Asia-Pacific

Proxy Voting Guideline Updates

2015 Benchmark Policy Recommendations

Effective for Meetings on or after Feb. 1, 2015

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TABLE OF CONTENTS

BOARD OF DIRECTORS

Election of Directors (Hong Kong)

Current Recommendation: ISS typically recommends a vote for the re/election of directors, unless:

- The nominee is classified by the company as independent, but fails to meet the ISS criteria for independence;
- The nominee has been a partner of the company's auditor within the last three years, and serves on the audit committee;
- The nominee has attended less than 75 percent of board and key committee meetings over the most recent fiscal year, without a satisfactory explanation. Acceptable reasons for director absences are generally limited to the following:
  - Medical issues/illness;
  - Family emergencies;
  - The director has served on the board for less than a year; and
  - Missing only one meeting (when the total of all meetings is three or fewer).
- The nominee is an executive director serving on the remuneration committee or nomination committee, and the committee is not majority independent;
- The nominee is an executive director serving on the audit committee;
- The nominee sits on a total of more than six public company boards (ISS will accept a commitment by an overboarded director to step down from one or more boards at the next annual meeting of the company or companies in question, if that will bring the total number of boards to no more than six); or
- Any non-independent director nominees where the board is less than one-third independent under ISS classification of directors.

In making these recommendations, ISS generally will not recommend against the election of a CEO, managing director, executive chairman, or founder who is integral to the company.

Key Changes:

- Eliminate the first factor in the current policy that results in an against recommendation when an independent director fails to meet ISS' criteria for independence.
- Exclude attendance by an alternate director in calculation of a principal director's overall attendance rate.
- Replace the term "integral to the company" with "whose removal would be expected to have a material negative impact on shareholder value."

New Recommendation: Generally vote for the re/election of directors, unless:

- The nominee has been a partner of the company's auditor within the last three years, and serves on the audit committee;
- The nominee has attended less than 75 percent of board and key committee meetings over the most recent fiscal year, without a satisfactory explanation. The calculation of director attendance will not include meetings attended by alternate directors. Acceptable reasons for director absences are generally limited to the following:
  - Medical issues/illness;
  - Family emergencies;
  - The director has served on the board for less than a year; and
  - Missing only one meeting (when the total of all meetings is three or fewer);
- The nominee is an executive director serving on the remuneration committee or nomination committee, and the committee is not majority independent;
- The nominee is an executive director serving on the audit committee;

- The nominee sits on a total of more than six public company boards (ISS will accept a commitment by an overboarded director to step down from one or more boards at the next annual meeting of the company or companies in question, if that will bring the total number of boards to no more than six); or
- Any non-independent director nominees where the board is less than one-third independent under ISS classification of directors.

In making these recommendations, ISS generally will not recommend against the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value.

Rationale for Update:

Director Attendance: It is not uncommon in Hong Kong for a director to appoint an alternate director to attend board or committee meetings on his or her behalf. Attendance by an alternate director raises concern as shareholders elected a particular individual to the board to represent their interests and not someone a director might appoint in his or her place. In most cases, alternate directors are not subject to shareholder review or vote. There are instances when the alternate director attended all the board meetings in place of the principal director. A principal director may not be sufficiently held accountable when this director fails to attend more than 75 percent of the meetings without the help of an alternate director. In 2012, the Hong Kong Code of Corporate Governance was amended to provide that "attendance at board or committee meetings by an alternate director should not be counted as attendance by the director himself." Therefore, exclusion of the attendance by an alternate director when calculating a principal director's overall attendance rate is consistent with the recommended best practice in this market.

Director Independence: ISS' definition of independence differs from those of local markets, and some directors who satisfy the independence definition under the relevant regulations may not meet ISS' definition, and thus be considered non-independent. However, not meeting ISS' classification of an independent director does not necessarily mean that this director is unfit to serve on the board. An "against" vote recommendation on a director solely based on ISS' classification of director independence may not be in shareholders' best interests given that the director may have less concerning conflicts of interest than other non-independent directors who fail to meet both ISS and local market definitions of independence.

Election of Directors (China)

Current Recommendation: Where independent directors represent at least one-third of the board, ISS will recommend supporting election of a board-nominated candidate unless:

- He or she is classified by the company as independent, but fails to meet the ISS criteria for independence;
- He or she has been a partner of the company's auditor within the last three years, and is on the audit committee of the company; or
- He or she has attended less than 75 percent of board meetings over the most recent two years, without a satisfactory explanation.

