United States

Proxy Voting Guidelines Updates

2016 Catholic Faith-Based Policy Updates

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BOARD OF DIRECTORS- VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

Unilateral Bylaw/Charter Amendments

Current Catholic Advisory Services Recommendation: Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors, as applicable:

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

Key Changes:

- Separate the methodology for evaluating adoptions of bylaw or charter provisions made prior to or in connection with a company's initial public offering from the methodology for evaluating unilateral board amendments to the bylaws or charter made following completion of a company's initial public offering, and
- Explicitly state that Catholic Advisory Services will consider both such actions in determining vote recommendations for director nominees until such time as the actions are reversed or submitted to a binding vote of public shareholders.

New General Recommendation:

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

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

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

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

For newly public companies, generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopts bylaw or charter provisions adverse to shareholders' rights, considering the following factors:

- The level of impairment of shareholders' rights caused by the provision;
- The company's or the board's rationale for adopting the provision;
- The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholder right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and,
- A public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering.

Unless the adverse provision is reversed or submitted to a vote of public shareholders, vote case-by-case on director nominees in subsequent years.

Rationale for Update:

This update clarifies the Catholic faith-based policy and aligns Catholic Advisory Services ' approach to evaluating unilateral bylaw and charter amendments by pre-IPO companies and post-IPO company board members with feedback received from institutional investors. This update also establishes separate methodologies to evaluate adoptions of bylaw or charter provisions made prior to or in connection with a company's initial public offering and unilateral board amendments made to the bylaws or charter following completion of a company's initial public offering. This bifurcation reflects the differing expectations that investors may have for the governance structures of a newly-public company versus a company that has been public for some period of time.

At companies that are already public, investors have seen a marked increase in moves by boards to circumvent votes by unilaterally amending their companies' governing documents—usually the bylaws—to reduce shareholders' rights. While ISS tracked 10 such cases in 2013 (the historic norm in terms of volume), unilateral adoptions jumped to 64 in 2014, and there have been 62 thus far in 2015.

A majority of investor respondents to the ISS 2015–2016 policy survey favor adverse vote recommendations for director nominees when a board unilaterally adopts bylaw or charter amendments that "materially diminish" shareholders' rights until such time as the rights are restored. Both investor and non-investor respondents identify "classifying the board" and "establishing supermajority vote requirements for bylaw/charter amendments" as the unilateral actions for which continuing adverse vote recommendations would be most appropriate.

A significant percentage of recent IPOs have included provisions that limit board accountability to post-IPO investors and make it difficult for shareholders to amend the company's governing documents or take other corporate actions. While some pre-IPO boards argue that these governance structures will benefit investors over the long run, few of them provide opportunities for post-IPO shareholders to ratify these provisions. Notably, the lion's share of recent IPO firms have limited directors' accountability to shareholders by staggering board terms (via classified boards) and adopting supermajority vote provisions to amend the firms' governing documents. A law firm analysis of governance practices at more than 400 “emerging growth companies” that completed their IPOs in the period from Jan. 1, 2013, through Dec. 31, 2014, for example, found that 69 percent of these firms went public with classified boards and nearly three-quarters had supermajority vote requirements in place.[1] A separate law firm analysis of large IPOs at 46 non-controlled companies for the Sept. 1, 2001, to Oct. 31, 2013, period, found that 70 percent of the boards had staggered terms and 70 percent of the firms required supermajority votes to amend their bylaws.[2]

Overboarded Directors

Current Catholic Advisory Services Recommendation: Vote against or withhold from individual directors who:

- Sit on more than six public company boards; or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own—withhold only at their outside boards[3].

Key Changes:

- In 2016, Catholic Advisory Services will note in its analysis if a director is serving on more than five (5) public company boards.
- Starting in February of 2017, Catholic Advisory Services will recommend against directors who sit on more than five (5) public company boards.

