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## 2014 Australian Proxy Voting Recommendations

### Benchmark Policy

July 31, 2014

Institutional Shareholder Services Inc.

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## ISS' 2014 Australian Proxy Voting Recommendations

### Benchmark Policy

Effective for Meetings on or after October 1, 2014

Published July 31, 2014

The following guidelines apply to ASX-registered issuers and those entities listed on the ASX and domiciled in countries not covered by a separate ISS policy.

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## INTRODUCTION

The principle underpinning all ISS' recommendations is that shareholders are the owners of listed companies.<sup>1</sup> As such, they are entitled to assess every resolution that seeks their approval in terms of how it affects their interests as the owners of the company.

### Overview

Regularly occurring agenda items include:

- Consideration of the financial statements and reports (not normally a voting item);
- Election of directors;
- Non-binding vote on the remuneration report;
- Approving issue of equity securities to directors;
- Approving an increase in the aggregate non-executive director fee cap;
- Approving changes to the company's constitution (requiring a 75-percent majority of votes cast).

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<sup>1</sup> The same principles will be applied to listed entities that are not 'pure' companies, such as trusts and stapled securities.

## General

### Company Name Change

#### ISS Recommendation: Generally For

ISS views decisions about the company name as 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.

### Postpone or Adjourn Meeting

#### ISS Recommendation: Generally Against

Generally vote against proposals to provide management with the authority to adjourn an annual or special meeting as a change to the company constitution, 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 "new business."

### Significant Change in Activities

#### ISS Recommendation: Generally For

ISS generally recommends 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

#### ISS Recommendation: Generally Against

ISS will recommend 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

#### ISS Recommendation for introduction: Case-by-Case

**ISS Recommendation for cancellation: Generally For**

ISS will recommend for proposals to create a new class of non-voting or subvoting shares only 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.

**Mergers and Demergers****ISS Recommendation for introduction: Case-by-Case**

ISS will generally recommend for mergers and acquisitions, and demergers/spinoffs, unless:

- The impact on earnings or voting rights for one class of shareholders is disproportionate to the relative contributions of the group;
- The company's structure following the acquisition or merger does not reflect good corporate governance;
- There are concerns over the process of negotiation that may have had an adverse impact on the valuation of the terms of the offer.

ISS will recommend against if the company does not provide sufficient information upon request to make an informed voting decision.

**Financial Statements****ISS Recommendation: Generally For**

ISS will recommend for 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.

## 1. SHARE CAPITAL

### 1.1 Reduction of Share Capital: Cash Consideration Payable to Shareholders

#### ISS Recommendation: Generally For

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. Thus, ISS generally recommends that shareholders vote for these proposals.

### 1.2 Reduction of Share Capital: Absorption of Losses

#### ISS Recommendation: Generally For

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. ISS usually supports such proposals as they are considered to be routine accounting measures.

### 1.3 Buybacks

#### ISS Recommendation: Generally For

ISS generally recommends for requests to repurchase shares, unless:

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

ISS considers 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. ISS considers that, when timed correctly, buybacks are a legitimate use of corporate funds and can add to long-term shareholder returns.

### 1.4 Issue of Shares (Placement): Advance Approval

#### ISS Recommendation: Case-by-Case

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;
- Conversion rates on convertible equity (if applicable).

### 1.5 Issue of Shares (Placement): Retrospective Approval

#### ISS Recommendation: Case-by-Case

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 ISS guidelines on share issuances in terms of dilution (see above), ISS routinely recommends in favor of such proposals.

## 2. BOARD OF DIRECTORS

### 2.1 Director Age Limits

#### ISS Recommendation: Generally Against

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

ISS considers that 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. As long as directors are able to fulfill their fiduciary responsibility to shareholders, ISS does not consider they should be disqualified from remaining in office.

### 2.2 Alteration of the Number of Directors

#### ISS Recommendation: Case-by-Case

The Australian Corporations Act requires a minimum of three directors for public companies. There is no maximum limit set out in the Act, although company constitutions may set a maximum limit. ISS considers these proposals on a case-by-case basis, but is generally supportive of resolutions that set a maximum limit on board size.

ISS generally recommends AGAINST resolutions that seek to remove any maximum limit on board size.

All proposals to alter board size during a proxy fight or other possible contests for control should be opposed. Allowing directors to alter the terms of a contest while it is under way is not in shareholders' interests, as this tactic could be used to thwart a takeover that is in shareholders' interests.