Where independent directors represent less than one-third of the board, ISS will generally NOT support the election of a candidate if:

- He or she is classified by the company as independent, but fails to meet the ISS criteria for independence;
- He or she is an executive director. If more than one executive director is up for election, ISS will recommend against only one (typically, the director with the worst attendance record). Executives do not need to sit on the board for directors to access their expertise. Executives can be invited to board meetings to make presentations and answer questions.

- He or she is a representative of a substantial shareholder on a board where the reason independent directors constitute less than one-third 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);
- He or she has been a partner of the company's auditor within the last three years, and is on the audit committee of the company; or
- He or she has attended less than 75 percent of board meetings over the most recent two years, without a satisfactory explanation.

In making these recommendations, ISS generally will not recommend against the election of the CEO or a company founder who is integral to the company.

Under extraordinary circumstances, ISS will recommend against individual directors, members of a committee, or the entire board, due to:

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

Key Changes:

- Eliminate the first factor in the current policy that results in an "against" recommendation when an independent director fails to meet ISS classification of independence.
- Clarify the director attendance policy to provide that it applies only to independent director nominees as well as to reduce the look back period to one year from two years. and specify "acceptable reasons" for a director's absence.
- Update the current policy to recommend against all non-independent director nominees up for election where the board is less than one-third independent, except for a CEO, managing director, executive chairman, or company founder whose removal from the board would be expected to have a material negative impact on shareholder value.
- Consolidate the two current policies regarding the one-third independence level into a single policy.
- Replace the term "integral to the company" with "whose removal would be expected to have a material negative impact on shareholder value."

New Recommendation: Generally vote for the re/election of directors, except where:

- The nominee has been a partner of the company's auditor within the last three years, and serves on the audit committee;
- The independent director nominee has attended less than 75 percent of board meetings over the most recent fiscal year[1], without a satisfactory explanation. Acceptable reasons for director absences are generally limited to the following:
  - Medical issues/illness;
  - Family emergencies;
  - The director has served on the board for less than a year; and

[1] Companies are required to disclose the attendance record of independent directors only, and committee memberships and attendance are generally not disclosed.

- Missing only one meeting (when the total of all meetings is three or fewer);
- Any non-independent director nominees where the board is less than one-third independent under ISS classification of directors.

Generally vote for the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value.

Under extraordinary circumstances, vote against individual directors, members of a committee, or the entire board, due to:

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

Rationale for Update:

ISS' definition of independence differs from those of local markets, and some directors who satisfy the independence definition under the relevant regulations may not meet ISS' definition, and thus be considered non-independent. However, not meeting ISS' classification of an independent director does not necessarily mean that this director is unfit to serve on the board. An against vote recommendation on a director solely based on ISS' classification of director independence may not be in shareholders' best interests given that the director may have less concerning conflicts of interest than other non-independent directors who fail to meet both ISS and local market definitions of independence.

Further, Chinese companies are mandated to disclose the meeting attendance of independent directors only. A small number of companies voluntarily disclose the attendance of non-independent directors. In line with disclosure requirements, attendance will only apply to independent directors under the updated policy. This approach is also in line with ISS policy applied in other markets where the attendance records of only non-executive directors are required to be disclosed, such as Japan and Korea. Further, the updated policy recognizes that attendance in the most recent year is a better predictor of future attendance than attendance in earlier years. Additionally, the updated policy includes acceptable reasons for absences which would clearly articulate when an exemption to the policy may be made, and would bring the policy more in line with ISS policy in other markets.

Chinese companies are required to have a minimum one-third independent board, and various Asian markets also mandate one-third board independence. Further, the Mainland China and Hong Kong markets share a number of similarities and many Chinese companies are listed also in Hong Kong. Almost half of Hong Kong-listed companies originate from Mainland China, most of which are subject to regulations in both jurisdictions. Thus, the updated policy brings the China policy in line with Hong Kong by recommending against all non-independent nominees when the board fails to meet the minimum independence threshold.

Election of Directors (Korea)

Current Recommendation:

Korean law imposes two different sets of corporate governance standards on listed companies – one for companies whose asset size is greater than KRW 2 trillion (large companies) and the other for companies whose asset size is below KRW 2 trillion (small companies). Under Korean law, large company boards must have a majority of outside directors, and small companies are required to have a board on which one-fourth of the directors are outsiders.

Consider the history of a particular director when deciding whether to vote in favor of his or her (re)election. Examples of circumstances where a vote against a director's (re)election should be considered include:

- Adequate disclosure has not been provided in a timely manner;
- There are clear concerns over questionable finances or restatements;
- There have been questionable transactions with conflicts of interest;
- There is any record of abuses against minority shareholder interests;
- The board fails to meet minimum corporate governance standards;
- A director has had significant involvement with a failed company;
- A director has in the past appeared not to have acted in the best interests of all shareholders;
- A director has breached fiduciary duties or engaged in willful misconduct or gross negligence in his/her capacity as a director (irrespective of whether such wrongdoing brings claims of losses and damages to the company);
- A director has been indicted by the Prosecutors' Office and there are pending investigations;
- An outside director has attended less than 75 percent of board meetings in the most recent financial year, without a satisfactory explanation; or
- An outside director sits on more than two public company boards, in violation of the Commercial Act and accompanying presidential decree.

