Australia

Proxy Voting Guidelines

2015-2016 Benchmark Policy Recommendations

Effective for Meetings on or after 1 October, 2015

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INTRODUCTION

These guidelines have been developed as the basis for ISS Australian Benchmark Policy for proxy voting recommendations.

The principle underpinning all ISS' benchmark recommendations is that security holders are the owners of listed entities, and as such, they are entitled to assess every resolution that seeks their approval and to understand how it affects their interests as the owners of the company. An overarching ideal in corporate governance is that the laws, standards and principles applied require accountability, transparency and fairness.

Shareholders have no decision-making ability in the management of the listed entity. Their main rights in this regard are to receive information about a company's performance and to vote on resolutions put before an annual or, where applicable, extraordinary general meeting.

Under current legislation in Australia, items typically put before a meeting of security holders can be characterized as follows:

- Consideration of the financial statements and reports (not normally a voting item);
- Election or re-election of directors;
- Consideration of the remuneration report and to cast a non-binding (advisory) vote on executive pay practices;
- Issuance of new securities in certain circumstances, including to executives and directors under their employment contracts, or as required under ASX Listing Rules;
- Changes in the Constitution of a company;
- Consideration of certain related party transactions;
- Consideration of an increase in the directors' total fee pool (directors are able to determine the quantum of fees each individual will receive from that pool);
- to consider and vote on termination payments to executives in excess of a statutory maximum of one year's remuneration; and
- Consideration of mergers and acquisitions.

The goals of these guidelines are to recognize that:

- The objective of most shareholders is to hold and manage their investments with long term value creation in mind; and
- The principles of corporate governance have an ability to impact shareholder value and risk.

1. GENERAL

Constitutional Amendment

General Recommendation: Vote case-by case on proposals to amend the company's constitution.

Proposals to amend the company's constitution are required to be approved by a special resolution (75-percent majority of votes cast). Proposals range from a general updating of various clauses to reflect changes in corporate law and ASX Listing Rules, to complete replacement of an existing constitution with a new "plain language," and updated, version.

Alteration of the Number of Directors/Board Size in Constitution

General Recommendation: Vote case-by-case on proposals to alter the size of the board.

The Australian Corporations Act requires a minimum of three directors for public companies, and nominees are elected if they receive 50% shareholder support. There is no maximum board size limit set out in the Act, although company constitutions may set a maximum limit. Consider on a case-by-case basis the justification provided by a company to set a maximum limit on the number of directors.

Vote against proposals to alter board size which have the effect of providing the company an ability to invoke "no vacancy" for new nominees seeking election to the board. Such a limitation is not considered to be in the best interests of shareholders, as it prevents a new shareholder nominee from being added to the board unless a management nominee is voted down.

Renewal of "Proportional Takeover" Clause in Constitution

General Recommendation: Vote for the renewal of the proportional takeover clause in the company's constitution.

The Australian Corporations Act allows a company to include in its constitution a clause that requires shareholder approval for a proportional (partial) takeover offer to be made. Under this type of clause, a proportional takeover offer cannot proceed to be mailed out to shareholders until after the company has held a general meeting at which shareholders vote on whether to allow the offer to be made. The clause can remain in the constitution for a maximum of three years. It is standard practice among ASX-listed companies to ask shareholders to reinsert the clause into the constitution at every third AGM. If a shareholder meeting to vote on the approval of the making of a proportional bid is not held within 14 days of the bid expiry deadline, then the making of the bid is taken as approved.

Change Company Name

General Recommendation: Vote for proposals to change the company name.

Decisions on the company name are best left to management. Typically, name changes are proposed to align the company name more closely with its primary businesses and activities and/or to simplify the company name. Such changes are usually made without detracting from market recognition of the company's identity and activities.

Authority to Postpone or Adjourn Meeting

General Recommendation: Vote case-by-case on proposals to amend the company's constitution to provide the board with the authority to adjourn annual or special meetings as a change to the company constitution, taking into account:

- the board's rationale for proposing the amendment, and
- the board's past practices in acting in the best interests of shareholders.