New General Recommendation: Vote against or withhold from individual directors who:

- Sit on more than six public company boards; for meetings on or after Feb. 1, 2017[4], sit on more than five public company boards; or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own—withhold only at their outside boards[3].

Rationale for Update:

More than a decade ago, in response to rising investor concerns about over-boarding and academic research questioning the performance of “busy” directors, Catholic Advisory Services set limits of six directorships for most board members and three total board memberships (service on the home company board and two outside directorships) for sitting CEOs.

Since these limits were adopted, the average time commitment for board service has exploded. According to the National Association of Corporate Directors’ (NACD) 2014-2015 Public Company Governance Survey, respondent directors of public companies now spend an average of 242 hours a year (or more than 30 eight-hour work days annually) on board service. This typical time commitment jumps up to 278 hours (or nearly five more eight-hour work days) when you add in the survey respondents’ estimates of additional time spent in informal meetings/conversations

[1] Morrison & Foerster, Getting the Measure of EGC Corporate Governance Practices: A survey and related resources, 2015.
[2] Davis Polk &Wardwell, Corporate Governance Practices in U.S. Initial Public Offerings (Excluding Controlled Companies, Jan, 2014.
[3] Although all of a CEO’s subsidiary boards will be counted as separate boards, Catholic Advisory Services will not recommend a withhold vote from the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships.
[4] This policy change includes a 1-year transition period to allow time for affected directors to address necessary changes if they wish.

with management. In contrast, the average annual director time commitment reported by NACD's survey respondents in 2005 was 190 hours (or fewer than 24 eight-hour work days).

Recent academic research generally shows a negative association between board "busyness" and firm performance and director attendance at board meetings[5]. Notably, the authors of most of these studies define a "busy" director's workload as three or more boards.

Many boards have responded to concerns about overboarding by placing limits on the number of public company directorships that that their members may hold. Some boards appear to address time commitment concerns via their nominating panels. Spurred by these policies and common sense, most board members limit their board seats to four or fewer directorships.

Catholic Advisory Services has periodically updated its overboarding policy since it was implemented in 2004, to incorporate the evolving market realities. The new policy aligns with feedback and research received from institutional investors as well as the issuer community (via our 2015-2016 policy survey and roundtable discussions) regarding the ability of a director to devote sufficient time to each board commitment. Based on that feedback as well as draft policy comments, Catholic Advisory Services will continue evaluating the optimal level of directorships for individuals who are CEOs of public companies.

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

Current General Recommendation: Vote case-by-case on the election of directors in contested elections, considering the following factors:

- Long-term financial performance of the target company relative to its industry;
- Management's track record;
- Background to the proxy contest;
- Nominee qualifications and any compensatory arrangements;
- Strategic plan of dissident slate and quality of critique against management;
- Likelihood that the proposed goals and objectives can be achieved (both slates);
- Stock ownership positions;
- Impact on stakeholders, such as job loss, community lending, equal opportunity, impact on environment.

Key Changes:

- Clarifying a policy analysis framework to evaluate candidates nominated pursuant to proxy access as well as nominees in a proxy contest.
- While several factors may be similar in each evaluation, there may be factors that are unique to analyzing proxy access nominations.

New General Recommendation: Vote case-by-case on the election of directors in contested elections, considering

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[5] Cashman, George D. and Gillan, Stuart and Jun, Chulhee, Going Overboard? On Busy Directors and Firm Value (March 1, 2012). Available at SSRN: http://ssrn.com/abstract=2044798 or http://dx.doi.org/10.2139/ssrn.2044798; Falato, Antonio and Kadyrzhanova, Dalida and Lel, Ugur, Distracted Directors: Does Board Busyness Hurt Shareholder Value? (December 10, 2013). Available at SSRN: http://ssrn.com/abstract=2272478 or http://dx.doi.org/10.2139/ssrn.2272478; Jiraporn, Pornsit and Davidson, Wallace N. and Ning, Yixi and DaDalt, Peter J., Too Busy to Show Up? An Analysis of Directors' Absences (January 21, 2008). Available at SSRN: http://ssrn.com/abstract=1254642 or http://dx.doi.org/10.2139/ssrn.1254642

the following factors:

- Long-term financial performance of the target company relative to its industry;
- Management's track record;
- Background to the contested election;
- Nominee qualifications and any compensatory arrangements;
- Strategic plan of dissident slate and quality of critique against management;
- Likelihood that the proposed goals and objectives can be achieved (both slates); and
- Stock ownership positions.