For large companies, in a case where independent non-executive directors (per ISS' classification of directors) represent less than a majority of the board, vote against the following directors:

- Inside/executive directors who are neither CEO nor a member of the founding family; and/or
- The most recently appointed non-independent non-executive director (per ISS' classification of directors) who represents a substantial shareholder, where the percentage of board seats held by representatives of the substantial shareholder are disproportionate to its holdings in the company.

Under extraordinary circumstances, vote against individual directors, members of a committee, or the entire board, due to:

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

Key Changes:

- Remove the exemption in the current policy whereby directors who are founding family members of large companies are not held accountable when the board is not majority independent, and limit the exemption to those whose removal from the board would be expected to have a material negative impact on shareholder value. This exemption applies to other policies on director elections as well.
- Codify the current approach into a separate policy whereby ISS may recommend a vote against a board member up for (re)election who has failed to perform his/her fiduciary duty to remove directors from the board who were convicted for breaking the law.
- Streamline the policy in alignment with other markets in the region by reducing the list of certain circumstances that would generally result in an against recommendation on directors, given that many of these factors are covered under the policy that addresses material failures of governance.
- Codify the current approach of recommending against the entire slate of directors if the election of multiple directors is presented as a single voting item and if any one of the nominees presents governance concerns.

New Recommendation: Generally vote for the re/election of directors, unless:

- Adequate disclosure has not been provided in a timely manner;
- An outside director sits on more than two public company boards, in violation of the Commercial Act and accompanying presidential decree;
- An outside director has attended less than 75 percent of board meetings[2] over the most recent fiscal year, without a satisfactory explanation. Acceptable reasons for director absences are generally limited to the following:
  - Medical issues/illness;
  - Family emergencies;
  - The director has served on the board for less than a year; and
  - Missing only one meeting (when the total of all meetings is three or fewer);
- For large companies, any non-independent director nominees (under ISS classification) where the board is less than majority-independent.

Where adequate disclosure has been provided, generally vote for the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value.

Under extraordinary circumstances, vote against individual directors, members of committees, or the entire board, due to:

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

Generally vote against directors for failure to remove a director convicted of wrongdoing from the board.

For cases where the election of multiple directors is presented as a bundled item, vote against the entire slate of directors if one of the nominees presents any of the governance concerns highlighted above.

Rationale for Update:

The current policy could be interpreted to mean that any inside director, by virtue of family ties, is always exempt from accountability when the board is not majority independent. The updated policy clarifies that the exemption should only be applied to directors whose removal from the board may have an adverse impact on shareholder value, such as the CEO or company founder. Such individuals should also be exempt from other standard director policies such as attendance or overboarding requirements.

With regard to the failure to remove a director convicted of wrongdoing, it is not uncommon in Korea to see a director being convicted of criminal charges and securities fraud, including accounting manipulation, insider trading, and misappropriation of corporate funds, but continue to remain on the board. Not only should a director who has been convicted of serious wrongdoing be removed from the board, but the board that fails to take action against such a director should be held accountable for its inaction. The updated policy codifies ISS' current approach.

[2] Korean law requires companies to disclose the attendance of only outside directors.

Election of Directors (Japan)

Current Recommendation:

ISS has two policies for director elections in Japan: one for companies with a statutory auditor board structure, and the other for companies with a U.S.-type three committee structure. Regardless of governance structure, vote for the election of directors, except for:

- A top executive[3] if the board, after the shareholder meeting, does not include at least one outsider, regardless of independence; or
- A top executive at a company that has a controlling shareholder, where the board, after the shareholder meeting, does not include at least two independent directors based on ISS independence criteria for Japan; or
- An outside director nominee who attended less than 75 percent of board meetings during the year under review[4]; or
- A top executive who is responsible for not implementing a shareholder proposal which has received a majority[5] of votes cast, or not putting a similar proposal on the ballot as a management proposal the following year (with a management recommendation of for), when that proposal is deemed to be in the interest of independent shareholders.

In addition, at companies with a U.S.-type three committee structure, vote for the election of directors, unless:

- The outside director nominee is regarded as non-independent based on ISS independence criteria for Japan, and the board, after the shareholder meeting, is not majority independent; or
- Where a company has a controlling shareholder, the director nominee who sits on the nomination committee and is an insider, or non-independent outsider, when the board, after the shareholder meeting, does not include at least two independent directors based on ISS independence criteria for Japan.