When adequate explanation for an adjournment or postponement of a company meeting is given (such as to consider an improvement in economic benefit available to shareholders), such discretion of the chairman and board should be supported. However, evidence of the misuse of the authority to adjourn an annual or special meeting may result in recommendations against the re-election of the chairperson, or, if the chairperson is not up for re-election, any non-executive directors up for re-election that were present at the relevant meeting.

Significant Change in Activities

General Recommendation: Vote for resolutions to change the nature or scale of business activities (ASX Listing Rule 11.1) provided the notice of meeting and explanatory statement provide a sound business case for the proposed change.

Capital Structure

Capital structures are generally non-contentious in Australia. Each fully-paid ordinary share carries one vote on a poll and equal dividends. Partly-paid shares, which are rare, normally carry votes proportional to the percentage of the share paid-up. Companies may also issue redeemable shares, preference shares, and shares with special, limited, or conditional voting rights. Shares with differing amounts of votes constitute different classes of shares, but, in practice, shares with limited or enhanced voting rights are seldom, if ever, seen in Australia outside of a handful of externally managed infrastructure entities.

Multiple Voting Rights

General Recommendation: Vote against proposals to create a new class of shares with superior voting rights.

Shareholders are better off opposing dual-class proposals on the grounds that they contribute to the entrenchment of management and allow for the possibility of management acquiring superior voting shares in the future. Empirical evidence also suggests that companies with simple capital structures also tend toward higher valuation because they are easier for investors to understand.

Non-Voting Shares

General Recommendation: Vote against proposals to create a new class of non-voting or sub-voting shares. Only vote for if:

- It is intended for financing purposes with minimal or no dilution to current shareholders;
- It is not designed to preserve the voting power of an insider or significant shareholder.

Generally vote for the cancellation of classes of non-voting or sub-voting shares.

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.*, abililty for alternate bidders to participate) 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.
- *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.

Financial Statements

General Recommendation: Vote for the approval of financial statements and director and auditor reports, unless:

- There are concerns about the accounts presented or the audit procedures used;
- The company is not responsive to shareholder questions about specific items that should be publicly disclosed.

Australian companies are not required to submit their annual accounts and reports to a shareholder vote.

Reappointment of Auditor, and Authorization for the Directors to Set Auditor's Remuneration

General Recommendation: Vote for the appointment of auditors and authorizing the board to fix their remuneration, unless:

- There are serious concerns about the accounts presented or the audit procedures used;
- Non-audit related fees are substantial or are routinely in excess of standard annual audit fees.

This type of resolution is not required under Australian law, but it will be a ballot item for ASX-listed companies that are incorporated in the United Kingdom, Papua New Guinea, and other countries where annual reappointment of the auditor is a statutory requirement.

Appointment of a New Auditor

General Recommendation: Generally vote for the appointment of a new auditor, unless there is a compelling reason why the new auditor selected by the board should not be endorsed. A compelling reason might be a past association as auditor during a period of financial trouble.

Whenever an Australian public company changes its auditor during the year, it is required to put the auditor up for election by shareholders at the next AGM. Often a new auditor is selected by the board during the year and may or may not have started work by the time the shareholders vote on its election.

2. SHARE CAPITAL

Reduction of Share Capital: Cash Consideration Payable to Shareholders

General Recommendation: Generally vote for the reduction of share capital with the accompanying return of cash to shareholders.

A company's decision to reduce its share capital, with an accompanying return of funds to shareholders, is usually part of a capital-management strategy. It is commonly an alternative to a buyback or a special dividend.

Such a reduction is normally effected proportionately against all outstanding capital, and therefore does not involve any material change relative to shareholder value.

Reduction of Share Capital: Absorption of Losses

General Recommendation: Vote for reduction of share capital proposals, with absorption of losses as they represent routine accounting measures.

This type of capital reduction does not involve any funds being returned to shareholders. A company may take this action if its net assets are in danger of falling below the aggregate of its liabilities and its stated capital.

Buybacks/Repurchases

General Recommendation: Generally vote for requests to repurchase shares, unless:

- There is clear evidence available of past abuse of this authority; or
- It is a selective buyback, and the notice of meeting and explanatory statement does not provide a sound business case for it.

