Unilateral adoption by the board of bylaw provisions which affect shareholders' litigation rights will be evaluated under ISS' policy on [Unilateral Bylaw/Charter Amendments](#).

### Net Operating Loss (NOL) Protective Amendments

- ▶ **General Recommendation:** Vote against proposals to adopt a protective amendment for the stated purpose of protecting a company's net operating losses (NOL) if the effective term of the protective amendment would exceed the shorter of three years and the exhaustion of the NOL.

Vote case-by-case, considering the following factors, for management proposals to adopt an NOL protective amendment that would remain in effect for the shorter of three years (or less) and the exhaustion of the NOL:

- › The ownership threshold (NOL protective amendments generally prohibit stock ownership transfers that would result in a new 5-percent holder or increase the stock ownership percentage of an existing 5-percent holder);
- › The value of the NOLs;
- › Shareholder protection mechanisms (sunset provision or commitment to cause expiration of the protective amendment upon exhaustion or expiration of the NOL);
- › The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- › Any other factors that may be applicable.

### Poison Pills (Shareholder Rights Plans)

#### Shareholder Proposals to Put Pill to a Vote and/or Adopt a Pill Policy

- ▶ **General Recommendation:** Vote for shareholder proposals requesting that the company submit its poison pill to a shareholder vote or redeem it unless the company has: (1) A shareholder approved poison pill in place; or (2) The company has adopted a policy concerning the adoption of a pill in the future specifying that the board will only adopt a shareholder rights plan if either:
  - › Shareholders have approved the adoption of the plan; or
  - › The board, in its exercise of its fiduciary responsibilities, determines that it is in the best interest of shareholders under the circumstances to adopt a pill without the delay in adoption that would result from seeking stockholder approval (i.e., the "fiduciary out" provision). A poison pill adopted under this fiduciary out will be put to a shareholder ratification vote within 12 months of adoption or expire. If the pill is not approved by a majority of the votes cast on this issue, the plan will immediately terminate.

If the shareholder proposal calls for a time period of less than 12 months for shareholder ratification after adoption, vote for the proposal, but add the caveat that a vote within 12 months would be considered sufficient implementation.

## Management Proposals to Ratify a Poison Pill

- ▶ **General Recommendation:** Vote case-by-case on management proposals on poison pill ratification, focusing on the features of the shareholder rights plan. Rights plans should contain the following attributes:
- › No lower than a 20 percent trigger, flip-in or flip-over;
  - › A term of no more than three years;
  - › No dead-hand, slow-hand, no-hand, or similar feature that limits the ability of a future board to redeem the pill;
  - › Shareholder redemption feature (qualifying offer clause); if the board refuses to redeem the pill 90 days after a qualifying offer is announced, 10 percent of the shares may call a special meeting or seek a written consent to vote on rescinding the pill.

In addition, the rationale for adopting the pill should be thoroughly explained by the company. In examining the request for the pill, take into consideration the company's existing governance structure, including: board independence, existing takeover defenses, and any problematic governance concerns.

## Management Proposals to Ratify a Pill to Preserve Net Operating Losses (NOLs)

- ▶ **General Recommendation:** Vote against proposals to adopt a poison pill for the stated purpose of protecting a company's net operating losses (NOL) if the term of the pill would exceed the shorter of three years and the exhaustion of the NOL.

Vote case-by-case on management proposals for poison pill ratification, considering the following factors, if the term of the pill would be the shorter of three years (or less) and the exhaustion of the NOL:

- › The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);
- › The value of the NOLs;
- › Shareholder protection mechanisms (sunset provision, or commitment to cause expiration of the pill upon exhaustion or expiration of NOLs);
- › The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- › Any other factors that may be applicable.

## Proxy Voting Disclosure, Confidentiality, and Tabulation

- ▶ **General Recommendation:** Vote case-by-case on proposals regarding proxy voting mechanics, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder rights. Specific issues covered under the policy include, but are not limited to, confidential voting of individual proxies and ballots, confidentiality of running vote tallies, and the treatment of abstentions and/or broker non-votes in the company's vote-counting methodology.

While a variety of factors may be considered in each analysis, the guiding principles are: transparency, consistency, and fairness in the proxy voting process. The factors considered, as applicable to the proposal, may include:

- › The scope and structure of the proposal;
- › The company's stated confidential voting policy (or other relevant policies) and whether it ensures a "level playing field" by providing shareholder proponents with equal access to vote information prior to the annual meeting;
- › The company's vote standard for management and shareholder proposals and whether it ensures consistency and fairness in the proxy voting process and maintains the integrity of vote results;
- › Whether the company's disclosure regarding its vote counting method and other relevant voting policies with respect to management and shareholder proposals are consistent and clear;
- › Any recent controversies or concerns related to the company's proxy voting mechanics;
- › Any unintended consequences resulting from implementation of the proposal; and

- › Any other factors that may be relevant.

### Ratification Proposals: Management Proposals to Ratify Existing Charter or Bylaw Provisions

- ▶ **General Recommendation:** Generally vote against management proposals to ratify provisions of the company's existing charter or bylaws, unless these governance provisions align with best practice.

In addition, voting against/withhold from individual directors, members of the governance committee, or the full board may be warranted, considering:

- › The presence of a shareholder proposal addressing the same issue on the same ballot;
- › The board's rationale for seeking ratification;
- › Disclosure of actions to be taken by the board should the ratification proposal fail;
- › Disclosure of shareholder engagement regarding the board's ratification request;
- › The level of impairment to shareholders' rights caused by the existing provision;
- › The history of management and shareholder proposals on the provision at the company's past meetings;
- › Whether the current provision was adopted in response to the shareholder proposal;
- › The company's ownership structure; and
- › Previous use of ratification proposals to exclude shareholder proposals.

### Reimbursing Proxy Solicitation Expenses

- ▶ **General Recommendation:** Vote case-by-case on proposals to reimburse proxy solicitation expenses.

When voting in conjunction with support of a dissident slate, vote for the reimbursement of all appropriate proxy solicitation expenses associated with the election.

Generally vote for shareholder proposals calling for the reimbursement of reasonable costs incurred in connection with nominating one or more candidates in a contested election where the following apply:

- › The election of fewer than 50 percent of the directors to be elected is contested in the election;
- › One or more of the dissident's candidates is elected;
- › Shareholders are not permitted to cumulate their votes for directors; and
- › The election occurred, and the expenses were incurred, after the adoption of this bylaw.

### Reincorporation Proposals

- ▶ **General Recommendation:** Management or shareholder proposals to change a company's state of incorporation should be evaluated case-by-case, giving consideration to both financial and corporate governance concerns including the following:
  - › Reasons for reincorporation;
  - › Comparison of company's governance practices and provisions prior to and following the reincorporation; and
  - › Comparison of corporation laws of original state and destination state.

Vote for reincorporation when the economic factors outweigh any neutral or negative governance changes.

### Shareholder Ability to Act by Written Consent

- ▶ **General Recommendation:** Generally vote against management and shareholder proposals to restrict or prohibit shareholders' ability to act by written consent.

Generally vote for management and shareholder proposals that provide shareholders with the ability to act by written consent, taking into account the following factors:

- › Shareholders' current right to act by written consent;
- › The consent threshold;
- › The inclusion of exclusionary or prohibitive language;
- › Investor ownership structure; and
- › Shareholder support of, and management's response to, previous shareholder proposals.

Vote case-by-case on shareholder proposals if, in addition to the considerations above, the company has the following governance and antitakeover provisions:

- › An unfettered<sup>8</sup> right for shareholders to call special meetings at a 10 percent threshold;
- › A majority vote standard in uncontested director elections;
- › No non-shareholder-approved pill; and
- › An annually elected board.

### Shareholder Ability to Call Special Meetings

- ▶ **General Recommendation:** Vote against management or shareholder proposals to restrict or prohibit shareholders' ability to call special meetings.

Generally vote for management or shareholder proposals that provide shareholders with the ability to call special meetings taking into account the following factors:

- › Shareholders' current right to call special meetings;
- › Minimum ownership threshold necessary to call special meetings (10 percent preferred);
- › The inclusion of exclusionary or prohibitive language;
- › Investor ownership structure; and
- › Shareholder support of, and management's response to, previous shareholder proposals.

### Stakeholder Provisions

- ▶ **General Recommendation:** Vote against proposals that ask the board to consider non-shareholder constituencies or other non-financial effects when evaluating a merger or business combination.

### State Antitakeover Statutes

- ▶ **General Recommendation:** Vote case-by-case on proposals to opt in or out of state takeover statutes (including fair price provisions, stakeholder laws, poison pill endorsements, severance pay and labor contract provisions, and anti-greenmail provisions).

### Supermajority Vote Requirements

- ▶ **General Recommendation:** Vote against proposals to require a supermajority shareholder vote.

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<sup>8</sup> "Unfettered" means no restrictions on agenda items, no restrictions on the number of shareholders who can group together to reach the 10 percent threshold, and only reasonable limits on when a meeting can be called: no greater than 30 days after the last annual meeting and no greater than 90 prior to the next annual meeting.

Vote for management or shareholder proposals to reduce supermajority vote requirements. However, for companies with shareholder(s) who have significant ownership levels, vote case-by-case, taking into account:

- › Ownership structure;
- › Quorum requirements; and
- › Vote requirements.

## 4. CAPITAL/RESTRUCTURING

### Capital

#### Adjustments to Par Value of Common Stock

- ▶ **General Recommendation:** Vote for management proposals to reduce the par value of common stock unless the action is being taken to facilitate an anti-takeover device or some other negative corporate governance action.

Vote for management proposals to eliminate par value.

#### Common Stock Authorization

- ▶ **General Recommendation:** Vote for proposals to increase the number of authorized common shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class of common stock to increase the number of authorized shares of the class of common stock that has superior voting rights.

Vote against proposals to increase the number of authorized common shares if a vote for a reverse stock split on the same ballot is warranted despite the fact that the authorized shares would not be reduced proportionally.

Vote case-by-case on all other proposals to increase the number of shares of common stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- › Past Board Performance:
  - › The company's use of authorized shares during the last three years;
- › The Current Request:
  - › Disclosure in the proxy statement of the specific purposes of the proposed increase;
  - › Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request; and
  - › The dilutive impact of the request as determined relative to an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns.

ISS will apply the relevant allowable increase below to requests to increase common stock that are for general corporate purposes (or to the general corporate purposes portion of a request that also includes a specific need):

- Most companies: **100 percent** of existing authorized shares.
- Companies with less than 50 percent of existing authorized shares either outstanding or reserved for issuance: **50 percent** of existing authorized shares.
- Companies with one- and three-year total shareholder returns (TSRs) in the bottom 10 percent of the U.S. market as of the end of the calendar quarter that is closest to their most recent fiscal year end: **50 percent** of existing authorized shares.
- Companies at which both conditions (B and C) above are both present: **25 percent** of existing authorized shares.



If there is an acquisition, private placement, or similar transaction on the ballot (not including equity incentive plans) that ISS is recommending FOR, the allowable increase will be the greater of (i) twice the amount needed to support the transactions on the ballot, and (ii) the allowable increase as calculated above.

## Dual Class Structure

- ▶ **General Recommendation:** Generally vote against proposals to create a new class of common stock unless:
  - › The company discloses a compelling rationale for the dual-class capital structure, such as:
    - › The company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or
    - › The new class of shares will be transitory;
  - › The new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and
  - › The new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

## Issue Stock for Use with Rights Plan

- ▶ **General Recommendation:** Vote against proposals that increase authorized common stock for the explicit purpose of implementing a non-shareholder-approved shareholder rights plan (poison pill).