Regardless of governance structure, under extraordinary circumstances, vote against individual directors, members of 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 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.

Key Changes:

- The new policy accommodates a new type of board structure, board with audit committee, that companies can adopt starting in the spring of 2015.

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[3] In most cases, the top executive will be the “shacho” (president). However, there are companies where the decision-making authority also rests with the “kaicho” (executive chairman) or “daihyo torishimariyaku” (representative director).
[4] The attendance of inside directors is not disclosed in Japan.
[5] Many Japanese shareholder proposals are submitted as article amendments, which require supermajority support in order to pass.

- ISS will recommend a vote against top executive(s) of companies posting average return on equity (ROE) of less than five percent over the past five fiscal years, unless an improvement is observed (i.e., ROE was five percent or greater in the most recent fiscal year).
- Starting in 2016, a new policy will be implemented to recommend a vote against top executive(s) if the board does not include multiple outsiders.

New Recommendation: ISS has three policies for director elections in Japan: one for companies with a statutory auditor board structure, one for companies with a U.S.-type three committee structure, and one for companies with a board with audit committee structure.

1. **At companies with a statutory auditory structure**: vote for the election of directors, except:

- Top executive(s)[6] at a company that has underperformed in terms of capital efficiency (i.e., when the company has posted average return on equity (ROE) of less than five percent over the last five fiscal years)[7], unless an improvement[8] is observed;
- Top executive(s) if the board, after the shareholder meeting, does not include at least one outsider, regardless of independence;
- Top executive(s) at a company that has a controlling shareholder, where the board, after the shareholder meeting, does not include at least two independent directors based on ISS independence criteria for Japan;
- An outside director nominee who attended less than 75 percent of board meetings during the year under review[9]; or
- Top executive(s) who are responsible for not implementing a shareholder proposal which has received a majority[10] of votes cast, or not putting a similar proposal on the ballot as a management proposal the following year (with a management recommendation of for), when that proposal is deemed to be in the interest of independent shareholders.

2. **At companies with a U.S.-type three committee structure:** (In addition to the guidelines for companies with a statutory auditor structure) vote for the election of directors, except where:

- An outside director nominee is regarded as non-independent based on ISS independence criteria for Japan, and the board, after the shareholder meeting, is not majority independent; or
- Where the company has a controlling shareholder, a director nominee sits on the nomination committee and is an insider, or non-independent outsider, when the board, after the shareholder meeting, does not include at least two independent directors based on ISS independence criteria for Japan.

3. **At companies with a board with audit committee structure:** (In addition to the guidelines for companies with a statutory auditor structure) vote for the election of directors, except where:

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[6] In most cases, the top executive will be the "shacho" (president). However, there are companies where the decision-making authority also rests with the "kaicho" (executive chairman) or "daihyo torishimariyaku" (representative director).
[7] Exceptions may be considered for cases such as where the top executive has newly joined the company in connection with a bailout or restructuring. This policy will not be applied to companies which have been public for less than five years.
[8] Improvement is defined as ROE of five percent or greater for the most recent fiscal year.
[9] The attendance of inside directors is not disclosed in Japan.
[10] Many Japanese shareholder proposals are submitted as article amendments, which require supermajority support in order to pass.

- An outside director nominee who is also nominated as an audit committee member[11] is regarded as non-independent based on ISS independence criteria for Japan.

Regardless of governance structure, under extraordinary circumstances, vote against individual directors, members of a committee, or the entire board, due to:

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

Policy for 2016

Starting in February 2016, vote against the top executive(s) at a company if the board after the shareholder meeting does not include multiple outsiders[12].

Rationale for Updates:

Board with Audit Committee Structure: The new structure is being introduced as part of a set of Corporate Law amendments designed to improve corporate governance of Japanese companies. With the new audit committee structure, companies now will be able to employ one of three types of board structures:

1. The traditional board with statutory auditor structure (employed by 98 percent of listed companies);
2. The board with three committee structure (so-called U.S. style board); and
3. The newly established board with audit committee structure.

The introduction of the new structure is intended to encourage companies with the statutory auditor structure to adopt the committee system. Essentially, the new structure is designed to facilitate a transition from the board with statutory auditor structure to the board with audit committee structure by replacing statutory auditors, who attend board meetings but do not have the authority to vote, with outside directors who also serve on the audit committee.

The new structure requires a minimum of two outside directors who are also designated as audit committee members, but does not require any other directors to be outsiders. Therefore, in line with ISS policy for statutory auditor appointments, the new policy requires all outside directors who are audit committee members to be independent.