Consider the following conditions in buyback plans:

- Limitations on a company's ability to use the plan to repurchase shares from third parties at a premium;
- Limitations on the exercise of the authority to thwart takeover threats; and
- A requirement that repurchases be made at arms-length through independent third parties.

Some shareholders object to companies repurchasing shares, preferring to see extra cash invested in new businesses or paid out as dividends. However, when timed correctly, buybacks are a legitimate use of corporate funds and can add to long-term shareholder returns.

Issue of Shares (Placement): Advance Approval

General Recommendation: Vote case-by-case on requests for the advance approval of issue of shares.

The ASX Listing Rules contain a general cap on non-pro rata share issues of 15 percent of total equity in a rolling 12-month period. Listing Rule 7.1 allows shareholders to vote to carve out from the "15-percent-in-12-months" cap a particular, proposed issue of shares. If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15-percent-in-12-months cap for the company.

Vote case-by-case on all requests taking into consideration:

- Dilution to shareholders:
  - In some cases, companies may need the ability to raise funds for routine business contingencies without the expense of carrying out a rights issue. Such contingencies could include the servicing of option plans, small acquisitions, or payment for services. When companies make issuance requests without preemptive rights, shareholders not participating in the placement will suffer dilution. While conventions regarding this type of authority vary widely among countries, ISS routinely supports issuance requests without preemptive rights for up to 20 percent of a company's outstanding capital;
- Discount/premium in purchase price to the investor;
- Use of proceeds;
- Any fairness opinion;
- Results in a change in control;
- Financing or strategic alternatives explored by the company;
- Arms-length negotiations; and
- Conversion rates on convertible equity (if applicable).

Issue of Shares (Placement): Retrospective Approval

General Recommendation: Vote case-by-case on retrospective approval of issue of shares.

Listing Rule 7.4 allows shareholders to vote to carve out from the 15-percent-in-12-months cap an issue of shares made some time in the previous 12 months. If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15-percent in-12-months cap for the company.

Australian companies routinely seek approval of previous share distributions. As long as the prior issuances conform to dilution guidelines above, vote for such proposals.

3. BOARD OF DIRECTORS

Director Age Limits

General Recommendation: Generally vote against age limits for directors. Vote for resolutions to remove age limitations in company constitutions.

The Australian Corporations Act no longer includes an age limit for directors of public companies. Companies submit resolutions seeking to remove the age limitation contained in companies' constitutions in order to bring them in line with the Australian Corporations Act.

Age should not be the sole factor in determining a director's value to a company. Rather, each director's performance should be evaluated on the basis of his or her individual contribution and experience.

Independence of Directors

ISS classifies directors as executive, non-independent non-executive, or independent non-executive. ISS' definition of an independent director uses the Financial Services Council (FSC, formerly the Investment and Financial Services Association or IFSA) definition as its core. The FSC definition closely reflects the definition used by the ASX Corporate Governance Council. The FSC defines an independent director as a non-executive director who:

- Is not a substantial shareholder (or an executive or associate of a substantial shareholder) of the company;
- Has not within the last three years been employed by the company in an executive capacity, or been a director after ceasing to hold any such employment;
- Has not within the last three years been a principal or employee of a material professional adviser or material consultant to the corporate group;
- Is not a material supplier/customer of the corporate group (or an executive or associate of a material supplier/customer);
- Does not have a material contractual relationship with the corporate group; and
- Is free from any other interest and any business or other relationship with the corporate group.

ISS’ definition of independence is as follows:

ISS Classification of Directors – Australia

Executive Director

- Employee or executive of the company.

Non-Independent Non-Executive Director (NED)

A non-executive director who is:

- classified as non-independent in the company's annual report;
- A former executive of the company or of another group member if there was less than a three year period between the cessation of employment and board service;
- A major shareholder, partner, or employee of a material adviser/supplier/customer[1];
- A founder of the company, even if no longer a substantial shareholder[2];
- A relative (or a person with close family ties) of a substantial shareholder[2] or of a current or former executive;
- A designated representative of a shareholder;
- A director who has served for 12 or more years on the board;
- A director with any material[3] relationship to the company, other than a board seat.