## Preemptive Rights

- ▶ **General Recommendation:** Vote case-by-case on shareholder proposals that seek preemptive rights, taking into consideration:
  - › The size of the company;
  - › The shareholder base; and
  - › The liquidity of the stock.

## Preferred Stock Authorization

- ▶ **General Recommendation:** Vote for proposals to increase the number of authorized preferred shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class or series of preferred stock to increase the number of authorized shares of the class or series of preferred stock that has superior voting rights.

Vote case-by-case on all other proposals to increase the number of shares of preferred stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- › Past Board Performance:
  - › The company's use of authorized preferred shares during the last three years;
- › The Current Request:
  - › Disclosure in the proxy statement of the specific purposes for the proposed increase;
  - › Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request;
  - › In cases where the company has existing authorized preferred stock, the dilutive impact of the request as determined by an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns; and
  - › Whether the shares requested are blank check preferred shares that can be used for antitakeover purposes.

## Recapitalization Plans

▶ **General Recommendation:** Vote case-by-case on recapitalizations (reclassifications of securities), taking into account the following:

- › More simplified capital structure;
- › Enhanced liquidity;
- › Fairness of conversion terms;
- › Impact on voting power and dividends;
- › Reasons for the reclassification;
- › Conflicts of interest; and
- › Other alternatives considered.

## Reverse Stock Splits

▶ **General Recommendation:** Vote for management proposals to implement a reverse stock split if:

- › The number of authorized shares will be proportionately reduced; or
- › The effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS' [Common Stock Authorization](#) policy.

Vote case-by-case on proposals that do not meet either of the above conditions, taking into consideration the following factors:

- › Stock exchange notification to the company of a potential delisting;
- › Disclosure of substantial doubt about the company's ability to continue as a going concern without additional financing;
- › The company's rationale; or
- › Other factors as applicable.

## Share Repurchase Programs

▶ **General Recommendation:** Vote for management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms.

## Stock Distributions: Splits and Dividends

▶ **General Recommendation:** Generally vote for management proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase in authorized shares is equal to or is less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

## Tracking Stock

▶ **General Recommendation:** Vote case-by-case on the creation of tracking stock, weighing the strategic value of the transaction against such factors as:

- › Adverse governance changes;
- › Excessive increases in authorized capital stock;
- › Unfair method of distribution;
- › Diminution of voting rights;
- › Adverse conversion features;

- › Negative impact on stock option plans; and
- › Alternatives such as spin-off.

## Restructuring

### Appraisal Rights

- ▶ **General Recommendation:** Vote for proposals to restore or provide shareholders with rights of appraisal.

### Asset Purchases

- ▶ **General Recommendation:** Vote case-by-case on asset purchase proposals, considering the following factors:
  - › Purchase price;
  - › Fairness opinion;
  - › Financial and strategic benefits;
  - › How the deal was negotiated;
  - › Conflicts of interest;
  - › Other alternatives for the business;
  - › Non-completion risk.

### Asset Sales

- ▶ **General Recommendation:** Vote case-by-case on asset sales, considering the following factors:
  - › Impact on the balance sheet/working capital;
  - › Potential elimination of diseconomies;
  - › Anticipated financial and operating benefits;
  - › Anticipated use of funds;
  - › Value received for the asset;
  - › Fairness opinion;
  - › How the deal was negotiated;
  - › Conflicts of interest.

### Bundled Proposals

- ▶ **General Recommendation:** Vote case-by-case on bundled or “conditional” proxy proposals. In the case of items that are conditioned upon each other, examine the benefits and costs of the packaged items. In instances when the joint effect of the conditioned items is not in shareholders’ best interests, vote against the proposals. If the combined effect is positive, support such proposals.

### Conversion of Securities

- ▶ **General Recommendation:** Vote case-by-case on proposals regarding conversion of securities. When evaluating these proposals, the investor should review the dilution to existing shareholders, the conversion price relative to market value, financial issues, control issues, termination penalties, and conflicts of interest.

Vote for the conversion if it is expected that the company will be subject to onerous penalties or will be forced to file for bankruptcy if the transaction is not approved.

## Corporate Reorganization/Debt Restructuring/Prepackaged Bankruptcy Plans/Reverse Leveraged Buyouts/Wrap Plans

▶ **General Recommendation:** Vote case-by-case on proposals to increase common and/or preferred shares and to issue shares as part of a debt restructuring plan, after evaluating:

- › Dilution to existing shareholders' positions;
- › Terms of the offer - discount/premium in purchase price to investor, including any fairness opinion; termination penalties; exit strategy;
- › Financial issues - company's financial situation; degree of need for capital; use of proceeds; effect of the financing on the company's cost of capital;
- › Management's efforts to pursue other alternatives;
- › Control issues - change in management; change in control, guaranteed board and committee seats; standstill provisions; voting agreements; veto power over certain corporate actions; and
- › Conflict of interest - arm's length transaction, managerial incentives.

Vote for the debt restructuring if it is expected that the company will file for bankruptcy if the transaction is not approved.

## Formation of Holding Company

▶ **General Recommendation:** Vote case-by-case on proposals regarding the formation of a holding company, taking into consideration the following:

- › The reasons for the change;
- › Any financial or tax benefits;
- › Regulatory benefits;
- › Increases in capital structure; and
- › Changes to the articles of incorporation or bylaws of the company.

Absent compelling financial reasons to recommend for the transaction, vote against the formation of a holding company if the transaction would include either of the following:

- › Increases in common or preferred stock in excess of the allowable maximum (see discussion under "Capital"); or
- › Adverse changes in shareholder rights.

## Going Private and Going Dark Transactions (LBOs and Minority Squeeze-outs)

▶ **General Recommendation:** Vote case-by-case on going private transactions, taking into account the following:

- › Offer price/premium;
- › Fairness opinion;
- › How the deal was negotiated;
- › Conflicts of interest;
- › Other alternatives/offers considered; and
- › Non-completion risk.

Vote case-by-case on going dark transactions, determining whether the transaction enhances shareholder value by taking into consideration:

- › Whether the company has attained benefits from being publicly-traded (examination of trading volume, liquidity, and market research of the stock);

- › Balanced interests of continuing vs. cashed-out shareholders, taking into account the following:
  - › Are all shareholders able to participate in the transaction?
  - › Will there be a liquid market for remaining shareholders following the transaction?
  - › Does the company have strong corporate governance?
  - › Will insiders reap the gains of control following the proposed transaction?
  - › Does the state of incorporation have laws requiring continued reporting that may benefit shareholders?

## Joint Ventures

▶ **General Recommendation:** Vote case-by-case on proposals to form joint ventures, taking into account the following:

- › Percentage of assets/business contributed;
- › Percentage ownership;
- › Financial and strategic benefits;
- › Governance structure;
- › Conflicts of interest;
- › Other alternatives; and
- › Non-completion risk.

## Liquidations

▶ **General Recommendation:** Vote case-by-case on liquidations, taking into account the following:

- › Management's efforts to pursue other alternatives;
- › Appraisal value of assets; and
- › The compensation plan for executives managing the liquidation.

Vote for the liquidation if the company will file for bankruptcy if the proposal is not approved.

## Mergers and Acquisitions

▶ **General Recommendation:** Vote case-by-case on mergers and acquisitions. Review and evaluate the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors including:

- › *Valuation* - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction, and strategic rationale.
- › *Market reaction* - How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.
- › *Strategic rationale* - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
- › *Negotiations and process* - Were the terms of the transaction negotiated at arm's-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation "wins" can also signify the deal makers' competency. The comprehensiveness of the sales process (e.g., full auction, partial auction, no auction) can also affect shareholder value.
- › *Conflicts of interest* - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. Consider whether these interests may have influenced these directors and officers to support or recommend the merger. The CIC figure presented in the "ISS Transaction Summary" section of this report is an aggregate figure that can in

certain cases be a misleading indicator of the true value transfer from shareholders to insiders. Where such figure appears to be excessive, analyze the underlying assumptions to determine whether a potential conflict exists.

- › *Governance* - Will the combined company have a better or worse governance profile than the current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

## Private Placements/Warrants/Convertible Debentures




**General Recommendation:** Vote case-by-case on proposals regarding private placements, warrants, and convertible debentures taking into consideration:

- › Dilution to existing shareholders' position: The amount and timing of shareholder ownership dilution should be weighed against the needs and proposed shareholder benefits of the capital infusion. Although newly issued common stock, absent preemptive rights, is typically dilutive to existing shareholders, share price appreciation is often the necessary event to trigger the exercise of "out of the money" warrants and convertible debt. In these instances from a value standpoint, the negative impact of dilution is mitigated by the increase in the company's stock price that must occur to trigger the dilutive event.
- › Terms of the offer (discount/premium in purchase price to investor, including any fairness opinion, conversion features, termination penalties, exit strategy):
  - › The terms of the offer should be weighed against the alternatives of the company and in light of company's financial condition. Ideally, the conversion price for convertible debt and the exercise price for warrants should be at a premium to the then prevailing stock price at the time of private placement.
  - › When evaluating the magnitude of a private placement discount or premium, consider factors that influence the discount or premium, such as, liquidity, due diligence costs, control and monitoring costs, capital scarcity, information asymmetry, and anticipation of future performance.
- › Financial issues:
  - › The company's financial condition;
  - › Degree of need for capital;
  - › Use of proceeds;
  - › Effect of the financing on the company's cost of capital;
  - › Current and proposed cash burn rate;
  - › Going concern viability and the state of the capital and credit markets.
- › Management's efforts to pursue alternatives and whether the company engaged in a process to evaluate alternatives: A fair, unconstrained process helps to ensure the best price for shareholders. Financing alternatives can include joint ventures, partnership, merger, or sale of part or all of the company.
- › Control issues:
  - › Change in management;
  - › Change in control;
  - › Guaranteed board and committee seats;
  - › Standstill provisions;
  - › Voting agreements;
  - › Veto power over certain corporate actions; and
  - › Minority versus majority ownership and corresponding minority discount or majority control premium.
- › Conflicts of interest:
  - › Conflicts of interest should be viewed from the perspective of the company and the investor.

- › Were the terms of the transaction negotiated at arm's length? Are managerial incentives aligned with shareholder interests?
- › Market reaction:
  - › The market's response to the proposed deal. A negative market reaction is a cause for concern. Market reaction may be addressed by analyzing the one day impact on the unaffected stock price.


Vote for the private placement, or for the issuance of warrants and/or convertible debentures in a private placement, if it is expected that the company will file for bankruptcy if the transaction is not approved.

### Reorganization/Restructuring Plan (Bankruptcy)

 **General Recommendation:** Vote case-by-case on proposals to common shareholders on bankruptcy plans of reorganization, considering the following factors including, but not limited to:

- › Estimated value and financial prospects of the reorganized company;
- › Percentage ownership of current shareholders in the reorganized company;
- › Whether shareholders are adequately represented in the reorganization process (particularly through the existence of an Official Equity Committee);
- › The cause(s) of the bankruptcy filing, and the extent to which the plan of reorganization addresses the cause(s);
- › Existence of a superior alternative to the plan of reorganization; and
- › Governance of the reorganized company.