In the case of candidates nominated pursuant to proxy access, vote case-by-case considering any applicable factors listed above or additional factors which may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether or not there are more candidates than board seats).

Rationale for Update:

This policy revision provides an analytical framework for evaluating candidates nominated pursuant to proxy access. Catholic Advisory Services has a policy for evaluating director nominees in contested elections, which currently applies to proxy contests as well as proxy access nominations. However, the circumstances and motivations of a proxy contest and a proxy access nomination may differ significantly. Therefore, it is necessary to create adequate analytical latitude for evaluating candidates nominated through proxy access.

Proxy access rights have grown into a high-visibility corporate governance issue for US-listed companies. In 2014, Catholic Advisory Services evaluated 18 shareholder proposals seeking proxy access rights. That number rose to more than 90 in 2015. Further, while five of the proposals received majority support in 2014, 52 have received majority support so far in 2015. Moreover, following the 2015 US proxy season, numerous companies have unilaterally adopted proxy access rights, even in the absence of majority-supported shareholder proposals.

While it is unlikely that many (or perhaps any) proxy access nominees will materialize in 2016, Catholic Advisory Services believes it is prudent to update its framework for evaluating candidates nominated via proxy access right. In some cases, the nominating shareholder's views on the current leadership or company strategy may be opposed to the existing board's views. Alternatively, a shareholder nominator may generally agree with the company's strategy or have no specific critiques of incumbent directors, but may propose an alternative candidate to address a specific concern, such as board diversity or boardroom skills gaps.

COMPENSATION

Advisory Votes on Executive Compensation— Problematic Pay Practices

Insufficient Executive Compensation Disclosure by Externally Managed Issuers

Current General Recommendation: None.

Currently, insufficient disclosure regarding compensation arrangements for executives at an externally-managed issuer (EMI) is not considered a problematic pay practice under the Catholic policy. Absent any other significant concerns identified, Catholic Advisory Services has generally not issued adverse say-on-pay recommendations on this basis. Catholic Advisory Services does raise concerns, however, regarding the lack of transparency resulting when an EMI provides a say-on-pay proposal without information that enables investors to make an informed voting decision on the proposal.

Key Changes: Update the Problematic Pay Practice policy, add "Insufficient Executive Compensation Disclosure by Externally Managed Issuers (EMIs)" to the list of practices that may result in an adverse recommendation on the advisory vote on executive compensation. This refers to an EMI's failure to provide sufficient disclosure to enable shareholders to make a reasonable assessment of compensation arrangements for the EMI's named executive officers.

New General Recommendation: For externally-managed issuers (EMIs), generally vote against the say-on-pay proposal when insufficient compensation disclosure precludes a reasonable assessment of pay programs and practices applicable to the EMI's executives.

Rationale for Update:

Lack of Disclosure Precludes a Reasonable Assessment of Executive Compensation Arrangements

Like most U.S. public companies, EMIs are subject to periodic, advisory say-on-pay vote requirements. However, an EMI typically does not directly compensate its executives. Instead, executives are compensated by the external manager, which is reimbursed by the EMI through a management fee.

EMIs typically do not disclose any details about their compensation arrangements or payments made to executives by external managers. Many EMIs do not provide even basic disclosure regarding executive compensation arrangements and payments between the external manager and the EMI's executives. When “executive compensation information” is disclosed, it is usually limited to the aggregate management fee paid by the EMI to its manager. Without adequate information, shareholders are unable to conduct a reasonable assessment of executive compensation arrangements in order to identify potentially problematic aspects of those arrangements and to make an informed decision when voting on the EMI's say-on-pay proposal.