Independent Non-Executive Director

A non-executive director who is not classified as non-independent according to the factors above. To clarify, this may include:

- A nominee proposed for election to a board by a shareholder but otherwise not affiliated to that shareholder.

Footnotes:

[1] The materiality threshold for transactions is A$500,000 per annum for large advisers/suppliers/customers and A$50,000 per annum for small advisers/suppliers/customers. "Large" advisers include all major law, accounting, and investment banking firms. These thresholds are assessed by looking at transactions during the three most recent financial years.

[2] A substantial shareholder is a shareholder controlling 5 percent or more of the voting rights in the company.

[3]For purposes of ISS' 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.

Voting on Director Nominees in Uncontested Elections

Overview

When voting on director nominees, take into consideration:

- The overall composition of the board;
- The composition of the audit, remuneration, risk (if applicable), and nomination committees;
- Skills of the individual directors;
- Individual directors' attendance records; and
- Service on other public company boards.

As a matter of best practice, the board of a listed entity should also have a committee or committees to oversee risk. Under the recent ASX Corporate Governance Council recommendations, the risk committee could be a stand-alone risk committee, a combined audit and risk committee or a combination of board committees addressing different elements of risk. ISS will include the level of disclosure related to a risk committee in our reports as additional information to institutional investors. Under certain circumstances, ISS may consider such disclosure in our vote recommendations on election of directors, as warranted.

In addition, ISS will include the disclosure provided by the company in a Skills Matrix of the board's composition. The skills matrix need not be prospective; instead it could be retrospective; which may alleviate commercial confidentiality issues around disclosure. Generally the skills matrix will identify the gaps in skills of the board to address the company's business strategy. ISS will include such disclosure in our reports as additional information to institutional investors. Under certain circumstances, ISS may consider such disclosure in our vote recommendations on election of directors, as warranted.

Voting on Director Nominees in Uncontested Elections

General Recommendation: Generally vote for director nominees in uncontested elections. However, generally vote against nominees in the following circumstances:

Attendance:
- Attended less than 75 percent of board and committee meetings over the most recent two years, without a satisfactory explanation.

Overboarding (unless exceptional circumstances exist):
- Sits on more than a total[1] of five listed boards (a chair as equivalent to two board positions); or
- An executive director holding more than one non-executive director role with unrelated listed companies.

Independence Considerations:
- Is an executive and board chair, and no "lead director" has been appointed from among the independent directors or other control mechanisms are in place. Exception may be made for company founders who are integral to the company or if other exceptional circumstances apply;
- An executive other than the CEO who servies on the audit committee;

[1] A one-year transition period will apply to the fiscal year ending 30 June 2016, to allow boards and affected directors (individuals with six directorships) to manage boardroom succession issues to address overboarding concerns if they so wish.

- A former partner or employee of the company's auditor who serves on the audit committee:
- An executive other than the CEO serving on the remuneration committee, and the remuneration committee is not majority-independent.

Board Independence:
If the board is not majority[2] independent under ISS' classification, generally vote against nominees who are:

- Executive directors (except for the CEO and founders integral to the company);
- A non-independent NED who is a designated representative of substantial shareholder. Vote against only one representative of the substantial shareholder (typically, the director with the worst attendance record);
- A non-independent NED whose presence causes the board not to be majority independent without sufficient justification.

Problematic Remuneration Practices:
Generally vote against members of the remuneration committee if the remuneration resolution at the previous general meeting (usually the previous year) received support of less than 75% of votes cast, taking into account:

- the company's response in addressing specific concerns, engagement with institutional investors, and other compensation practices;
- the company's ownership structure;
- whether the issues are considered to be recurring or isolated; and
- whether the level of support was less than 50%.

Problematic Audit-Related Practices:
Generally vote against members of the audit committee as constituted in the most recently completed fiscal year if:

- If the entity receives an adverse opinion of the entity's financial statements from the auditor; or
- Non-audit fees (Other Fees) paid to the external audit firm exceed audit and audit-related fees and tax compliance/preparation fees.