### 2.3 Classification 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;
- Is free from any other interest and any business or other relationship with the corporate group.

ISS interprets this definition as follows:

#### Substantial Shareholders

- A “substantial” shareholder is a shareholder controlling 5 percent or more of the voting rights in the company.

- Where a person is a non-executive director of a substantial shareholder, he or she is classified as independent (unless a separate reason exists for classifying as non-independent). However, if the person is specifically designated as a representative of the substantial shareholder, he or she is classified as non-independent.

#### Former Executives

- The three-year rule is treated as a genuine “cooling off” period. Therefore, a non-executive director is treated as affiliated if he or she has previously been employed in an executive capacity by the company or another group member, and there was not a period of at least three years between ceasing such employment and serving on the board.

#### Advisers, Suppliers, Customers, Close Family Ties

Where a person is a non-executive director of a material adviser/supplier/customer, and not a major shareholder (or partner) in the material adviser/supplier/customer, he or she is classified as independent, (unless a separate reason exists for classifying as non-independent).

- 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.

#### Residual

- A company founder is classified as non-independent under the “residual” category (other interests or relationships) even if he or she is no longer a substantial shareholder.
- A relative (or a person with close family ties) of a substantial shareholder, or of a current or former executive, is classified as non-independent under the residual category.
- If the company's annual report classifies a director as non-independent without further information, he or she is classified as non-independent under the residual category.
- There is no hard and fast rule about tenure (length of time on the board) impacting independence. However, a non-executive director who has served 12 or more years may be classified as non-independent under the residual category.

## **2.4 Election of Directors**

ISS considers the overall composition of the board, and of the audit, remuneration, risk (if applicable), and nomination committees, as well as individual directors' attendance records.

As a matter of best practice, the board of a listed entity should also have a committee or committees to oversee risk. Such a committee(s) 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 by 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.

ISS will also consider the history of a particular director when deciding whether to recommend in favor of a director's (re)election. Examples of circumstances where ISS will consider recommending against a director's (re)election, regardless of board composition, are when a director has had significant involvement with a failed company and/or where a director has in the past appeared not to have acted in the best interests of all shareholders.

Where there is a majority-independent board (greater than 50 percent), ISS will recommend for the (re)election of a board-nominated director unless:

- He or she is executive and chairperson, and no "lead director" has been appointed from among the independent directors (recommend against; but if he or she is company founder and integral to the company, recommend for);
- He or she is executive (but not the CEO) and is on the audit committee (recommend against);
- He or she is non-independent due to being a former partner or employee of the company's auditor, and is on audit committee (recommend against);
- He or she is executive (but not the CEO) and is on the remuneration committee, and the remuneration committee is not majority-independent (recommend against);
- He or she has attended less than 75 percent of board and committee meetings over the most recent two years, without a satisfactory explanation (recommend against);
- He or she sits on more than five other listed company boards (counting a chair as equivalent to two board positions), or is an executive director and holds more than one non-executive directorship at unrelated listed companies (recommend against, in the absence of exceptional circumstances).

Where there is not a majority-independent board (less than or equal to 50 percent):

- Generally recommend against executive directors (except the CEO and founders integral to the company) because executives do not need to sit on the board for directors to access their expertise. It is common in Australia for senior executives to be invited to board meetings to make presentations and answer questions;
- Recommend against a representative of a substantial shareholder on a board where the reason independent directors constitute a minority of the board is because of a preponderance of executive directors and representatives of one substantial shareholder. In these cases, ISS will recommend against only one representative of the substantial shareholder (typically, the director with the worst attendance record);
- Recommend against any director who is non-independent due to being a former partner or employee of the company's auditor, and is on the audit committee;
- Recommend against any director who has attended less than 75 percent of board and committee meetings over the most recent two years, without a satisfactory explanation;
- Recommend against any director who sits on more than five other listed company boards (counting a chair as equivalent to two board positions), or is an executive director and holds more than one non-executive directorship at unrelated listed companies, unless exceptional circumstances exist.

Recommend against shareholder-nominated candidates who lack board endorsement, unless they demonstrate a clear ability to contribute positively to board deliberations.

#### **Excessive Non-Audit Fees**

Generally vote against the reelection of individual directors who are members of the audit committee as constituted in the most recently completed fiscal year if Non-audit fees (Other Fees) paid to the external audit firm exceeds 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.

Under extraordinary circumstances, recommend against directors individually, on a committee, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company; or
- Failure to replace management as appropriate; or
- Egregious actions related to the 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.