### Special Purpose Acquisition Corporations (SPACs)

 **General Recommendation:** Vote case-by-case on SPAC mergers and acquisitions taking into account the following:

- › *Valuation* - Is the value being paid by the SPAC reasonable? SPACs generally lack an independent fairness opinion and the financials on the target may be limited. Compare the conversion price with the intrinsic value of the target company provided in the fairness opinion. Also, evaluate the proportionate value of the combined entity attributable to the SPAC IPO shareholders versus the pre-merger value of SPAC. Additionally, a private company discount may be applied to the target, if it is a private entity.
- › *Market reaction* - How has the market responded to the proposed deal? A negative market reaction may be a cause for concern. Market reaction may be addressed by analyzing the one-day impact on the unaffected stock price.
- › *Deal timing* - A main driver for most transactions is that the SPAC charter typically requires the deal to be complete within 18 to 24 months, or the SPAC is to be liquidated. Evaluate the valuation, market reaction, and potential conflicts of interest for deals that are announced close to the liquidation date.
- › *Negotiations and process* - What was the process undertaken to identify potential target companies within specified industry or location specified in charter? Consider the background of the sponsors.
- › *Conflicts of interest* - How are sponsors benefiting from the transaction compared to IPO shareholders? Potential conflicts could arise if a fairness opinion is issued by the insiders to qualify the deal rather than a third party or if management is encouraged to pay a higher price for the target because of an 80 percent rule (the charter requires that the fair market value of the target is at least equal to 80 percent of net assets of the SPAC). Also, there may be sense of urgency by the management team of the SPAC to close the deal since its charter typically requires a transaction to be completed within the 18-24 month timeframe.
- › *Voting agreements* - Are the sponsors entering into any voting agreements/tender offers with shareholders who are likely to vote against the proposed merger or exercise conversion rights?
- › *Governance* - What is the impact of having the SPAC CEO or founder on key committees following the proposed merger?

## Special Purpose Acquisition Corporations (SPACs) - Proposals for Extensions

- ▶ **General Recommendation:** Vote case-by-case on SPAC extension proposals taking into account the length of the requested extension, the status of any pending transaction(s) or progression of the acquisition process, any added incentive for non-redeeming shareholders, and any prior extension requests.
- › *Length of request:* Typically, extension requests range from two to six months, depending on the progression of the SPAC's acquisition process.
  - › *Pending transaction(s) or progression of the acquisition process:* Sometimes an initial business combination was already put to a shareholder vote, but, for varying reasons, the transaction could not be consummated by the termination date and the SPAC is requesting an extension. Other times, the SPAC has entered into a definitive transaction agreement, but needs additional time to consummate or hold the shareholder meeting.
  - › *Added incentive for non-redeeming shareholders:* Sometimes the SPAC sponsor (or other insiders) will contribute, typically as a loan to the company, additional funds that will be added to the redemption value of each public share as long as such shares are not redeemed in connection with the extension request. The purpose of the "equity kicker" is to incentivize shareholders to hold their shares through the end of the requested extension or until the time the transaction is put to a shareholder vote, rather than electing redemption at the extension proposal meeting.
  - › *Prior extension requests:* Some SPACs request additional time beyond the extension period sought in prior extension requests.

## Spin-offs

- ▶ **General Recommendation:** Vote case-by-case on spin-offs, considering:
- › Tax and regulatory advantages;
  - › Planned use of the sale proceeds;
  - › Valuation of spinoff;
  - › Fairness opinion;
  - › Benefits to the parent company;
  - › Conflicts of interest;
  - › Managerial incentives;
  - › Corporate governance changes;
  - › Changes in the capital structure.

## Value Maximization Shareholder Proposals

- ▶ **General Recommendation:** Vote case-by-case on shareholder proposals seeking to maximize shareholder value by:
- › Hiring a financial advisor to explore strategic alternatives;
  - › Selling the company; or
  - › Liquidating the company and distributing the proceeds to shareholders.

These proposals should be evaluated based on the following factors:

- › Prolonged poor performance with no turnaround in sight;
- › Signs of entrenched board and management (such as the adoption of takeover defenses);
- › Strategic plan in place for improving value;
- › Likelihood of receiving reasonable value in a sale or dissolution; and
- › The company actively exploring its strategic options, including retaining a financial advisor.




## 5. COMPENSATION

### Executive Pay Evaluation

Underlying all evaluations are five global principles that most investors expect corporations to adhere to in designing and administering executive and director compensation programs:

1. Maintain appropriate pay-for-performance alignment, with emphasis on long-term shareholder value: This principle encompasses overall executive pay practices, which must be designed to attract, retain, and appropriately motivate the key employees who drive shareholder value creation over the long term. It will take into consideration, among other factors, the link between pay and performance; the mix between fixed and variable pay; performance goals; and equity-based plan costs;
2. Avoid arrangements that risk “pay for failure”: This principle addresses the appropriateness of long or indefinite contracts, excessive severance packages, and guaranteed compensation;
3. Maintain an independent and effective compensation committee: This principle promotes oversight of executive pay programs by directors with appropriate skills, knowledge, experience, and a sound process for compensation decision-making (*e.g.*, including access to independent expertise and advice when needed);
4. Provide shareholders with clear, comprehensive compensation disclosures: This principle underscores the importance of informative and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly;
5. Avoid inappropriate pay to non-executive directors: This principle recognizes the interests of shareholders in ensuring that compensation to outside directors is reasonable and does not compromise their independence and ability to make appropriate judgments in overseeing managers’ pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

### Advisory Votes on Executive Compensation—Management Proposals (Management Say-on-Pay)

 **General Recommendation:** Vote case-by-case on ballot items related to executive pay and practices, as well as certain aspects of outside director compensation.

Vote against Advisory Votes on Executive Compensation (Say-on-Pay or “SOP”) if:

- › There is an unmitigated misalignment between CEO pay and company performance ([pay for performance](#));
- › The company maintains significant [problematic pay practices](#);
- › The board exhibits a significant level of [poor communication and responsiveness](#) to shareholders.

Vote against or withhold from the members of the Compensation Committee and potentially the full board if:

- › There is no SOP on the ballot, and an against vote on an SOP would otherwise be warranted due to pay-for-performance misalignment, problematic pay practices, or the lack of adequate responsiveness on compensation issues raised previously, or a combination thereof;
- › The board fails to respond adequately to a previous SOP proposal that received less than 70 percent support of votes cast;
- › The company has recently practiced or approved problematic pay practices, such as option repricing or option backdating; or
- › The situation is egregious.

## Primary Evaluation Factors for Executive Pay

### Pay-for-Performance Evaluation

ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the S&P1500, Russell 3000, or Russell 3000E Indices<sup>9</sup>, this analysis considers the following:

1. Peer Group<sup>10</sup> Alignment:
  - › The degree of alignment between the company's annualized TSR rank and the CEO's annualized total pay rank within a peer group, each measured over a three-year period.
  - › The rankings of CEO total pay and company financial performance within a peer group, each measured over a three-year period.
  - › The multiple of the CEO's total pay relative to the peer group median in the most recent fiscal year.
2. Absolute Alignment<sup>11</sup> – the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – i.e., the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

If the above analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment or, in the case of companies outside the Russell indices, misaligned pay and performance are otherwise suggested, our analysis may include any of the following qualitative factors, as relevant to evaluating how various pay elements may work to encourage or to undermine long-term value creation and alignment with shareholder interests:

- › The ratio of performance- to time-based incentive awards;
- › The overall ratio of performance-based compensation;
- › The completeness of disclosure and rigor of performance goals;
- › The company's peer group benchmarking practices;
- › Actual results of financial/operational metrics, both absolute and relative to peers;
- › Special circumstances related to, for example, a new CEO in the prior FY or anomalous equity grant practices (e.g., bi-annual awards);
- › Realizable pay<sup>12</sup> compared to grant pay; and
- › Any other factors deemed relevant.

### Problematic Pay Practices

The focus is on executive compensation practices that contravene the global pay principles, including:

- › Problematic practices related to non-performance-based compensation elements;
- › Incentives that may motivate excessive risk-taking or present a windfall risk; and
- › Pay decisions that circumvent pay-for-performance, such as options backdating or waiving performance requirements.

<sup>9</sup> The [Russell 3000E](#) Index includes approximately 4,000 of the largest U.S. equity securities.

<sup>10</sup> The revised peer group is generally comprised of 14-24 companies that are selected using market cap, revenue (or assets for certain financial firms), GICS industry group, and company's selected peers' GICS industry group, with size constraints, via a process designed to select peers that are comparable to the subject company in terms of revenue/assets and industry, and also within a market-cap bucket that is reflective of the company's. For Oil, Gas & Consumable Fuels companies, market cap is the only size determinant.

<sup>11</sup> Only Russell 3000 Index companies are subject to the Absolute Alignment analysis.

<sup>12</sup> ISS research reports include realizable pay for S&P1500 companies.

### Problematic Pay Practices related to Non-Performance-Based Compensation Elements

Pay elements that are not directly based on performance are generally evaluated case-by-case considering the context of a company's overall pay program and demonstrated pay-for-performance philosophy. Please refer to ISS' [U.S. Compensation Policies FAQ](#) document for detail on specific pay practices that have been identified as potentially problematic and may lead to negative recommendations if they are deemed to be inappropriate or unjustified relative to executive pay best practices. The list below highlights the problematic practices that carry significant weight in this overall consideration and may result in adverse vote recommendations:

- › Repricing or replacing of underwater stock options/SARS without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- › Extraordinary perquisites or tax gross-ups;
- › New or materially amended agreements that provide for:
  - › Excessive termination or CIC severance payments (generally exceeding 3 times base salary and average/target/most recent bonus);
  - › CIC severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers) or in connection with a problematic Good Reason definition;
  - › CIC excise tax gross-up entitlements (including "modified" gross-ups);
  - › Multi-year guaranteed awards that are not at risk due to rigorous performance conditions;
  - › Liberal CIC definition combined with any single-trigger CIC benefits;
- › Insufficient executive compensation disclosure by externally-managed issuers (EMIs) such that a reasonable assessment of pay programs and practices applicable to the EMI's executives is not possible;
- › Any other provision or practice deemed to be egregious and present a significant risk to investors.

### Options Backdating

The following factors should be examined case-by-case to allow for distinctions to be made between “sloppy” plan administration versus deliberate action or fraud:

- › Reason and motive for the options backdating issue, such as inadvertent vs. deliberate grant date changes;
- › Duration of options backdating;
- › Size of restatement due to options backdating;
- › Corrective actions taken by the board or compensation committee, such as canceling or re-pricing backdated options, the recouping of option gains on backdated grants; and
- › Adoption of a grant policy that prohibits backdating, and creates a fixed grant schedule or window period for equity grants in the future.

### Compensation Committee Communications and Responsiveness

Consider the following factors case-by-case when evaluating ballot items related to executive pay on the board's responsiveness to investor input and engagement on compensation issues:

- › Failure to respond to majority-supported shareholder proposals on executive pay topics; or
- › Failure to adequately respond to the company's previous say-on-pay proposal that received the support of less than 70 percent of votes cast, taking into account:
  - › The company's response, including:
    - › Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);

- › Disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;
- › Disclosure of specific and meaningful actions taken to address shareholders' concerns;
- › Other recent compensation actions taken by the company;
- › Whether the issues raised are recurring or isolated;
- › The company's ownership structure; and
- › Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.

### Frequency of Advisory Vote on Executive Compensation ("Say When on Pay")

- ▶ **General Recommendation:** Vote for annual advisory votes on compensation, which provide the most consistent and clear communication channel for shareholder concerns about companies' executive pay programs.

### Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale

- ▶ **General Recommendation:** Vote case-by-case on say on Golden Parachute proposals, including consideration of existing change-in-control arrangements maintained with named executive officers rather than focusing primarily on new or extended arrangements.