In circumstances where "other" fees include fees related to significant one-time capital structure events (such as initial public offerings) 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 Nominees:
Generally vote against shareholder-nominated candidates who lack board endorsement and do not present conclusive rationale to justify their nomination, including unmatched skills and experience, or other reason. Vote for such candidates if they demonstrate a clear ability to contribute positively to board deliberations.

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

- Failure to act in the best interests of all shareholders;
- Material failures of governance, stewardship, risk oversight[3], or fiduciary responsibilities at the company;

[2] "Majority independent" is defined as over 50% independent.

- Failure to replace management as appropriate; or
- Significant involvement with a failed company, 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.

[3] 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 settlements; hedging of company stock; or significant pledging of company stock.

4. REMUNERATION

Underlying all evaluations of remuneration structure and practices are five global principles that most investors expect companies to adhere to in designing and administering executive and director remuneration plans:

- *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 plans;
- *Avoid arrangements that risk "pay for failure"*: This principle addresses the appropriateness of long or indefinite contracts, excessive severance packages, guaranteed remuneration, or excessive fixed remuneration;
- *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 remuneration decision-making (e.g., including access to independent expertise and advice when needed);
- *Provide shareholders with clear, comprehensive remuneration disclosures*: This principle underscores the importance of informative and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly;
- *Avoid inappropriate pay to non-executive directors*: This principle recognizes the interests of shareholders in ensuring that compensation to outside directors does not compromise their independence and ability to make appropriate judgments in overseeing executive pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

Remuneration Report

General Recommendation: Vote case-by-case on the remuneration report, taking into account:

- The pay of the executives and non-executive directors, including where applicable:
  - The quantum of total fixed remuneration and short term incentive payments relative to peers;
  - The listed entity's workforce;
  - Financial performance and alignment with shareholder returns;
  - The adequacy and quality of the company's disclosure generally; and
  - The appropriateness and quality of the company's disclosure linking identified material business risks and pre-determined key performance indicators (KPIs) that determine annual variable executive compensation outcomes.

The Australian Securities and Investment Commission (ASIC) released Regulatory Guide (RG) 247 on 27 March 2013 to give guidance to companies on their compliance to disclosure under section 299A of the Corporations Act 2001 (Cth) (the Act) – Annual directors' report – additional and general requirements for listed entities. Specifically sub sections (1) – (a) to (c) of section 299A of the Act. RG 247 sets out the required disclosure in the Operating and Financial Review (OFR) in terms of the company's prospects for *future financial years* in terms of the company's business strategies and material business risks.

Ascertain from the OFR if the company has linked, in the remuneration report, the management of its material business risks to its key performance indicators (KPI) in determining remuneration for key management personnel (KMP).

The approach to long-term incentive plans is covered in "Remuneration of Executives: Long-Term Incentives" below.

Non-Executive Director Perks/Fringe Benefits

General Recommendation: Vote case-by-case on:

- The remuneration report;
- Proposals to increase the non-executive directors' aggregate fee cap; and/or
- The election of the chairman of the board, chairman of the remuneration committee, or any member of the remuneration committee standing for re-election

Where a company provides fringe benefits to non-executive directors in addition to directors' board and committee fees. Fringe benefits may include payments made, or services provided without charge, by the company. Examples may include, but are not limited to, additional "travel time fees", which may be charged by the hour, in travelling to board or company meetings either domestically or overseas.

Also, vote against when post-employment fringe benefits are paid to non-executive directors, which are often represented as an entitlement per year of service on the board of the company. Unless the same or similar benefits are also offered to shareholders, such benefits are not considered good market practice, and they represent a potential conflict of interest to incentivize longevity on the board which may not be in the best interests of board succession planning or shareholders. These fringe benefits may be offered to non-executive directors as a cash payment (for example, retirement benefits) or in services provided or procured by the company.