## 2.5 Combination of CEO and Chairperson

### ISS Recommendation: Case-by-Case

ISS supports the separation of the roles of chairperson and CEO in principle but acknowledges that there may be certain mitigating factors to counterbalance a board structure where the roles are combined, such as the appointment of a lead director. ISS also considers companies should be allowed the discretion in exceptional circumstances to temporarily combine the roles if adequate justification is provided. If the company combines these two positions into one person, then the company must provide for adequate control mechanisms.

## 2.6 Removal of Directors

### ISS Recommendation: Case-by-Case

The major decision factors are:

- Company performance relative to its peers;
- Strategy of the incumbents versus the dissidents;
- Independence of directors/nominees;
- Experience and skills of board candidates;
- Governance profile of the company;
- Evidence of management entrenchment;
- Responsiveness to shareholders.

### 3. REMUNERATION

#### 3.1 Remuneration Report

##### ISS Recommendation: Case-by-Case

ISS' approach is to ascertain, from the remuneration report, the key positive and negative features of the company's approach to executive and non-executive remuneration, and then make a voting recommendation after balancing those positive and negative features. An assessment is made of: (a) the way in which the company pays its executives and non-executive directors; (b) the adequacy and quality of the company's disclosure generally; and (c) the appropriateness and quality of the company's disclosure linking identified material business risks and the predetermined key performance indicators (KPI) 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.

ISS' approach is to 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).

In relation to (a), ISS' approach to long-term incentive plans is covered in “Remuneration of Executives: Long-Term Incentives” below.

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

##### ISS Recommendation: Case-by-Case

This type of resolution seeks shareholder approval for an increase in the maximum aggregate level of fees able to be paid 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.

When assessing requests for an increase in the fee cap, ISS applies a case-by-case approach, taking into account the following factors:

- 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.

If the company has an active retirement benefits plan for non-executive directors, recommend against the increase. ISS also will recommend against a fee cap increase 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 being sought for the purposes of board renewal.

### 3.3 Remuneration of Non-Executive Directors: Approval of Share Plan

#### ISS Recommendation: Generally For

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).

The ISS recommendation in such cases is generally for because 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.

### 3.4 Remuneration of Executive Directors: Share Incentive Schemes

#### ISS Recommendation: Case-by-Case

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

The use of share option plans has significantly declined to a level which makes them rare. This is largely because of the introduction in Division 83A (the Income Tax Assessment Act 1997 (Cth) effective from 1 July 2009) of taxation at vesting. In addition, the elimination of tax refunds for vested but "out of the money" options has also exacerbated the situation following the introduction of Division 83A of the Income Tax Assessment Act 1997 (Cth) effective from 1 July 2009.

A smaller number of share incentive schemes are structured as loan-funded share plans.

### 3.5 Remuneration of Executives: Long-Term Incentives

#### ISS Recommendation: Case-by-Case

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 a plan so that equity instruments issued under it do not count toward 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. In ISS' view - reflecting the views of many institutional investors in Australia - the carve-out is inappropriate, and long-term incentive grants of shares to executive directors should be put to shareholders for a vote, regardless of whether the shares are newly issued or purchased on market. If a company utilizes the Listing Rule 10.14 carve-out, this is treated as a negative factor in ISS' assessment of the Remuneration Report.

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

#### Exercise Price

- Option exercise prices should not be at a discount to the 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 rights.

#### Vesting Period

- Should be appropriate time restrictions before rights can be exercised (if 50 percent or more of securities can vest in two years or less, this is too short).

#### 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 for sub-median performance, and the peer group should be defensible (e.g. not too small, and not “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 generally preferable to a hurdle under which 100 percent of options vest once a single target is achieved.
- 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 retesting provisions.
- An accounting-related hurdle does not necessarily require that shareholder value be improved before the incentive vests. In other words, with an accounting performance hurdle, it is possible for incentives to vest – and executives to be rewarded – without any medium to long-term improvement in 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.
- Two different types of options should be distinguished: (1) grants of market-exercise-price options (traditional options), and (2) ZEPOs. Traditional options have an in-built share price appreciation hurdle, because the share price must increase above its level at the grant date for the executive to have an incentive to exercise. ZEPOs have no exercise price; the executive pays nothing to the company on exercising the rights. An EPS hurdle can lead to executive reward without any increase in shareholder return if the instruments are ZEPOs, but not if they are traditional options. Therefore, an EPS hurdle can more readily be supported if traditional options, rather than ZEPOs, are being granted.
- For an EPS target to be sufficiently stretching, the target should specify a hurdle that will require EPS to have grown significantly. In assessing whether an EPS hurdle is sufficiently stretching for a particular company, 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 should vest only for EPS performance that exceeds consensus analyst forecasts.