Features that may result in an "against" recommendation include one or more of the following, depending on the number, magnitude, and/or timing of issue(s):

- › Single- or modified-single-trigger cash severance;
- › Single-trigger acceleration of unvested equity awards;
- › Full acceleration of equity awards granted shortly before the change in control;
- › Acceleration of performance awards above the target level of performance without compelling rationale;
- › Excessive cash severance (generally >3x base salary and bonus);
- › Excise tax gross-ups triggered and payable;
- › Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value); or
- › Recent amendments that incorporate any problematic features (such as those above) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; or
- › The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote.

Recent amendment(s) that incorporate problematic features will tend to carry more weight on the overall analysis. However, the presence of multiple legacy problematic features will also be closely scrutinized.

In cases where the golden parachute vote is incorporated into a company's advisory vote on compensation (management say-on-pay), ISS will evaluate the say-on-pay proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

## Equity-Based and Other Incentive Plans

Please refer to ISS' [U.S. Equity Compensation Plans FAQ](#) document for additional details on the Equity Plan Scorecard policy.

- ▶ **General Recommendation:** Vote case-by-case on certain equity-based compensation plans<sup>13</sup> depending on a combination of certain plan features and equity grant practices, where positive factors may counterbalance negative factors, and vice versa, as evaluated using an "Equity Plan Scorecard" (EPSC) approach with three pillars:
- › **Plan Cost:** The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
    - › SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
    - › SVT based only on new shares requested plus shares remaining for future grants.
  - › **Plan Features:**
    - › Quality of disclosure around vesting upon a change in control (CIC);
    - › Discretionary vesting authority;
    - › Liberal share recycling on various award types;
    - › Lack of minimum vesting period for grants made under the plan;
    - › Dividends payable prior to award vesting.
  - › **Grant Practices:**
    - › The company's three-year burn rate relative to its industry/market cap peers;
    - › Vesting requirements in CEO's recent equity grants (3-year look-back);
    - › The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years);
    - › The proportion of the CEO's most recent equity grants/awards subject to performance conditions;
    - › Whether the company maintains a sufficient claw-back policy;
    - › Whether the company maintains sufficient post-exercise/vesting share-holding requirements.

Generally vote against the plan proposal if the combination of above factors indicates that the plan is not, overall, in shareholders' interests, or if any of the following egregious factors ("overriding factors") apply:

- › Awards may vest in connection with a liberal change-of-control definition;
- › The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it – for NYSE and Nasdaq listed companies – or by not prohibiting it when the company has a history of repricing – for non-listed companies);
- › The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances;
- › The plan is excessively dilutive to shareholders' holdings; or
- › Any other plan features are determined to have a significant negative impact on shareholder interests.

### Further Information on certain EPSC Factors:

<sup>13</sup> Proposals evaluated under the EPSC policy generally include those to approve or amend (1) stock option plans for employees and/or employees and directors, (2) restricted stock plans for employees and/or employees and directors, and (3) omnibus stock incentive plans for employees and/or employees and directors; amended plans will be further evaluated case-by-case.

## Shareholder Value Transfer (SVT)

The cost of the equity plans is expressed as Shareholder Value Transfer (SVT), which is measured using a binomial option pricing model that assesses the amount of shareholders' equity flowing out of the company to employees and directors. SVT is expressed as both a dollar amount and as a percentage of market value, and includes the new shares proposed, shares available under existing plans, and shares granted but unexercised (using two measures, in the case of plans subject to the Equity Plan Scorecard evaluation, as noted above). All award types are valued. For omnibus plans, unless limitations are placed on the most expensive types of awards (for example, full-value awards), the assumption is made that all awards to be granted will be the most expensive types. See discussion of specific types of awards.

Except for proposals subject to Equity Plan Scorecard evaluation, Shareholder Value Transfer is reasonable if it falls below a company-specific benchmark. The benchmark is determined as follows: The top quartile performers in each industry group (using the Global Industry Classification Standard: GICS) are identified. Benchmark SVT levels for each industry are established based on these top performers' historic SVT. Regression analyses are run on each industry group to identify the variables most strongly correlated to SVT. The benchmark industry SVT level is then adjusted upwards or downwards for the specific company by plugging the company-specific performance measures, size and cash compensation into the industry cap equations to arrive at the company's benchmark.<sup>14</sup>

## Three-Year Burn Rate

Burn-rate benchmarks (utilized in Equity Plan Scorecard evaluations) are calculated as the greater of: (1) the mean ( $\mu$ ) plus one standard deviation ( $\sigma$ ) of the company's GICS group segmented by S&P 500, Russell 3000 index (less the S&P500), and non-Russell 3000 index; and (2) two percent of weighted common shares outstanding. In addition, year-over-year burn-rate benchmark changes will be limited to a maximum of two (2) percentage points plus or minus the prior year's burn-rate benchmark. See the [U.S. Equity Compensation Plans FAQ](#) for the benchmarks.

## Egregious Factors

### Liberal Change in Control Definition

Generally vote against equity plans if the plan has a liberal definition of change in control and the equity awards could vest upon such liberal definition of change in control, even though an actual change in control may not occur. Examples of such a definition include, but are not limited to, announcement or commencement of a tender offer, provisions for acceleration upon a "potential" takeover, shareholder approval of a merger or other transactions, or similar language.

### Repricing Provisions

Vote against plans that expressly permit the repricing or exchange of underwater stock options/stock appreciate rights (SARs) without prior shareholder approval. "Repricing" typically includes the ability to do any of the following:

- › Amend the terms of outstanding options or SARs to reduce the exercise price of such outstanding options or SARs;
- › Cancel outstanding options or SARs in exchange for options or SARs with an exercise price that is less than the exercise price of the original options or SARs;
- › The cancellation of underwater options in exchange for stock awards; or
- › Cash buyouts of underwater options.

While the above cover most types of repricing, ISS may view other provisions as akin to repricing depending on the facts and circumstances.

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<sup>14</sup> For plans evaluated under the Equity Plan Scorecard policy, the company's SVT benchmark is considered along with other factors.

Also, vote against or withhold from members of the Compensation Committee who approved repricing (as defined above or otherwise determined by ISS), without prior shareholder approval, even if such repricings are allowed in their equity plan.

Vote against plans that do not expressly prohibit repricing or cash buyout of underwater options without shareholder approval if the company has a history of repricing/buyouts without shareholder approval, and the applicable listing standards would not preclude them from doing so.

### **Problematic Pay Practices or Significant Pay-for-Performance Disconnect**

If the equity plan on the ballot is a vehicle for [problematic pay practices](#), vote against the plan.

ISS may recommend a vote against the equity plan if the plan is determined to be a vehicle for pay-for-performance misalignment. Considerations in voting against the equity plan may include, but are not limited to:

- › Severity of the pay-for-performance misalignment;
- › Whether problematic equity grant practices are driving the misalignment; and/or
- › Whether equity plan awards have been heavily concentrated to the CEO and/or the other NEOs.

### **Amending Cash and Equity Plans (including Approval for Tax Deductibility (162(m)))**



**General Recommendation:** Vote case-by-case on amendments to cash and equity incentive plans.

Generally vote for proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- › Addresses administrative features only; or
- › Seeks approval for Section 162(m) purposes only, and the plan administering committee consists entirely of independent directors, per [ISS' Classification of Directors](#). Note that if the company is presenting the plan to shareholders for the first time for any reason (including after the company's initial public offering), or if the proposal is bundled with other material plan amendments, then the recommendation will be case-by-case (see below).

Vote against proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- › Seeks approval for Section 162(m) purposes only, and the plan administering committee does not consist entirely of independent directors, per [ISS' Classification of Directors](#).

Vote case-by-case on all other proposals to amend cash incentive plans. This includes plans presented to shareholders for the first time after the company's IPO and/or proposals that bundle material amendment(s) other than those for Section 162(m) purposes.

Vote case-by-case on all other proposals to amend equity incentive plans, considering the following:

- › If the proposal requests additional shares and/or the amendments include a term extension or addition of full value awards as an award type, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of the amendments.
- › If the plan is being presented to shareholders for the first time (including after the company's IPO), whether or not additional shares are being requested, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of any amendments.
- › If there is no request for additional shares and the amendments do not include a term extension or addition of full value awards as an award type, then the recommendation will be based entirely on an analysis of the overall impact of the amendments, and the EPSC evaluation will be shown only for informational purposes.

In the first two case-by-case evaluation scenarios, the EPSC evaluation/score is the more heavily weighted consideration.

## Specific Treatment of Certain Award Types in Equity Plan Evaluations

### Dividend Equivalent Rights

Options that have Dividend Equivalent Rights (DERs) associated with them will have a higher calculated award value than those without DERs under the binomial model, based on the value of these dividend streams. The higher value will be applied to new shares, shares available under existing plans, and shares awarded but not exercised per the plan specifications. DERs transfer more shareholder equity to employees and non-employee directors and this cost should be captured.

### Operating Partnership (OP) Units in Equity Plan Analysis of Real Estate Investment Trusts (REITs)

For Real Estate Investment Trusts (REITs), include the common shares issuable upon conversion of outstanding Operating Partnership (OP) units in the share count for the purposes of determining: (1) market capitalization in the Shareholder Value Transfer (SVT) analysis and (2) shares outstanding in the burn rate analysis.

## Other Compensation Plans

### 401(k) Employee Benefit Plans

- ▶ **General Recommendation:** Vote for proposals to implement a 401(k) savings plan for employees.

### Employee Stock Ownership Plans (ESOPs)

- ▶ **General Recommendation:** Vote for proposals to implement an ESOP or increase authorized shares for existing ESOPs, unless the number of shares allocated to the ESOP is excessive (more than five percent of outstanding shares).

### Employee Stock Purchase Plans—Qualified Plans

- ▶ **General Recommendation:** Vote case-by-case on qualified employee stock purchase plans. Vote for employee stock purchase plans where all of the following apply:
  - › Purchase price is at least 85 percent of fair market value;
  - › Offering period is 27 months or less; and
  - › The number of shares allocated to the plan is 10 percent or less of the outstanding shares.

Vote against qualified employee stock purchase plans where any of the following apply:

- › Purchase price is less than 85 percent of fair market value; or
- › Offering period is greater than 27 months; or
- › The number of shares allocated to the plan is more than 10 percent of the outstanding shares.

### Employee Stock Purchase Plans—Non-Qualified Plans


- ▶ **General Recommendation:** Vote case-by-case on nonqualified employee stock purchase plans. Vote for nonqualified employee stock purchase plans with all the following features:



- › Broad-based participation (*i.e.*, all employees of the company with the exclusion of individuals with 5 percent or more of beneficial ownership of the company);
- › Limits on employee contribution, which may be a fixed dollar amount or expressed as a percent of base salary;
- › Company matching contribution up to 25 percent of employee's contribution, which is effectively a discount of 20 percent from market value; and
- › No discount on the stock price on the date of purchase when there is a company matching contribution.

Vote against nonqualified employee stock purchase plans when the plan features do not meet all of the above criteria. If the matching contribution or effective discount exceeds the above, ISS may evaluate the SVT cost of the plan as part of the assessment.