Remuneration of Non-Executive Directors: Increase in Aggregate Fee Cap

General Recommendation: Vote case-by-case on resolution seeks shareholder approval for an increase in the maximum aggregate level of fees payable to the company's non-executive directors. It is a requirement of the ASX Listing Rules for companies to obtain shareholder approval for any increase in the fee cap. Take into account:

- The size of the proposed increase;
- The level of fees compared to those at peer companies;
- The explanation the board has given for the proposed increase;
- Whether the company has discontinued retirement benefits;
- The company's absolute and relative performance over (at least) the past three years based on measures such as (but not limited to) share price, earnings per share and return on capital employed;
- The company's policy and practices on non-executive director remuneration, including equity ownership;
- The number of directors presently on the board and any planned increases to the size of the board;
- The level of board turnover.

Vote against the increase if the company has an active retirement benefits plan for non-executive directors. Vote where a company is seeking an increase after a period of poor absolute and relative performance, where the same board (or largely the same board) has overseen this period of poor performance and where the fee cap increase is not sought for the purposes of board renewal.

Remuneration of Non-Executive Directors: Approval of Share Plan

General Recommendation: Generally vote for the approval of share plans.

This type of resolution seeks shareholder approval for the company's non-executive directors to receive some of their fees in the form of shares rather than cash. The reason for the resolution is that listed companies can only issue equity securities to directors if shareholders approve such issuances in advance (Listing Rule 10.14).

All three key sets of guidelines in Australia (ASX Corporate Governance Council, FSC, and those of the Australian Council of Super Investors - ACSI) support companies taking steps to encourage non-executive directors to acquire a material shareholding in their companies in order to achieve a greater alignment with shareholder interests.

Remuneration of Executive Directors: Share Incentive Schemes

General Recommendation: Vote case-by-case on share incentive schemes for executive directors.

Share incentive schemes in Australia usually provide for “performance rights,” “performance shares,” “conditional rights,” or similar derivative instruments, all of which are economically zero exercise price options (ZEPOs).

Following the change in Australian taxation law regarding options effective 1 July 2015, the use of share option plans is expected to again increase in popularity.

There are also a smaller number of share incentive schemes which are structured as loan-funded share plans, pursuant to Australian Securities & Investments Commission guidelines.

Remuneration of Executives: Long-Term Incentives

General Recommendation: Vote case-by-case on long-term incentives for executives. Vote against plans and proposed grants under plans if:

- Exercise price is excessively discounted;
- Vesting period is insufficiently long to reflect an appropriate long term horizon (ie less than three years);
- Performance hurdles are not sufficiently demanding (although ISS will take into account whether the plan is used for a wide group of employees in evaluating performance hurdles under a particular plan);
- Extensive retesting of performance criteria is permitted over an extended time period if the original performance criteria are not met in the initial testing period;
- Plan provides for excessive dilution;
- Company failed to disclose adequate information regarding any element of the scheme.

In Australia, there is no statutory or listing rule requirement for companies to put long-term incentive plans before shareholders for approval. Some companies choose to seek shareholder approval of equity-based plans so that equity instruments issued under them do not count towards the “15 percent in 12 months” dilution cap (see “Issue of Shares (Placement): Advance Approval”, above).

Under ASX Listing Rule 10.14, companies must seek shareholder approval for any grant of equity awards to a director. However, there is a carve-out for grants of shares where those shares were purchased on-market rather than being newly issued. This carve-out was introduced in a controversial amendment to Listing Rule 10.14 in October 2005. Many institutional investors in Australia regard the carve-out as inappropriate and long-term incentive grants of shares to executive directors should be put to a vote of shareholders, regardless of whether the shares are newly issued or purchased on market. If a company utilizes the Listing Rule 10.14 carve-out, and fails to put the grant to a shareholder vote, this is regarded as a negative factor in the assessment of the Remuneration Report.

Evaluate long-term incentive plans (and proposed grants of equity awards to particular directors) according to the following criteria:

<u>Exercise Price</u>

- Option exercise prices should not be at a discount to the prevailing market price at the grant date. (Many Australian companies now issue performance rights or performance shares, which are ZEPOs. These are not treated as “discounted” rights, but the following requirements in terms of vesting period, performance hurdles, etc., apply equally.)
- Plans should not allow the repricing of underwater options.