On the other hand, (as with ISS policy for director elections at companies with the traditional board structure), the new policy does not require outside directors who are not committee members to be independent. The law does not require the appointment of outside directors who are not audit committee members and therefore, recommending a vote against such outside directors risks leaving the board with fewer outside directors overall, which will not be beneficial to shareholders.

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[11] Outside director nominees who are not nominated as audit committee members are not subject to this policy.

[12] "Multiple outsiders" could mean two outsiders (regardless of independence) or two outsiders (at least one of whom is independent). The definition may depend on factors such as the provisions of Japan's Corporate Governance Code, currently in the draft stage. The new policy may initially be applied only to large companies (i.e., those in major indices).

Low ROE: ISS believes that a voting policy in a given market should reflect specific characteristics of that market. In Japan, lack of board independence is the core governance issue. A lack of board independence makes it difficult for shareholders' voices to be reflected in board discussions. Japanese boards are often criticized for shareholder unfriendly decisions, such as hoarding cash, and tying up assets in cross-shareholdings. In other cases, they appear reluctant to sell or shut down unprofitable businesses, thus putting the interests of company insiders ahead of the benefits for common shareholders. Alternatively, Japanese corporate managers are often criticized for not taking risks in making value enhancing strategic investment decisions for future growth, due to a consensus-based decision-making process on boards dominated by insiders.

These problematic practices, which tend to lead to low capital efficiency, can be assessed by evaluating ROE. The updated policy therefore is adopted to augment the current policy of opposing top executives on all-insider boards (intended to increase board independence), by newly applying a financial metric which measures shareholder value creation, which in turn should be the ultimate goal of increasing board independence.

ROE is not the sole indicator to measure shareholder value creation, but it still can be a viable metric in the context of Japanese corporate governance for the following reasons.

First, many investors have cited low capital efficiency as a primary reason for the low returns from Japanese equity investments over the years. Indeed, Japanese companies' ROE is low compared to other markets. According to the Ito Review[13] by the Ministry of Economy, Trade and Industry, the average ROE for fiscal 2012 was only 5.3 percent for Japanese companies, compared to 22.6 percent for U.S. companies and 15.0 percent for European companies. In the report, Japanese companies are encouraged to increase their ROEs "in a manner befitting their respective businesses and connect this activity to generating sustainable growth." It also notes that "… [Japanese] companies should be conscious that the minimum expected level of ROE is 8%, and should strive to further increase their ROEs beyond this level…"

Second, the recent corporate governance debate in Japan has evolved with ROE as an important element. The Abe administration's economic policy includes measures to improve Japanese companies' capital efficiency. The administration requested the Tokyo Stock Exchange and Nikkei to create a new equity index to be composed of companies deemed shareholder friendly. The new JPX Nikkei 400 index, launched in response to the request, evaluates, among other factors, ROE to select index component companies, with a view to increasing awareness of the importance of ROE among Japanese companies.

In addition, at the request of the administration, the Financial Services Agency released in February Japan's Stewardship Code[14] for investors holding Japanese equities, which aims to increase constructive shareholder engagement with companies. Measures to increase capital efficiency are cited in the code as one topic for such engagement. As of August 29, 160 institutions have signed the code.

According to ISS' 2013-14 policy survey results, a significant majority of investor respondents indicated that ISS should either always consider company performance when evaluating directors or consider it when a company has exhibited problematic governance practices that the board does not appear to be addressing.

In fact, Japanese institutional shareholders have already used ROE (in many cases a 3 - 5 percent ROE threshold) as a key factor when evaluating director election proposals, to address the issue of low capital efficiency at Japanese companies. The approach was originally inspired by the Pension Fund Association (PFA) of Japan, which employed a

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[13] http://www.meti.go.jp/english/press/2014/0806_04.html
[14] http://www.fsa.go.jp/en/refer/councils/stewardship/index.html

director election policy factoring in ROE beginning in 2007. Although the PFA currently does not have a stated ROE-based director election policy, domestic institutional shareholders continue to employ ROE in voting on directors.

As Japanese boards virtually function as management committees, rather than as supervising organs, it is reasonable for shareholders to oppose top executives when performance is poor. Note that 98 percent of Japanese companies employ a statutory auditor system, under which they do not have legally binding nomination committees. Therefore, it is unrealistic to expect that board members could remove top executives when necessary. The updated policy reflects the unique market circumstances of Japan.

The five percent threshold was chosen as a minimum ROE level acceptable to investors as an equity risk premium, based on discussions with institutional investors in Japan holding Japanese equities. Therefore, the threshold should be interpreted as a minimum acceptable level and not as a target. The five year measurement period was chosen so as not to penalize companies for a short-term performance downturn which could be needed for investments for sustainable growth over the long term.