### Option Exchange Programs/Repricing Options

 **General Recommendation:** Vote case-by-case on management proposals seeking approval to exchange/reprice options taking into consideration:


- › Historic trading patterns--the stock price should not be so volatile that the options are likely to be back "in-the-money" over the near term;
- › Rationale for the re-pricing--was the stock price decline beyond management's control?;
- › Is this a value-for-value exchange?;
- › Are surrendered stock options added back to the plan reserve?;
- › Timing--repricing should occur at least one year out from any precipitous drop in company's stock price;
- › Option vesting--does the new option vest immediately or is there a black-out period?;
- › Term of the option--the term should remain the same as that of the replaced option;
- › Exercise price--should be set at fair market or a premium to market;
- › Participants--executive officers and directors must be excluded.

If the surrendered options are added back to the equity plans for re-issuance, then also take into consideration the company's total cost of equity plans and its three-year average burn rate.

In addition to the above considerations, evaluate the intent, rationale, and timing of the repricing proposal. The proposal should clearly articulate why the board is choosing to conduct an exchange program at this point in time. Repricing underwater options after a recent precipitous drop in the company's stock price demonstrates poor timing and warrants additional scrutiny. Also, consider the terms of the surrendered options, such as the grant date, exercise price and vesting schedule. Grant dates of surrendered options should be far enough back (two to three years) so as not to suggest that repricings are being done to take advantage of short-term downward price movements. Similarly, the exercise price of surrendered options should be above the 52-week high for the stock price.

Vote for shareholder proposals to put option repricings to a shareholder vote.

### Stock Plans in Lieu of Cash

 **General Recommendation:** Vote case-by-case on plans that provide participants with the option of taking all or a portion of their cash compensation in the form of stock.

Vote for non-employee director-only equity plans that provide a dollar-for-dollar cash-for-stock exchange.

Vote case-by-case on plans which do not provide a dollar-for-dollar cash for stock exchange. In cases where the exchange is not dollar-for-dollar, the request for new or additional shares for such equity program will be considered

using the binomial option pricing model. In an effort to capture the total cost of total compensation, ISS will not make any adjustments to carve out the in-lieu-of cash compensation.

### Transfer Stock Option (TSO) Programs

- ▶ **General Recommendation:** One-time Transfers: Vote against or withhold from compensation committee members if they fail to submit one-time transfers to shareholders for approval.

Vote case-by-case on one-time transfers. Vote for if:

- › Executive officers and non-employee directors are excluded from participating;
- › Stock options are purchased by third-party financial institutions at a discount to their fair value using option pricing models such as Black-Scholes or a Binomial Option Valuation or other appropriate financial models; and
- › There is a two-year minimum holding period for sale proceeds (cash or stock) for all participants.

Additionally, management should provide a clear explanation of why options are being transferred to a third-party institution and whether the events leading up to a decline in stock price were beyond management's control. A review of the company's historic stock price volatility should indicate if the options are likely to be back "in-the-money" over the near term.

Ongoing TSO program: Vote against equity plan proposals if the details of ongoing TSO programs are not provided to shareholders. Since TSOs will be one of the award types under a stock plan, the ongoing TSO program, structure and mechanics must be disclosed to shareholders. The specific criteria to be considered in evaluating these proposals include, but not limited, to the following:

- › Eligibility;
- › Vesting;
- › Bid-price;
- › Term of options;
- › Cost of the program and impact of the TSOs on company's total option expense; and
- › Option repricing policy.

Amendments to existing plans that allow for introduction of transferability of stock options should make clear that only options granted post-amendment shall be transferable.

## Director Compensation

### Shareholder Ratification of Director Pay Programs

- ▶ **General Recommendation:** Vote case-by-case on management proposals seeking ratification of non-employee director compensation, based on the following factors:

- › If the equity plan under which non-employee director grants are made is on the ballot, whether or not it warrants support; and
- › An assessment of the following qualitative factors:
  - › The relative magnitude of director compensation as compared to companies of a similar profile;
  - › The presence of problematic pay practices relating to director compensation;
  - › Director stock ownership guidelines and holding requirements;
  - › Equity award vesting schedules;
  - › The mix of cash and equity-based compensation;
  - › Meaningful limits on director compensation;

- › The availability of retirement benefits or perquisites; and
- › The quality of disclosure surrounding director compensation.

## Equity Plans for Non-Employee Directors

▶ **General Recommendation:** Vote case-by-case on compensation plans for non-employee directors, based on:

- › The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants;
- › The company's three-year burn rate relative to its industry/market cap peers (in certain circumstances); and
- › The presence of any egregious plan features (such as an option repricing provision or liberal CIC vesting risk).

On occasion, non-employee director stock plans will exceed the plan cost or burn-rate benchmarks when combined with employee or executive stock plans. In such cases, vote case-by-case on the plan taking into consideration the following qualitative factors:

- › The relative magnitude of director compensation as compared to companies of a similar profile;
- › The presence of problematic pay practices relating to director compensation;
- › Director stock ownership guidelines and holding requirements;
- › Equity award vesting schedules;
- › The mix of cash and equity-based compensation;
- › Meaningful limits on director compensation;
- › The availability of retirement benefits or perquisites; and
- › The quality of disclosure surrounding director compensation.

## Non-Employee Director Retirement Plans

▶ **General Recommendation:** Vote against retirement plans for non-employee directors. Vote for shareholder proposals to eliminate retirement plans for non-employee directors.

## Shareholder Proposals on Compensation

### Bonus Banking/Bonus Banking "Plus"

▶ **General Recommendation:** Vote case-by-case on proposals seeking deferral of a portion of annual bonus pay, with ultimate payout linked to sustained results for the performance metrics on which the bonus was earned (whether for the named executive officers or a wider group of employees), taking into account the following factors:

- › The company's past practices regarding equity and cash compensation;
- › Whether the company has a holding period or stock ownership requirements in place, such as a meaningful retention ratio (at least 50 percent for full tenure); and
- › Whether the company has a rigorous claw-back policy in place.

### Compensation Consultants—Disclosure of Board or Company's Utilization

▶ **General Recommendation:** Generally vote for shareholder proposals seeking disclosure regarding the Company, Board, or Compensation Committee's use of compensation consultants, such as company name, business relationship(s), and fees paid.

## Disclosure/Setting Levels or Types of Compensation for Executives and Directors

- ▶ **General Recommendation:** Generally vote for shareholder proposals seeking additional disclosure of executive and director pay information, provided the information requested is relevant to shareholders' needs, would not put the company at a competitive disadvantage relative to its industry, and is not unduly burdensome to the company.

Generally vote against shareholder proposals seeking to set absolute levels on compensation or otherwise dictate the amount or form of compensation (such as types of compensation elements or specific metrics) to be used for executive or directors.

Generally vote against shareholder proposals that mandate a minimum amount of stock that directors must own in order to qualify as a director or to remain on the board.

Vote case-by-case on all other shareholder proposals regarding executive and director pay, taking into account relevant factors, including but not limited to: company performance, pay level and design versus peers, history of compensation concerns or pay-for-performance disconnect, and/or the scope and prescriptive nature of the proposal.

## Golden Coffins/Executive Death Benefits

- ▶ **General Recommendation:** Generally vote for proposals calling for companies to adopt a policy of obtaining shareholder approval for any future agreements and corporate policies that could oblige the company to make payments or awards following the death of a senior executive in the form of unearned salary or bonuses, accelerated vesting or the continuation in force of unvested equity grants, perquisites and other payments or awards made in lieu of compensation. This would not apply to any benefit programs or equity plan proposals for which the broad-based employee population is eligible.

## Hold Equity Past Retirement or for a Significant Period of Time

- ▶ **General Recommendation:** Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain a portion of net shares acquired through compensation plans. The following factors will be taken into account:
  - › The percentage/ratio of net shares required to be retained;
  - › The time period required to retain the shares;
  - › Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
  - › Whether the company has any other policies aimed at mitigating risk taking by executives;
  - › Executives' actual stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's existing requirements; and
  - › Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.

## Non-Deductible Compensation

- ▶ **General Recommendation:** Generally vote for proposals seeking disclosure of the extent to which the company paid non-deductible compensation to senior executives due to Internal Revenue Code Section 162(m), while considering the company's existing disclosure practices.


## Pay Disparity

- ▶ **General Recommendation:** Vote case-by-case on proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The following factors will be considered:

- › The company's current level of disclosure of its executive compensation setting process, including how the company considers pay disparity;
- › If any problematic pay practices or pay-for-performance concerns have been identified at the company; and
- › The level of shareholder support for the company's pay programs.

Generally vote against proposals calling for the company to use the pay disparity analysis or pay ratio in a specific way to set or limit executive pay.


### Pay for Performance/Performance-Based Awards

 **General Recommendation:** Vote case-by-case on shareholder proposals requesting that a significant amount of future long-term incentive compensation awarded to senior executives shall be performance-based and requesting that the board adopt and disclose challenging performance metrics to shareholders, based on the following analytical steps:

- › First, vote for shareholder proposals advocating the use of performance-based equity awards, such as performance contingent options or restricted stock, indexed options or premium-priced options, unless the proposal is overly restrictive or if the company has demonstrated that it is using a "substantial" portion of performance-based awards for its top executives. Standard stock options and performance-accelerated awards do not meet the criteria to be considered as performance-based awards. Further, premium-priced options should have a meaningful premium to be considered performance-based awards.
- › Second, assess the rigor of the company's performance-based equity program. If the bar set for the performance-based program is too low based on the company's historical or peer group comparison, generally vote for the proposal. Furthermore, if target performance results in an above target payout, vote for the shareholder proposal due to program's poor design. If the company does not disclose the performance metric of the performance-based equity program, vote for the shareholder proposal regardless of the outcome of the first step to the test.

In general, vote for the shareholder proposal if the company does not meet both of the above two steps.

### Pay for Superior Performance

 **General Recommendation:** Vote case-by-case on shareholder proposals that request the board establish a pay-for-superior performance standard in the company's executive compensation plan for senior executives. These proposals generally include the following principles:

- › Set compensation targets for the plan's annual and long-term incentive pay components at or below the peer group median;
- › Deliver a majority of the plan's target long-term compensation through performance-vested, not simply time-vested, equity awards;
- › Provide the strategic rationale and relative weightings of the financial and non-financial performance metrics or criteria used in the annual and performance-vested long-term incentive components of the plan;
- › Establish performance targets for each plan financial metric relative to the performance of the company's peer companies;
- › Limit payment under the annual and performance-vested long-term incentive components of the plan to when the company's performance on its selected financial performance metrics exceeds peer group median performance.

Consider the following factors in evaluating this proposal:

- › What aspects of the company's annual and long-term equity incentive programs are performance driven?
- › If the annual and long-term equity incentive programs are performance driven, are the performance criteria and hurdle rates disclosed to shareholders or are they benchmarked against a disclosed peer group?

- › Can shareholders assess the correlation between pay and performance based on the current disclosure?
- › What type of industry and stage of business cycle does the company belong to?

### Pre-Arranged Trading Plans (10b5-1 Plans)

- ▶ **General Recommendation:** Generally vote for shareholder proposals calling for certain principles regarding the use of prearranged trading plans (10b5-1 plans) for executives. These principles include:
  - › Adoption, amendment, or termination of a 10b5-1 Plan must be disclosed within two business days in a Form 8-K;
  - › Amendment or early termination of a 10b5-1 Plan is allowed only under extraordinary circumstances, as determined by the board;
  - › Ninety days must elapse between adoption or amendment of a 10b5-1 Plan and initial trading under the plan;
  - › Reports on Form 4 must identify transactions made pursuant to a 10b5-1 Plan;
  - › An executive may not trade in company stock outside the 10b5-1 Plan;
  - › Trades under a 10b5-1 Plan must be handled by a broker who does not handle other securities transactions for the executive.