- The allocation of ZEPOs should not be based on a substantially discounted, or "fair value", price of the company's securities, thereby increasing the number of equity awards which are granted, which could exponentially increase the value of the incentive received by the executive once vested.

Vesting Period

- Should be appropriate time restrictions before rights can be exercised (if securities can vest in a timeframe which is less than three years, then this is not considered to be an appropriate representation of a shareholder's long term horizon for an ASX listed entity).

Performance Hurdles

- Generally, a hurdle that relates to total shareholder return (TSR) is preferable to a hurdle that specifies an absolute share price target or an accounting measure of performance (such as earnings per share (EPS)).
- Where a relative hurdle is used (comparing the company's performance against a group of peers or against an index), no vesting should occur at below-median performance, and the peer group should be appropriate and defensible (e.g. the peer group is not to be unacceptably small, or “cherry picked”).
- A sliding-scale hurdle – under which the percentage of rights that vest increases according to a sliding scale of performance (whether absolute or relative) – is required compared with a hurdle under which 100 percent of the award vests once a single target is achieved (ie. no "cliff vesting").
- Where an absolute share-price target is used, executives can be rewarded by a rising market even if their company does relatively poorly. In addition, even if a share-price hurdle is set at a significantly higher level than the prevailing share price, then the hurdle may not be particularly stretching if the option has a long life and there are generous re-testing provisions.
- Two different types of options should be distinguished:
  - Grants of market-exercise-price options ("traditional options"), which have an in-built share price appreciation hurdle, because the share price must increase above its "strike price" at the grant date for the executive to have an incentive to exercise, and
  - Grants of ZEPOs, which have no exercise price and the executive pays nothing to the company on exercising the rights.
- Accounting-related hurdles do not necessarily involve shareholder value creation before an incentive vests. In other words, an accounting performance hurdle may allow incentives to vest – and executives to be rewarded – without any medium to long-term improvement in total shareholder return having been delivered. Growth in EPS may, but does not always, translate into a material increase in share price and dividends over the medium to long term. Accordingly, an EPS hurdle can lead to executive reward without any increase in shareholder return in the case of ZEPOs, which may not be the same if incorporated with traditional options. Therefore, an EPS hurdle can more readily be supported if used with traditional options, rather than with ZEPOs.
- An EPS target is to be sufficiently demanding, or stretching, such that a hurdle should require a substantial cumulative growth rate in EPS. In order to assess whether an EPS hurdle is sufficiently demanding, ISS will consider the EPS forecasts for a particular company produced and published by analysts and any earnings guidance provided by management. If a sliding-scale EPS hurdle is used, a significant proportion of the options are to vest only for EPS performance that exceeds consensus analyst forecasts.
- Operational hurdles are non-market and non-financial targets which are often difficult to assess. These include delivery of projects or production targets or discovery of mining reserves. ISS will assess these on a case-by-case basis, in order to establish if the hurdle is sufficiently demanding and capable of creating longer term shareholder value. These would more generally be accepted when used in conjunction with traditional options in order to align more closely with a tangible increase in shareholder value in excess of the strike price.

Retesting

- A re-test is where the performance hurdle has not been achieved during the initial vesting period, and the plan permits further testing of the performance hurdle on a later date or dates. Many investors, in markets like the U.K., do not support retesting of performance criteria on share options or other share-based incentive awards, arguing that retesting undermines the incentive value of such awards. Such provisions have not been uncommon in the Australian market. However, as companies have moved toward annual grants of awards that mitigate the concerns over "cliff-vesting," and the increasingly held view among institutional investors that retesting does not constitute best practice, companies have now moved to a minimal number of retests, or they have eliminated retesting altogether.
- In cases where retesting exists evaluate the type of retesting, either fixed-base or rolling, and the frequency of the retesting. (Fixed-base testing means performance is always tested over an ever-increasing period, starting from grant date. This is less concerning than retesting from a rolling start date.) Where a company has a particularly generous retesting regime, and has not committed to significantly reduce the number of retests, vote against a resolution to approve the scheme in question, or a grant of rights under the scheme. This may also warrant a vote against the remuneration report, depending on other aspects of executive and non-executive remuneration practices. In the case of new plans, as a best practice companies should not include retesting provisions, but evaluate on a case-by-case approach basis.