Multiple Outsiders: Corporate governance in Japan has long been criticized for lack of outside director oversight. However, the situation has changed. Companies with at least one outside director made up a minority of those companies tracked by ISS until recently, but the proportion of such companies, which had been increasing by one to two percentage points every year, began to increase sharply in 2013. As of June 2014, only 29 percent of listed company boards lack even a single outside director, according to ISS data.

In 2013, ISS began recommending against top executives if the board after the shareholder meeting did not include at least one outsider, regardless of independence. It was in 2010 when more than half of Japanese companies started to have at least one outsider for the first time. Given that a majority of Japanese boards have at least one outsider, having outsiders on the board is no longer an alien concept among the Japanese business community, corporations and institutional shareholders alike.

In fact, today, a majority of large Japanese companies already have at least two outside directors. Of Nikkei 225 index member companies, 72 percent have multiple outsiders, and of companies constituting the JPX-Nikkei 400 index, 55 percent have multiple outsiders (as of September 2014). Given this progress, strengthening the board independence threshold by requiring multiple outsiders, particularly for such large companies, is reasonable.

Under the new approach, the policy will not be implemented until 2016. This one-year moratorium is intended to give companies sufficient time to recruit qualified outside director candidates. For 2015, we will not recommend against a top executive if the board has only one outsider.

REMUNERATION

Remuneration Cap on Directors (and Internal Auditor) (Korea)

Current Recommendation: Generally vote for the approval of a remuneration cap on directors (or the internal auditor), unless:

- The proposed limit on directors' remuneration is excessive relative to peer companies' remuneration caps; and/or
- The company is asking for a significant fee cap increase where:
  - The company reported sound financial performance but its dividend payout ratio has been low in the past couple of years (or for the most recent five years for widely held companies) without any reasonable justification; and/or
  - The company has generated a net loss in the most recent two financial years.

Key Changes:

- ISS is separating the policy into two policies, one for director remuneration and one for internal auditors renumeration:
  - For the director remuneration cap, the emphasis is on disclosure and transparency, encouraging companies to provide an explanation of an increase in the cap as well as a remuneration cap that is excessive relative to the company's peers;
  - For the internal auditors' remuneration cap, absent concerns, such resolutions are generally supported.
- ISS is clarifying that, for both policy provisions, significant concerns over board or internal auditor supervision would warrant an against recommendation unless the company provides sufficient justification for the proposed pay.

New Recommendations:

Remuneration cap for directors

Generally vote for approval of the remuneration cap for directors, unless:

- The proposed cap on directors' remuneration is excessive relative to peer companies' remuneration without reasonable justification; or
- The company is asking for an increase in the remuneration cap where the company has not provided a reasonable justification for the proposed increase.

Vote against if there are material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company and the company has not provided a reasonable justification for the proposed remuneration.

Remuneration cap for internal auditors

Generally vote for approval of the remuneration cap for internal auditors, unless there are serious concerns about the statutory reports presented or audit procedures used.

Rationale for Update:

The revised Financial Investment Services and Capital Markets Act (Article 159) amended in May 2013 now requires companies to disclose the compensation paid out to individuals who receive more than KRW 500 million during a given fiscal year. Prior to the revision, companies only disclosed the lump sum paid to all inside directors and outside directors. The updated policy reflects the regulatory movements pushing for improvement in pay disclosure, placing greater emphasis on disclosure and transparency. Based on an ISS study of the 144 most widely-held companies in Korea, on average companies utilize only 56 percent of the remuneration cap approved by shareholders. The onus should be on the issuer to justify why it needs to raise the total remuneration cap for its directors. Such an approach was also supported by institutional investor participants at ISS Policy Roundtables.

Equity Compensation Plans (Hong Kong and Singapore)

Current Recommendation for Hong Kong

ISS will recommend voting against an option scheme if:

- The maximum dilution level for the scheme exceeds ISS guidelines of 5 percent of issued capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features such as challenging performance criteria and meaningful vesting periods as these features partially offset dilution concerns by reducing the likelihood that options will become exercisable unless there is a clear improvement in shareholder value; or

- Directors eligible to receive options under the scheme are involved in the administration of the scheme and the administrator has the discretion over their awards[1].

Current Recommendation for Singapore:

ISS has historically recommended voting against a proposed option plan if the maximum dilution level for the plan exceeds ISS guidelines of 5 percent of issued capital for a mature company and 10 percent for a growth company. ISS has also recommended voting against stock option plans that allow for the granting of options with an exercise price at a discount to the current market price.