### Prohibit Outside CEOs from Serving on Compensation Committees

- ▶ **General Recommendation:** Generally vote against proposals seeking a policy to prohibit any outside CEO from serving on a company's compensation committee, unless the company has demonstrated problematic pay practices that raise concerns about the performance and composition of the committee.

### Recoupment of Incentive or Stock Compensation in Specified Circumstances

- ▶ **General Recommendation:** Vote case-by-case on proposals to recoup incentive cash or stock compensation made to senior executives if it is later determined that the figures upon which incentive compensation is earned turn out to have been in error, or if the senior executive has breached company policy or has engaged in misconduct that may be significantly detrimental to the company's financial position or reputation, or if the senior executive failed to manage or monitor risks that subsequently led to significant financial or reputational harm to the company. Many companies have adopted policies that permit recoupment in cases where an executive's fraud, misconduct, or negligence significantly contributed to a restatement of financial results that led to the awarding of unearned incentive compensation. However, such policies may be narrow given that not all misconduct or negligence may result in significant financial restatements. Misconduct, negligence or lack of sufficient oversight by senior executives may lead to significant financial loss or reputational damage that may have long-lasting impact.

In considering whether to support such shareholder proposals, ISS will take into consideration the following factors:

- › If the company has adopted a formal recoupment policy;
- › The rigor of the recoupment policy focusing on how and under what circumstances the company may recoup incentive or stock compensation;
- › Whether the company has chronic restatement history or material financial problems;
- › Whether the company's policy substantially addresses the concerns raised by the proponent;
- › Disclosure of recoupment of incentive or stock compensation from senior executives or lack thereof; or
- › Any other relevant factors.

### Severance Agreements for Executives/Golden Parachutes

- ▶ **General Recommendation:** Vote for shareholder proposals requiring that golden parachutes or executive severance agreements be submitted for shareholder ratification, unless the proposal requires shareholder approval *prior* to entering into employment contracts.

Vote case-by-case on proposals to ratify or cancel golden parachutes. An acceptable parachute should include, but is not limited to, the following:

- › The triggering mechanism should be beyond the control of management;
- › The amount should not exceed three times base amount (defined as the average annual taxable W-2 compensation during the five years prior to the year in which the change of control occurs);
- › Change-in-control payments should be double-triggered, i.e., (1) after a change in control has taken place, and (2) termination of the executive as a result of the change in control. Change in control is defined as a change in the company ownership structure.

## Share Buyback Proposals

- ▶ **General Recommendation:** Generally vote against shareholder proposals prohibiting executives from selling shares of company stock during periods in which the company has announced that it may or will be repurchasing shares of its stock. Vote for the proposal when there is a pattern of abuse by executives exercising options or selling shares during periods of share buybacks.

Vote case-by-case on proposals requesting the company exclude the impact of share buybacks from the calculation of incentive program metrics, considering the following factors:

- › The frequency and timing of the company's share buybacks;
- › The use of per-share metrics in incentive plans;
- › The effect of recent buybacks on incentive metric results and payouts; and
- › Whether there is any indication of metric result manipulation.

## Supplemental Executive Retirement Plans (SERPs)

- ▶ **General Recommendation:** Generally vote for shareholder proposals requesting to put extraordinary benefits contained in SERP agreements to a shareholder vote unless the company's executive pension plans do not contain excessive benefits beyond what is offered under employee-wide plans.

Generally vote for shareholder proposals requesting to limit the executive benefits provided under the company's supplemental executive retirement plan (SERP) by limiting covered compensation to a senior executive's annual salary or those pay elements covered for the general employee population.

## Tax Gross-Up Proposals

- ▶ **General Recommendation:** Generally vote for proposals calling for companies to adopt a policy of not providing tax gross-up payments to executives, except in situations where gross-ups are provided pursuant to a plan, policy, or arrangement applicable to management employees of the company, such as a relocation or expatriate tax equalization policy.

## Termination of Employment Prior to Severance Payment/Eliminating Accelerated Vesting of Unvested Equity

- ▶ **General Recommendation:** Vote case-by-case on shareholder proposals seeking a policy requiring termination of employment prior to severance payment and/or eliminating accelerated vesting of unvested equity.

The following factors will be considered:

- › The company's current treatment of equity upon employment termination and/or in change-in-control situations (i.e., vesting is double triggered and/or pro rata, does it allow for the assumption of equity by acquiring company, the treatment of performance shares, etc.);

- › Current employment agreements, including potential poor pay practices such as gross-ups embedded in those agreements.

Generally vote for proposals seeking a policy that prohibits automatic acceleration of the vesting of equity awards to senior executives upon a voluntary termination of employment or in the event of a change in control (except for pro rata vesting considering the time elapsed and attainment of any related performance goals between the award date and the change in control).



## 6. ROUTINE/MISCELLANEOUS

### Adjourn Meeting

- ▶ **General Recommendation:** Generally vote against proposals to provide management with the authority to adjourn an annual or special meeting absent compelling reasons to support the proposal.

Vote for proposals that relate specifically to soliciting votes for a merger or transaction if supporting that merger or transaction. Vote against proposals if the wording is too vague or if the proposal includes "other business."

### Amend Quorum Requirements

- ▶ **General Recommendation:** Vote against proposals to reduce quorum requirements for shareholder meetings below a majority of the shares outstanding unless there are compelling reasons to support the proposal.

### Amend Minor Bylaws

- ▶ **General Recommendation:** Vote for bylaw or charter changes that are of a housekeeping nature (updates or corrections).

### Change Company Name

- ▶ **General Recommendation:** Vote for proposals to change the corporate name unless there is compelling evidence that the change would adversely impact shareholder value.

### Change Date, Time, or Location of Annual Meeting

- ▶ **General Recommendation:** Vote for management proposals to change the date, time, or location of the annual meeting unless the proposed change is unreasonable.

Vote against shareholder proposals to change the date, time, or location of the annual meeting unless the current scheduling or location is unreasonable.

### Other Business

- ▶ **General Recommendation:** Vote against proposals to approve other business when it appears as a voting item.

## 7. SOCIAL AND ENVIRONMENTAL ISSUES

### Global Approach

Issues covered under the policy include a wide range of topics, including consumer and product safety, environment and energy, labor standards and human rights, workplace and board diversity, and corporate political issues. While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short or long term.

- ▶ **General Recommendation:** Generally vote case-by-case, examining primarily whether implementation of the proposal is likely to enhance or protect shareholder value. The following factors will be considered:
- › If the issues presented in the proposal are more appropriately or effectively dealt with through legislation or government regulation;
  - › If the company has already responded in an appropriate and sufficient manner to the issue(s) raised in the proposal;
  - › Whether the proposal's request is unduly burdensome (scope or timeframe) or overly prescriptive;
  - › The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
  - › Whether there are significant controversies, fines, penalties, or litigation associated with the company's environmental or social practices;
  - › If the proposal requests increased disclosure or greater transparency, whether reasonable and sufficient information is currently available to shareholders from the company or from other publicly available sources; and
  - › If the proposal requests increased disclosure or greater transparency, whether implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

### Endorsement of Principles

- ▶ **General Recommendation:** Generally vote against proposals seeking a company's endorsement of principles that support a particular public policy position. Endorsing a set of principles may require a company to take a stand on an issue that is beyond its own control and may limit its flexibility with respect to future developments. Management and the board should be afforded the flexibility to make decisions on specific public policy positions based on their own assessment of the most beneficial strategies for the company.

### Animal Welfare

#### Animal Welfare Policies

- ▶ **General Recommendation:** Generally vote for proposals seeking a report on a company's animal welfare standards, or animal welfare-related risks, unless:
- › The company has already published a set of animal welfare standards and monitors compliance;
  - › The company's standards are comparable to industry peers; and
  - › There are no recent significant fines, litigation, or controversies related to the company's and/or its suppliers' treatment of animals.

## Animal Testing

- ▶ **General Recommendation:** Generally vote against proposals to phase out the use of animals in product testing, unless:
- › The company is conducting animal testing programs that are unnecessary or not required by regulation;
  - › The company is conducting animal testing when suitable alternatives are commonly accepted and used by industry peers; or
  - › There are recent, significant fines or litigation related to the company's treatment of animals.

## Animal Slaughter

- ▶ **General Recommendation:** Generally vote against proposals requesting the implementation of Controlled Atmosphere Killing (CAK) methods at company and/or supplier operations unless such methods are required by legislation or generally accepted as the industry standard.

Vote case-by-case on proposals requesting a report on the feasibility of implementing CAK methods at company and/or supplier operations considering the availability of existing research conducted by the company or industry groups on this topic and any fines or litigation related to current animal processing procedures at the company.

## Consumer Issues

### Genetically Modified Ingredients

- ▶ **General Recommendation:** Generally vote against proposals requesting that a company voluntarily label genetically engineered (GE) ingredients in its products. The labeling of products with GE ingredients is best left to the appropriate regulatory authorities.

Vote case-by-case on proposals asking for a report on the feasibility of labeling products containing GE ingredients, taking into account:

- › The potential impact of such labeling on the company's business;
- › The quality of the company's disclosure on GE product labeling, related voluntary initiatives, and how this disclosure compares with industry peer disclosure; and
- › Company's current disclosure on the feasibility of GE product labeling.

Generally vote against proposals seeking a report on the social, health, and environmental effects of genetically modified organisms (GMOs). Studies of this sort are better undertaken by regulators and the scientific community.

Generally vote against proposals to eliminate GE ingredients from the company's products, or proposals asking for reports outlining the steps necessary to eliminate GE ingredients from the company's products. Such decisions are more appropriately made by management with consideration of current regulations.

### Reports on Potentially Controversial Business/Financial Practices

- ▶ **General Recommendation:** Vote case-by-case on requests for reports on a company's potentially controversial business or financial practices or products, taking into account:

- › Whether the company has adequately disclosed mechanisms in place to prevent abuses;
- › Whether the company has adequately disclosed the financial risks of the products/practices in question;

- › Whether the company has been subject to violations of related laws or serious controversies; and
- › Peer companies' policies/practices in this area.

### Pharmaceutical Pricing, Access to Medicines, and Prescription Drug Reimportation

- ▶ **General Recommendation:** Generally vote against proposals requesting that companies implement specific price restraints on pharmaceutical products unless the company fails to adhere to legislative guidelines or industry norms in its product pricing practices.

Vote case-by-case on proposals requesting that a company report on its product pricing or access to medicine policies, considering:

- › The potential for reputational, market, and regulatory risk exposure;
- › Existing disclosure of relevant policies;
- › Deviation from established industry norms;
- › Relevant company initiatives to provide research and/or products to disadvantaged consumers;
- › Whether the proposal focuses on specific products or geographic regions;
- › The potential burden and scope of the requested report;
- › Recent significant controversies, litigation, or fines at the company.

Generally vote for proposals requesting that a company report on the financial and legal impact of its prescription drug reimportation policies unless such information is already publicly disclosed.

Generally vote against proposals requesting that companies adopt specific policies to encourage or constrain prescription drug reimportation. Such matters are more appropriately the province of legislative activity and may place the company at a competitive disadvantage relative to its peers.

### Product Safety and Toxic/Hazardous Materials

- ▶ **General Recommendation:** Generally vote for proposals requesting that a company report on its policies, initiatives/procedures, and oversight mechanisms related to toxic/hazardous materials or product safety in its supply chain, unless:
  - › The company already discloses similar information through existing reports such as a supplier code of conduct and/or a sustainability report;
  - › The company has formally committed to the implementation of a toxic/hazardous materials and/or product safety and supply chain reporting and monitoring program based on industry norms or similar standards within a specified time frame; and
  - › The company has not been recently involved in relevant significant controversies, fines, or litigation.