Transparency

- Methodology for determining exercise price should be disclosed.
- Shareholders should be presented with sufficient information to determine whether the scheme will reward superior future performance.
- Proposed volume of securities which may be issued should be disclosed to enable shareholders to assess dilutionary impact.
- Time restrictions before options can be exercised should be disclosed.
- Any restrictions on disposing of shares received should be disclosed.
- Full cost of options to the company should be disclosed.
- Method used to calculate cost of options should be disclosed, including any discount applied to account for the probability of equity incentives not vesting.
- Method of purchase or issue of shares on exercise of options should be disclosed.

Dilution of Existing Shareholders' Equity

- Aggregate number of all shares and options issued under all employee and executive incentive schemes should not exceed 10 percent of issued capital.

Level of Reward

- Value of options granted (assuming performance hurdles are met) should be consistent with comparable schemes operating in similar companies.

Eligibility for Participation in the Scheme

- Scheme should be open to all key executives.
- Scheme should not be open to non-executive directors.

Other

- Plans should include reasonable change-in-control provisions (i.e. pro rata vesting and size of awards).

- Plans should include "good leaver"/"bad leaver" provisions to minimize excessive and unearned payouts (see below for a discussion of the approach to resolutions seeking approval for termination benefits to executives generally and under equity plans).

Remuneration of Executives: Long-Term Incentive Plan Amendments

General Recommendation: Vote case-by-case on amendments to long-term incentive plans.

Evaluate amendments to existing plans initially using the long-term incentive plan guidelines (above). Then, determine if the amendment is improving/removing negative features or if it is exacerbating such features. If the amendment is eliminating negative features, the amendment could potentially be supported. However, if the amendment is neutral, vote against the amendment to express dissatisfaction with the underlying terms of the plan.

Remuneration of Executives: Termination Benefit Approvals

General Recommendation: Vote case-by-case on termination benefits.

Amendments to the Australian Corporations Act in November 2009 provide a cap on allowable "termination benefits" to senior executives of 12 months' base pay (i.e. without shareholder approval). Formerly the Corporations Act required shareholder approval only where the termination payment was in excess of seven times total remuneration.

Companies are able to seek shareholder approval for termination payments in advance, including benefits from unvested equity grants on termination. This also includes general approval for vesting of equity incentives on termination under a specific equity plan.

Generally vote against resolutions seeking approval of termination payments to executives in excess of the statutory maximum (i.e. 12 months' base pay), except where there is clear evidence that the termination payment would provide a benefit to shareholders.

In cases where shareholder approval is sought for termination benefits under any equity plan, which provides for termination benefits in excess of 12 months' base salary, vote for the resolution if the approval is sought for three years or less and there is no vesting of awards without satisfaction of sufficiently demanding performance hurdles.

5. ENVIRONMENTAL AND SOCIAL ISSUES

Voting on Environmental and Social Proposals

Issues covered under the policy include a wide range of topics, including consumer and product safety, environment and energy, labor covered 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 term or long term.

General Recommendation: Generally vote case-by-case, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder value, and in addition the following 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, timeframe, or cost) or overly prescriptive;
- The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
- If the proposal requests increased disclosure or greater transparency, whether or not 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 or not implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

Board Diversity

Diversity on boards is an important topic for many shareholders. ISS will examine board diversity, including gender, skills, ethnicity and age as part of board refreshment and succession planning, in order to provide our clients with sufficient information on which to base informed engagement and voting decisions.

Proxy research reports on each company will include whether:
- There is a disclosed diversity policy;
- There are disclosed and measurable objectives in promoting gender diversity, amongst others;
- The company reports on progress against those measurable objectives;
- The company reports on the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the company has defined “senior executive” and various management positions, for these purposes);
- The company is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act; and
- The company uses Box 1.5 of the ASX Guidelines 3rd ed. to create the company's diversity policy.

Economic, Environmental, and Sustainability Risks

Where appropriate, ISS will report on the quality of the company's disclosure on its economic, environmental, and sustainability risks and how it regards these risks.

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