Some EMIs provide disclosure about the value and nature of NEOs' compensation arrangements in sufficient detail to enable shareholders to reasonably assess the arrangements and cast an informed vote on the EMI's say-on-pay proposal. Some EMIs, for example, disclose the aggregate portion of such fees that is allocable to executive compensation expenses. A small number of EMIs disclose detailed information on behalf of their external managers. This enhanced transparency demonstrates that such information can be made available within the constraints of company agreements with external managers.

As such, Catholic Advisory Services will consider insufficient disclosure regarding compensation arrangements between executives and the external manager to be a problematic practice that warrants an AGAINST recommendation on the say-on-pay proposal.

Hold Equity Past Retirement or for a Significant Period of Time

Current General Recommendation: Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain all or a significant portion of the shares acquired through compensation plans, either:

- while employed and/or for two years following the termination of their employment ; or
- for a substantial period following the lapse of all other vesting requirements for the award (“lock-up period”), with ratable release of a portion of the shares annually during the lock-up period.

The following factors will be taken into account:

- Whether the company has any holding period, retention ratio, or officer ownership requirements in place. These should consist of:
  - Rigorous stock ownership guidelines;

  - A holding period requirement coupled with a significant long-term ownership requirement; or
  - A meaningful retention ratio;
- Actual officer stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's own stock ownership or retention requirements;
- Post-termination holding requirement policies or any policies aimed at mitigating risk taking by senior executives;
- Problematic pay practices, current and past, which may promote a short-term versus a long-term focus.

A rigorous stock ownership guideline should be at least 10x base salary for the CEO, with the multiple declining for other executives. A meaningful retention ratio should constitute at least 50 percent of the stock received from equity awards (on a net proceeds basis) held on a long-term basis, such as the executive's tenure with the company or even a few years past the executive's termination with the company.

Generally vote against shareholder proposals that mandate a minimum amount of stock that directors must own in order to qualify as a director or to remain on the board. While Catholic Advisory Services favors stock ownership on the part of directors, the company should determine the appropriate ownership requirement.

Key Changes:

- Broaden policy to encompass executive equity retention proposals more generally, eliminating the need for a separate policy covering proposals seeking retention of 75% of net shares.
- Clarify that the proposed retention ratio and the required duration of retention are some of the several factors that will be considered in Catholic Advisory Services' case-by-case analysis.

New General Recommendation: Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain a portion of net shares acquired through compensation plans. The following factors will be taken into account:

- The percentage/ratio of net shares required to be retained;
- The time period required to retain the shares;
- Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
- Whether the company has any other policies aimed at mitigating risk taking by executives;
- Executives' actual stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's existing requirements; and
- Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.

Rationale for Update:

This policy update clarifies the factors considered in Catholic Advisory Services' case-by-case analysis. It also broadens the policy to encompass equity retention proposals more generally, thereby eliminating the need for a separate policy tied to a specified retention ratio.

Specifically, the revised policy clarifies that the proponent's suggested retention percentage/ratio and the required retention duration are two of the several factors to be assessed under Catholic Advisory Services' case-by-case approach. This change eliminates the need for separate policies tied to specified retention ratios (i.e. a separate policy for proposals requesting 75% net share retention), since the retention ratio is a factor to be considered for every proposal. In more clearly identifying the factors and eliminating repetitive language, the new policy is more streamlined and easier to understand.