Vote case-by-case on resolutions requesting that companies develop a feasibility assessment to phase-out of certain toxic/hazardous materials, or evaluate and disclose the potential financial and legal risks associated with utilizing certain materials, considering:

- › The company's current level of disclosure regarding its product safety policies, initiatives, and oversight mechanisms;
- › Current regulations in the markets in which the company operates; and
- › Recent significant controversies, litigation, or fines stemming from toxic/hazardous materials at the company.

Generally vote against resolutions requiring that a company reformulate its products.

### Tobacco-Related Proposals

- ▶ **General Recommendation:** Vote case-by-case on resolutions regarding the advertisement of tobacco products, considering:
- › Recent related fines, controversies, or significant litigation;
  - › Whether the company complies with relevant laws and regulations on the marketing of tobacco;
  - › Whether the company's advertising restrictions deviate from those of industry peers;
  - › Whether the company entered into the Master Settlement Agreement, which restricts marketing of tobacco to youth; and
  - › Whether restrictions on marketing to youth extend to foreign countries.

Vote case-by-case on proposals regarding second-hand smoke, considering;

- › Whether the company complies with all laws and regulations;
- › The degree that voluntary restrictions beyond those mandated by law might hurt the company's competitiveness; and
- › The risk of any health-related liabilities.

Generally vote against resolutions to cease production of tobacco-related products, to avoid selling products to tobacco companies, to spin-off tobacco-related businesses, or prohibit investment in tobacco equities. Such business decisions are better left to company management or portfolio managers.

Generally vote against proposals regarding tobacco product warnings. Such decisions are better left to public health authorities.

## Climate Change

### Climate Change/Greenhouse Gas (GHG) Emissions

- ▶ **General Recommendation:** Generally vote for resolutions requesting that a company disclose information on the financial, physical, or regulatory risks it faces related to climate change on its operations and investments or on how the company identifies, measures, and manages such risks, considering:
- › Whether the company already provides current, publicly-available information on the impact that climate change may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
  - › The company's level of disclosure compared to industry peers; and
  - › Whether there are significant controversies, fines, penalties, or litigation associated with the company's climate change-related performance.

Generally vote for proposals requesting a report on greenhouse gas (GHG) emissions from company operations and/or products and operations, unless:

- › The company already discloses current, publicly-available information on the impacts that GHG emissions may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
- › The company's level of disclosure is comparable to that of industry peers; and
- › There are no significant, controversies, fines, penalties, or litigation associated with the company's GHG emissions.

Vote case-by-case on proposals that call for the adoption of GHG reduction goals from products and operations, taking into account:

- › Whether the company provides disclosure of year-over-year GHG emissions performance data;

- › Whether company disclosure lags behind industry peers;
- › The company's actual GHG emissions performance;
- › The company's current GHG emission policies, oversight mechanisms, and related initiatives; and
- › Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to GHG emissions.

## Energy Efficiency

- ▶ **General Recommendation:** Generally vote for proposals requesting that a company report on its energy efficiency policies, unless:
  - › The company complies with applicable energy efficiency regulations and laws, and discloses its participation in energy efficiency policies and programs, including disclosure of benchmark data, targets, and performance measures; or
  - › The proponent requests adoption of specific energy efficiency goals within specific timelines.

## Renewable Energy

- ▶ **General Recommendation:** Generally vote for requests for reports on the feasibility of developing renewable energy resources unless the report would be duplicative of existing disclosure or irrelevant to the company's line of business.

Generally vote against proposals requesting that the company invest in renewable energy resources. Such decisions are best left to management's evaluation of the feasibility and financial impact that such programs may have on the company.

Generally vote against proposals that call for the adoption of renewable energy goals, taking into account:

- › The scope and structure of the proposal;
- › The company's current level of disclosure on renewable energy use and GHG emissions; and
- › The company's disclosure of policies, practices, and oversight implemented to manage GHG emissions and mitigate climate change risks.

## Diversity

### Board Diversity

- ▶ **General Recommendation:** Generally vote for requests for reports on a company's efforts to diversify the board, unless:
  - › The gender and racial minority representation of the company's board is reasonably inclusive in relation to companies of similar size and business; and
  - › The board already reports on its nominating procedures and gender and racial minority initiatives on the board and within the company.

Vote case-by-case on proposals asking a company to increase the gender and racial minority representation on its board, taking into account:

- › The degree of existing gender and racial minority diversity on the company's board and among its executive officers;
- › The level of gender and racial minority representation that exists at the company's industry peers;
- › The company's established process for addressing gender and racial minority board representation;
- › Whether the proposal includes an overly prescriptive request to amend nominating committee charter language;

- › The independence of the company's nominating committee;
- › Whether the company uses an outside search firm to identify potential director nominees; and
- › Whether the company has had recent controversies, fines, or litigation regarding equal employment practices.

### Equality of Opportunity

▶ **General Recommendation:** Generally vote for proposals requesting a company disclose its diversity policies or initiatives, or proposals requesting disclosure of a company's comprehensive workforce diversity data, including requests for EEO-1 data, unless:

- › The company publicly discloses equal opportunity policies and initiatives in a comprehensive manner;
- › The company already publicly discloses comprehensive workforce diversity data; and
- › The company has no recent significant EEO-related violations or litigation.

Generally vote against proposals seeking information on the diversity efforts of suppliers and service providers. Such requests may pose a significant burden on the company.

### Gender Identity, Sexual Orientation, and Domestic Partner Benefits

▶ **General Recommendation:** Generally vote for proposals seeking to amend a company's EEO statement or diversity policies to prohibit discrimination based on sexual orientation and/or gender identity, unless the change would be unduly burdensome.

Generally vote against proposals to extend company benefits to, or eliminate benefits from, domestic partners. Decisions regarding benefits should be left to the discretion of the company.

### Gender Pay Gap

▶ **General Recommendation:** Generally vote case-by-case on requests for reports on a company's pay data by gender, or a report on a company's policies and goals to reduce any gender pay gap, taking into account:

- › The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy and fair and equitable compensation practices;
- › Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender pay gap issues; and
- › Whether the company's reporting regarding gender pay gap policies or initiatives is lagging its peers.

## Environment and Sustainability

### Facility and Workplace Safety

▶ **General Recommendation:** Vote case-by-case on requests for workplace safety reports, including reports on accident risk reduction efforts, taking into account:

- › The company's current level of disclosure of its workplace health and safety performance data, health and safety management policies, initiatives, and oversight mechanisms;
- › The nature of the company's business, specifically regarding company and employee exposure to health and safety risks;
- › Recent significant controversies, fines, or violations related to workplace health and safety; and
- › The company's workplace health and safety performance relative to industry peers.

Vote case-by-case on resolutions requesting that a company report on safety and/or security risks associated with its operations and/or facilities, considering:

- › The company's compliance with applicable regulations and guidelines;
- › The company's current level of disclosure regarding its security and safety policies, procedures, and compliance monitoring; and
- › The existence of recent, significant violations, fines, or controversy regarding the safety and security of the company's operations and/or facilities.

## General Environmental Proposals and Community Impact Assessments

**General Recommendation:** Vote case-by-case on requests for reports on policies and/or the potential (community) social and/or environmental impact of company operations, considering:

- › Current disclosure of applicable policies and risk assessment report(s) and risk management procedures;
- › The impact of regulatory non-compliance, litigation, remediation, or reputational loss that may be associated with failure to manage the company's operations in question, including the management of relevant community and stakeholder relations;
- › The nature, purpose, and scope of the company's operations in the specific region(s);
- › The degree to which company policies and procedures are consistent with industry norms; and
- › The scope of the resolution.

## Hydraulic Fracturing

**General Recommendation:** Generally vote for proposals requesting greater disclosure of a company's (natural gas) hydraulic fracturing operations, including measures the company has taken to manage and mitigate the potential community and environmental impacts of those operations, considering:

- › The company's current level of disclosure of relevant policies and oversight mechanisms;
- › The company's current level of such disclosure relative to its industry peers;
- › Potential relevant local, state, or national regulatory developments; and
- › Controversies, fines, or litigation related to the company's hydraulic fracturing operations.

## Operations in Protected Areas

**General Recommendation:** Generally vote for requests for reports on potential environmental damage as a result of company operations in protected regions, unless:

- › Operations in the specified regions are not permitted by current laws or regulations;
- › The company does not currently have operations or plans to develop operations in these protected regions; or
- › The company's disclosure of its operations and environmental policies in these regions is comparable to industry peers.

## Recycling

**General Recommendation:** Vote case-by-case on proposals to report on an existing recycling program, or adopt a new recycling program, taking into account:

- › The nature of the company's business;
- › The current level of disclosure of the company's existing related programs;
- › The timetable and methods of program implementation prescribed by the proposal;
- › The company's ability to address the issues raised in the proposal; and
- › How the company's recycling programs compare to similar programs of its industry peers.



## Sustainability Reporting

- ▶ **General Recommendation:** Generally vote for proposals requesting that a company report on its policies, initiatives, and oversight mechanisms related to social, economic, and environmental sustainability, unless:
  - › The company already discloses similar information through existing reports or policies such as an environment, health, and safety (EHS) report; a comprehensive code of corporate conduct; and/or a diversity report; or
  - › The company has formally committed to the implementation of a reporting program based on Global Reporting Initiative (GRI) guidelines or a similar standard within a specified time frame.

## Water Issues

- ▶ **General Recommendation:** Vote case-by-case on proposals requesting a company report on, or adopt a new policy on, water-related risks and concerns, taking into account:
  - › The company's current disclosure of relevant policies, initiatives, oversight mechanisms, and water usage metrics;
  - › Whether or not the company's existing water-related policies and practices are consistent with relevant internationally recognized standards and national/local regulations;
  - › The potential financial impact or risk to the company associated with water-related concerns or issues; and
  - › Recent, significant company controversies, fines, or litigation regarding water use by the company and its suppliers.

## General Corporate Issues

### Charitable Contributions

- ▶ **General Recommendation:** Vote against proposals restricting a company from making charitable contributions. Charitable contributions are generally useful for assisting worthwhile causes and for creating goodwill in the community. In the absence of bad faith, self-dealing, or gross negligence, management should determine which, and if, contributions are in the best interests of the company.

### Data Security, Privacy, and Internet Issues

- ▶ **General Recommendation:** Vote case-by-case on proposals requesting the disclosure or implementation of data security, privacy, or information access and management policies and procedures, considering:
  - › The level of disclosure of company policies and procedures relating to data security, privacy, freedom of speech, information access and management, and Internet censorship;
  - › Engagement in dialogue with governments or relevant groups with respect to data security, privacy, or the free flow of information on the Internet;
  - › The scope of business involvement and of investment in countries whose governments censor or monitor the Internet and other telecommunications;
  - › Applicable market-specific laws or regulations that may be imposed on the company; and
  - › Controversies, fines, or litigation related to data security, privacy, freedom of speech, or Internet censorship.

## Environmental, Social, and Governance (ESG) Compensation-Related Proposals

- ▶ **General Recommendation:** Vote case-by-case on proposals to link, or report on linking, executive compensation to sustainability (environmental and social) criteria, considering:
  - › The scope and prescriptive nature of the proposal;

- › Whether the company has significant and/or persistent controversies or regulatory violations regarding social and/or environmental issues;
- › Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- › The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- › The company's current level of disclosure regarding its environmental and social performance.