ISS will recommend voting against an option plan if:

- The maximum dilution level for the scheme exceeds ISS guidelines of 5 percent of issued capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features such as challenging performance criteria and meaningful vesting periods as these features partially offset dilution concerns by reducing the likelihood that options will become exercisable unless there is a clear improvement in shareholder value;
- The plan permits options to be issued with an exercise price at a discount to the current market price; or
- Directors eligible to receive options under the scheme are involved in the administration of the scheme and the administrator has the discretion over their awards[1].

This rationale recognizes the benefit of well-structured option plans at plans at mature companies, provided that performance criteria are sufficiently robust.

Key Changes:

- Incorporate annual grant limits when reviewing the dilution limits of equity compensation plans.
- Harmonize the policies for Hong Kong and Singapore.

New Recommendation: Generally vote for an equity-based compensation plan unless:

- The maximum dilution level for the scheme exceeds 5 percent of issued capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features such as challenging performance criteria and meaningful vesting periods as these features partially offset dilution concerns by reducing the likelihood that options will become exercisable unless there is a clear improvement in shareholder value. In addition, ISS will support a plan's dilution limit that exceeds these thresholds if the annual grant limit under the plan is 0.5 percent or less for a mature company (1 percent or less for a mature company with clearly disclosed performance criteria) and 1 percent or less for a growth company.

- The plan permits options to be issued with an exercise price at a discount to the current market price; or
- Directors eligible to receive options or awards under the scheme are involved in the administration of the scheme and the administrator has the discretion over their awards.[15]

Rationale for Update:

Companies in Hong Kong and Singapore typically have equity compensation plans with dilution limits ranging from 10 to 15 percent, which often are above the allowable limit of 5 percent (for mature companies without disclosed performance criteria) or 10 percent (for growth companies) under ISS policy. However, a number of companies have responded to investor concerns of excessive dilution by imposing an annual dilution limit. The updated policy is in line with this market development, recognizing companies for adopting best practice, and incentivizing companies to reduce the risk of excessive dilution in any given year.

ARTICLE AMENDMENTS

Adoption of a Board with Audit Committee Structure (Japan)

Current Recommendation: Not Applicable

Key Changes: The new policy is intended for a new type of board structure, board with audit committee, which companies can adopt starting in the spring of 2015.

New Recommendation: Generally vote for an article amendment to adopt a board with audit committee structure. However, if the adoption of the new governance structure would eliminate shareholders' ability to submit shareholder proposals on income allocation, vote against the article amendments. Vote case-by-case if the board currently has a three-committee structure.

Rationale for Update:

Please see the discussion of this item under the Election of Directors (Japan).

SHARE ISSUANCE REQUESTS

General Issuance Mandate (Hong Kong)

Current Recommendation:

Hong Kong companies routinely seek shareholder approval to authorize their boards to:

[15] Equity awards granted or taken in lieu of cash fees generally would not be considered discretionary awards.

- Issue shares up to 20 percent of existing capital without preemptive rights (General Issuance Mandate);
- Repurchase shares of up to 10 percent of issued capital (Repurchase Mandate); *and*
- Reissue repurchased shares by extending the General Issuance Mandate to include the number of shares repurchased (Share Reissuance Mandate).

This section deals with the General Issuance Mandate, while the other two mandates are discussed below. The interrelationship between the three items is, however, extremely important because the Share Reissuance Mandate extends the board's authority to issue shares without preemptive rights from 20 percent to 30 percent, assuming a 20 percent request has been made under the General Issuance Mandate.

Hong Kong companies routinely ask shareholders to grant the board of directors a "general mandate to issue shares" without preemptive rights, at least once every year. This mandate, pursuant to the Listing Rules, allows companies to issue shares of up to 20 percent of issued capital without preemptive rights at a discount to market prices of up to 20 percent (or more under special circumstances). This is a routine item on AGM agendas, but companies can also seek to renew (or 'refresh') the share issuance amount at an EGM later in the year. The authority is limited to one year or the next general meeting, as revoked or renewed by shareholders.

In recent years, many institutional investors have voted against all requests to issue shares without preemptive rights in Hong Kong as this mandate is subject to abuse by companies that could issue shares at steep discounts, potentially to related parties, and renew the share issuance amount several times within a period of one year. A small number of Hong Kong companies have, recently, made mandate requests smaller than the 20 percent maximum that the Listing Rules allow.