#### Retesting

- A retest 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. However, such provisions have not been uncommon in the Australian market. At the same time, however, as companies have moved toward annual grants of awards that mitigate the concerns over “cliff-vesting,” and the increasingly held view among institutions that retesting does not constitute best practice, companies are encouraged to review such practices and move toward reducing the number of retests to a small number, if not eliminating retesting altogether.

- In cases where retesting exists, ISS will 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 reduce the number of retests to a small number, ISS will recommend against a resolution to approve the scheme in question, or a grant of rights under the scheme. This may also lead to an against recommendation on the remuneration report, depending on other aspects of executive and non-executive pay. In the case of new plans, ISS considers that companies should not include retesting provisions as a matter of best practice, but will take a case-by-case approach in such instances.

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

In summary, ISS generally opposes plans, and proposed grants under plans, if any of the following apply:

- Exercise price is discounted;
- Vesting period is too short;
- 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 during the initial testing period;

- Plan allows for excessive dilution;
- Company failed to disclose adequate information regarding any element of the scheme.

### 3.6 Long-Term Incentive Plan Amendments

#### ISS recommendation: Case-by-Case

When evaluating amendments to existing plans ISS initially uses its long-term incentive plan guidelines (see above). ISS then determines 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, ISS would recommend against the amendment to express dissatisfaction with the underlying terms of the plan.

### 3.7 Termination Benefit Approvals

#### ISS recommendation: Case-by-Case

Amendments to the Australian Corporations Act in November 2009 capped allowable (i.e. without shareholder approval) "termination benefits" to senior executives at 12 months' base pay. 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 approval of such payments, including benefits from unvested equity grants on termination, in advance including by seeking general approval for vesting of equity incentives on termination under a specific equity plan.

ISS will generally recommend against resolutions seeking approval of termination payments for 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 approval is sought for termination benefits under any equity plan, vote for the provision of termination benefits under the plan in excess of 12 months' base salary, only if the approval is for three years or less and no vesting without satisfaction of sufficiently demanding performance hurdles is permitted.

## 4. AUDITORS

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

**ISS Recommendation: Generally For**

This type of resolution is not required under Australian law, and so it arises 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.

ISS will recommend 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.

### 4.2 Appointment of a New Auditor

**ISS Recommendation: Generally For**

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.

Unless there is some compelling reason why a new auditor selected by the board should not be endorsed, the recommendation is for. A compelling reason might be a past association as auditor during a period of financial trouble.

## 5. Environmental and Social Issues

### 5.1 Global Approach

#### ISS recommendation: Case-by-Case

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.

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.

### 5.2 Board diversity

ISS views diversity on boards as an important topic for engagement with the company, we examine diversity as part of board refreshment so as to provide our clients with the best information on which to base an informed voting decision.

#### What are Measurable objectives?

Objectives such as introducing a diversity policy or a committee charter by themselves are not effective unless they contain appropriate numerical targets. The diversity policy should include appropriate and meaningful benchmarks that are able to be, and are, measured and monitored for effectiveness in addressing any gender imbalance issues in an organisation.

#### Defining Diversity:

It is accepted that a company may take a broader definition of diversity in its approach than only gender. Such a definition may include matters of age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity.

ISS reports on whether a company:

- has a diversity policy;
- has measurable objectives on promoting gender diversity;
- reports on progress against those measurable objectives; and
- 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" for these purposes); or

- if the entity 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;
- Whether the company uses Box 1.5 of the ASX Guidelines 3rd Ed. to create the company’s diversity policy.

ISS will report on the company's disclosure on the measures to achieve greater diversity.

### **5.3 Economic, Environmental, and Sustainability Risks**

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

## MISCELLANEOUS

### Constitutional Amendment

#### ISS Recommendation: Case-by-Case

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.

### Renewal of "Proportional Takeover" Clause in Constitution

#### ISS Recommendation: Generally For

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 their shareholders to reinsert the clause into the constitution, at every third AGM. The clause cannot be used as a management entrenchment device given that 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, allowing the bid to be made will be taken as approved.

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