## Human Rights, Labor Issues, and International Operations

### Human Rights Proposals

- ▶ **General Recommendation:** Generally vote for proposals requesting a report on company or company supplier labor and/or human rights standards and policies unless such information is already publicly disclosed.

Vote case-by-case on proposals to implement company or company supplier labor and/or human rights standards and policies, considering:

- › The degree to which existing relevant policies and practices are disclosed;
- › Whether or not existing relevant policies are consistent with internationally recognized standards;
- › Whether company facilities and those of its suppliers are monitored and how;
- › Company participation in fair labor organizations or other internationally recognized human rights initiatives;
- › Scope and nature of business conducted in markets known to have higher risk of workplace labor/human rights abuse;
- › Recent, significant company controversies, fines, or litigation regarding human rights at the company or its suppliers;
- › The scope of the request; and
- › Deviation from industry sector peer company standards and practices.

Vote case-by-case on proposals requesting that a company conduct an assessment of the human rights risks in its operations or in its supply chain, or report on its human rights risk assessment process, considering:

- › The degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms;
- › The company's industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
- › Recent significant controversies, fines, or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and
- › Whether the proposal is unduly burdensome or overly prescriptive.

### Operations in High Risk Markets

- ▶ **General Recommendation:** Vote case-by-case on requests for a report on a company's potential financial and reputational risks associated with operations in "high-risk" markets, such as a terrorism-sponsoring state or politically/socially unstable region, taking into account:

- › The nature, purpose, and scope of the operations and business involved that could be affected by social or political disruption;
- › Current disclosure of applicable risk assessment(s) and risk management procedures;
- › Compliance with U.S. sanctions and laws;
- › Consideration of other international policies, standards, and laws; and

- › Whether the company has been recently involved in recent, significant controversies, fines, or litigation related to its operations in "high-risk" markets.

### Outsourcing/Offshoring

▶ **General Recommendation:** Vote case-by-case on proposals calling for companies to report on the risks associated with outsourcing/plant closures, considering:

- › Controversies surrounding operations in the relevant market(s);
- › The value of the requested report to shareholders;
- › The company's current level of disclosure of relevant information on outsourcing and plant closure procedures; and
- › The company's existing human rights standards relative to industry peers.

### Weapons and Military Sales

▶ **General Recommendation:** Vote against reports on foreign military sales or offsets. Such disclosures may involve sensitive and confidential information. Moreover, companies must comply with government controls and reporting on foreign military sales.

Generally vote against proposals asking a company to cease production or report on the risks associated with the use of depleted uranium munitions or nuclear weapons components and delivery systems, including disengaging from current and proposed contracts. Such contracts are monitored by government agencies, serve multiple military and non-military uses, and withdrawal from these contracts could have a negative impact on the company's business.

## Political Activities

### Lobbying

▶ **General Recommendation:** Vote case-by-case on proposals requesting information on a company's lobbying (including direct, indirect, and grassroots lobbying) activities, policies, or procedures, considering:

- › The company's current disclosure of relevant lobbying policies, and management and board oversight;
- › The company's disclosure regarding trade associations or other groups that it supports, or is a member of, that engage in lobbying activities; and
- › Recent significant controversies, fines, or litigation regarding the company's lobbying-related activities.

### Political Contributions

▶ **General Recommendation:** Generally vote for proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities, considering:

- › The company's policies, and management and board oversight related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes;
- › The company's disclosure regarding its support of, and participation in, trade associations or other groups that may make political contributions; and

- › Recent significant controversies, fines, or litigation related to the company's political contributions or political activities.

Vote against proposals barring a company from making political contributions. Businesses are affected by legislation at the federal, state, and local level; barring political contributions can put the company at a competitive disadvantage.

Vote against proposals to publish in newspapers and other media a company's political contributions. Such publications could present significant cost to the company without providing commensurate value to shareholders.

### Political Ties



**General Recommendation:** Generally vote against proposals asking a company to affirm political nonpartisanship in the workplace, so long as:

- › There are no recent, significant controversies, fines, or litigation regarding the company's political contributions or trade association spending; and
- › The company has procedures in place to ensure that employee contributions to company-sponsored political action committees (PACs) are strictly voluntary and prohibit coercion.

Vote against proposals asking for a list of company executives, directors, consultants, legal counsels, lobbyists, or investment bankers that have prior government service and whether such service had a bearing on the business of the company. Such a list would be burdensome to prepare without providing any meaningful information to shareholders.

## 8. MUTUAL FUND PROXIES

### Election of Directors

- ▶ **General Recommendation:** Vote case-by-case on the election of directors and trustees, following the same guidelines for uncontested directors for public company shareholder meetings. However, mutual fund boards do not usually have compensation committees, so do not withhold for the lack of this committee.

### Converting Closed-end Fund to Open-end Fund

- ▶ **General Recommendation:** Vote case-by-case on conversion proposals, considering the following factors:
  - › Past performance as a closed-end fund;
  - › Market in which the fund invests;
  - › Measures taken by the board to address the discount; and
  - › Past shareholder activism, board activity, and votes on related proposals.

### Proxy Contests

- ▶ **General Recommendation:** Vote case-by-case on proxy contests, considering the following factors:
  - › Past performance relative to its peers;
  - › Market in which the fund invests;
  - › Measures taken by the board to address the issues;
  - › Past shareholder activism, board activity, and votes on related proposals;
  - › Strategy of the incumbents versus the dissidents;
  - › Independence of directors;
  - › Experience and skills of director candidates;
  - › Governance profile of the company;
  - › Evidence of management entrenchment.

### Investment Advisory Agreements

- ▶ **General Recommendation:** Vote case-by-case on investment advisory agreements, considering the following factors:
  - › Proposed and current fee schedules;
  - › Fund category/investment objective;
  - › Performance benchmarks;
  - › Share price performance as compared with peers;
  - › Resulting fees relative to peers;
  - › Assignments (where the advisor undergoes a change of control).

### Approving New Classes or Series of Shares

- ▶ **General Recommendation:** Vote for the establishment of new classes or series of shares.

### Preferred Stock Proposals

- ▶ **General Recommendation:** Vote case-by-case on the authorization for or increase in preferred shares, considering the following factors:
  - › Stated specific financing purpose;
  - › Possible dilution for common shares;

- › Whether the shares can be used for antitakeover purposes.

### 1940 Act Policies

- ▶ **General Recommendation:** Vote case-by-case on policies under the Investment Advisor Act of 1940, considering the following factors:
  - › Potential competitiveness;
  - › Regulatory developments;
  - › Current and potential returns; and
  - › Current and potential risk.

Generally vote for these amendments as long as the proposed changes do not fundamentally alter the investment focus of the fund and do comply with the current SEC interpretation.

### Changing a Fundamental Restriction to a Nonfundamental Restriction

- ▶ **General Recommendation:** Vote case-by-case on proposals to change a fundamental restriction to a non-fundamental restriction, considering the following factors:
  - › The fund's target investments;
  - › The reasons given by the fund for the change; and
  - › The projected impact of the change on the portfolio.

### Change Fundamental Investment Objective to Nonfundamental

- ▶ **General Recommendation:** Vote against proposals to change a fund's fundamental investment objective to non-fundamental.

### Name Change Proposals

- ▶ **General Recommendation:** Vote case-by-case on name change proposals, considering the following factors:
  - › Political/economic changes in the target market;
  - › Consolidation in the target market; and
  - › Current asset composition.

### Change in Fund's Subclassification

- ▶ **General Recommendation:** Vote case-by-case on changes in a fund's sub-classification, considering the following factors:
  - › Potential competitiveness;
  - › Current and potential returns;
  - › Risk of concentration;
  - › Consolidation in target industry.

### Business Development Companies—Authorization to Sell Shares of Common Stock at a Price below Net Asset Value

- ▶ **General Recommendation:** Vote for proposals authorizing the board to issue shares below Net Asset Value (NAV) if:
  - › The proposal to allow share issuances below NAV has an expiration date no more than one year from the date shareholders approve the underlying proposal, as required under the Investment Company Act of 1940;

- › The sale is deemed to be in the best interests of shareholders by (1) a majority of the company's independent directors and (2) a majority of the company's directors who have no financial interest in the issuance; and
- › The company has demonstrated responsible past use of share issuances by either:
- › Outperforming peers in its 8-digit GICS group as measured by one- and three-year median TSRs; or
- › Providing disclosure that its past share issuances were priced at levels that resulted in only small or moderate discounts to NAV and economic dilution to existing non-participating shareholders.

### Disposition of Assets/Termination/Liquidation

▶ **General Recommendation:** Vote case-by-case on proposals to dispose of assets, to terminate or liquidate, considering the following factors:

- › Strategies employed to salvage the company;
- › The fund's past performance;
- › The terms of the liquidation.

### Changes to the Charter Document

▶ **General Recommendation:** Vote case-by-case on changes to the charter document, considering the following factors:

- › The degree of change implied by the proposal;
- › The efficiencies that could result;
- › The state of incorporation;
- › Regulatory standards and implications.

Vote against any of the following changes:

- › Removal of shareholder approval requirement to reorganize or terminate the trust or any of its series;
- › Removal of shareholder approval requirement for amendments to the new declaration of trust;
- › Removal of shareholder approval requirement to amend the fund's management contract, allowing the contract to be modified by the investment manager and the trust management, as permitted by the 1940 Act;
- › Allow the trustees to impose other fees in addition to sales charges on investment in a fund, such as deferred sales charges and redemption fees that may be imposed upon redemption of a fund's shares;
- › Removal of shareholder approval requirement to engage in and terminate subadvisory arrangements;
- › Removal of shareholder approval requirement to change the domicile of the fund.

### Changing the Domicile of a Fund

▶ **General Recommendation:** Vote case-by-case on re-incorporations, considering the following factors:

- › Regulations of both states;
- › Required fundamental policies of both states;
- › The increased flexibility available.

### Authorizing the Board to Hire and Terminate Subadvisers Without Shareholder Approval

▶ **General Recommendation:** Vote against proposals authorizing the board to hire or terminate subadvisers without shareholder approval if the investment adviser currently employs only one subadviser.

## Distribution Agreements

▶ **General Recommendation:** Vote case-by-case on distribution agreement proposals, considering the following factors:

- › Fees charged to comparably sized funds with similar objectives;
- › The proposed distributor's reputation and past performance;
- › The competitiveness of the fund in the industry;
- › The terms of the agreement.

## Master-Feeder Structure

▶ **General Recommendation:** Vote for the establishment of a master-feeder structure.

## Mergers

▶ **General Recommendation:** Vote case-by-case on merger proposals, considering the following factors:

- › Resulting fee structure;
- › Performance of both funds;
- › Continuity of management personnel;
- › Changes in corporate governance and their impact on shareholder rights.

## Shareholder Proposals for Mutual Funds

### Establish Director Ownership Requirement

▶ **General Recommendation:** Generally vote against shareholder proposals that mandate a specific minimum amount of stock that directors must own in order to qualify as a director or to remain on the board.

### Reimburse Shareholder for Expenses Incurred

▶ **General Recommendation:** Vote case-by-case on shareholder proposals to reimburse proxy solicitation expenses. When supporting the dissidents, vote for the reimbursement of the proxy solicitation expenses.

### Terminate the Investment Advisor

▶ **General Recommendation:** Vote case-by-case on proposals to terminate the investment advisor, considering the following factors:

- › Performance of the fund's Net Asset Value (NAV);
- › The fund's history of shareholder relations;
- › The performance of other funds under the advisor's management.



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