Taking account of the views of a wide range of institutional investors with investments in Hong Kong companies, ISS will now recommend a vote supporting the General Issuance Mandate for companies that:

- Limit the aggregate issuance request – that is, for the General Issuance Mandate and the Share Reissuance Mandate combined – to 10 percent or less of the existing issued share capital (rather than the maximum 20 percent + 10 percent that the Listing Rules permit companies to request);
- Limit the discount to 10 percent of the market price of shares (rather than the maximum 20 percent permitted by the Listing Rules); and
- Have no history of renewing the General Issuance Mandate several times within a period of one year.

Key Changes: Clarify that the 10 percent limit regarding General Issuance Mandates applies to the relevant class of shares.

New Recommendation: Generally vote for the general issuance mandate for companies that:

- Limit the aggregate issuance request – that is, for the general issuance mandate and the share reissuance mandate combined – to 10 percent or less of the relevant class of issued share capital;
- Limit the discount to 10 percent of the market price of shares; and
- Have no history of renewing the General Issuance Mandate several times within a period of one year.

Rationale for Update:

In some cases, issuers with different classes of shares (Mainland-listed A shares, unlisted Domestic shares, and Hong Kong-listed H shares) seek a general issuance mandate for a specific class of shares only. The updated policy clarifies that the 10 percent limit under the general issuance mandate is applied to the relevant class of shares.

General Issuance Requests (Singapore)

Current Recommendation:
Share issuance authorizations are good for only one year. The listing manual of the SGX, as amended in 1999, allows companies to seek an annual mandate for the issuance of ordinary shares up to 50 percent of issued capital, with a sub-limit of 20 percent of issued capital on shares that may be issued without preemptive rights. Most companies seek such a mandate every year, to prevent the need to convene a shareholder meeting for each share issuance, however small. ISS believes shareholders should have preemptive rights for large stock issuances, but also believes companies should have the flexibility to transact ordinary business and should not have to incur the extra expense of providing preemptive rights for small issuances.

Key Changes:

- Reduce share issuance without preemptive rights limit from 20 percent to 10 percent for Mainboard-listed companies;
- Adopt a 20 percent share issuance limit for Catalist-listed companies.

New Recommendation: For companies listed on the Mainboard of the Singapore Exchange, generally vote for a general issuance of equity or equity-linked securities without preemptive rights when the share issuance limit is not more than 10 percent of the company's issued share capital and 50 percent with preemptive rights.

For companies listed on the Catalist market of the SGX, generally vote for a general issuance of equity or equity-linked securities without preemptive rights when the share issuance limit is not more than 20 percent of the company's issued share capital and 100 percent with preemptive rights.

Discussion

The listing manual of the SGX allows companies to seek an annual mandate for the issuance of ordinary shares up to 50 percent of issued capital for issuance with preemptive rights and 20 percent without preemptive rights for Mainboard-listed companies and 100 percent with preemptive rights and 50 percent without preemptive rights for Catalist-listed companies. Most companies seek such a mandate every year, to prevent the need to convene a shareholder meeting for each share issuance, however small.

Rationale for Update:

Companies should have flexibility to issue shares, but the granting of a general authority to issue shares creates risks of dilution to shareholders. Therefore, the need for flexibility must be balanced with providing reasonable protection for shareholder interests. Many investors view the maximum issuance limit provided under the SGX listing manual to be too high, a view echoed during ISS' policy roundtables held in Hong Kong and Singapore. Roundtable participants generally agreed that ISS should lower the maximum limit on share issuance requests in Singapore. There was a general consensus among the participants on the 10 percent limit for Mainboard-listed companies and 20 percent limit for Catalist-listed companies, while some believe that a more stringent standard is appropriate.

The 10 percent limit for Mainboard-listed companies under the updated policy is in line with ISS' policy currently applied on Hong Kong companies. The 10 percent limit is also the maximum limit allowed under local regulations in Malaysia and Thailand. Further, the CFA institute recently released a report highlighting the lack of minority shareholder protections in the region, including Singapore, calling for lower share issuance limits such as the 5 percent annual limit and 7.5 percent rolling three-year limit adopted in the U.K. Additionally, some blue-chip companies have voluntarily adopted a lower threshold, including Singapore Telecom, Sembcorp Industries, and Keppel Corporation which have all adopted a share issuance limit of 5 percent without preemptive rights.

The Catalist market is primarily for start-up companies and thus companies listed on Catalist are likely to need to rely more heavily on equity financing than Mainboard-listed companies. As such, a higher dilution limit is justified, but the 50 percent limit for share issuance without preemptive rights allowed under the listing manual creates significant risk of dilution. The 20 percent cap for Catalist-listed companies should be sufficient to meet most capital needs, and companies could always seek specific approval for issuance exceeding this limit. Additionally, this limit is in line with ISS' policy in applicable markets that includes a 20 percent share issuance limit regarding general issuances without preemptive rights.

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