ENVIRONMENTAL AND SOCIAL ISSUES

Animal Welfare

Current Catholic Advisory Services Recommendation:

- Vote for shareholder proposals that seek to limit unnecessary animal testing where alternative testing methods are feasible or not barred by law.
- Vote for shareholder proposals that ask companies to adopt or/and report on company animal welfare standards.
- Vote for shareholder proposals asking companies to report on the operational costs and liabilities associated with selling animals.
- Vote for shareholder proposals to eliminate cruel product testing methods.
- Vote for shareholder proposals that seek to monitor, limit, report, or eliminate the outsourcing of animal testing to overseas laboratories.
- Vote for shareholder proposals to adopt or adhere to a public animal welfare policy at both company and contracted laboratory levels.
- Vote for shareholder proposals to evaluate, adopt, or require suppliers to adopt Controlled Atmosphere Killing (CAK) slaughter methods.

Key Changes:

- Add "or animal welfare-related risks" to the second bullet point.

New Catholic Advisory Services Recommendation:

- Vote FOR shareholder proposals that seek to limit unnecessary animal testing where alternative testing methods are feasible or not barred by law.
- Vote FOR shareholder proposals that ask companies to adopt or/and report on company animal welfare standards or animal-related risks.
- Vote FOR shareholder proposals asking companies to report on the operational costs and liabilities associated with selling animals.
- Vote FOR shareholder proposals to eliminate cruel product testing methods.
- Vote FOR shareholder proposals that seek to monitor, limit, report, or eliminate the outsourcing of animal testing to overseas laboratories.
- Vote FOR shareholder proposals to adopt or adhere to a public animal welfare policy at both company and contracted laboratory levels.
- Vote FOR shareholder proposals to evaluate, adopt, or require suppliers to adopt Controlled Atmosphere Killing (CAK) slaughter methods.

Rationale for Update:

In 2014, some proponents began submitting shareholder proposals requesting reports on the risks associated with the use of certain methods of animal housing (e.g. gestation crates and battery cages) and other animal welfare practices deemed inhumane in a company’s supply chain. The updated policy clarifies that proposals requesting a report on animal welfare-related risks, including the aforementioned resolutions on supply chain risks, are analyzed under this policy.

Climate Change/Greenhouse Gas (GHG) Emissions

Current Catholic Advisory Services Recommendation:

- Vote FOR shareholder proposals seeking disclosure of liabilities or preparation of reports pertaining to global warming and climate change risk.
- Vote FOR shareholder proposals calling for the reduction of GHG or adoption of GHG goals in products and operations.
- Vote FOR shareholder proposals seeking reports on responses to regulatory and public pressures surrounding climate change, and for disclosure of research that aided in setting company policies around climate change.
- Vote FOR shareholder proposals requesting reports on greenhouse gas emissions from companies' operations and/or products.

Key Changes:

Add "such as financial, physical, or regulatory risks" to the first bullet point.

New Catholic Advisory Services Recommendation:

- Vote FOR shareholder proposals seeking disclosure of liabilities or preparation of reports pertaining to global warming and climate change-related risks, such as financial, physical, or regulatory risks.
- Vote FOR shareholder proposals calling for the reduction of GHG or adoption of GHG goals in products and operations.
- Vote FOR shareholder proposals seeking reports on responses to regulatory and public pressures surrounding climate change, and for disclosure of research that aided in setting company policies around climate change.
- Vote FOR shareholder proposals requesting reports on greenhouse gas emissions from companies' operations and/or products.

Rationale for Update:

During the 2015 proxy season, proponents filed new shareholder proposals addressing companies' capital expenditure strategies as they relate to investments in fossil fuel and stranded carbon asset risk (investment in high-cost, high-carbon assets could be stranded, as global demand for fossil fuels slows in the coming years and/or potential climate change regulations make them unburnable). These resolutions asked companies to either report on the consistency of their capital expenditure strategies with policymakers' goals to limit greenhouse gas emissions, or a company's strategy to address the risk of stranded assets presented by global climate change and associated demand reductions for oil and gas.

The revisions to the current policy clarify the types of risks related to climate change that can impact a company's operations and investments. It also clarifies that the capital expenditure strategy and stranded carbon asset resolutions are evaluated pursuant to this policy.

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