United States

Public Fund
Proxy Voting Guidelines Updates

2016 Policy Recommendations

Published January 27, 2016

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BOARD OF DIRECTORS- VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

Unilateral Bylaw/Charter Amendments

Current 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, 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 Public Fund 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.

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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 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,

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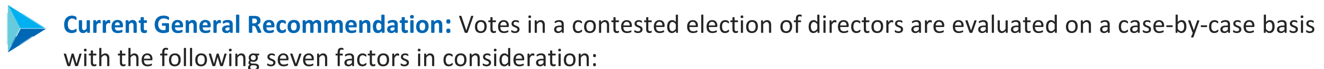
through Dec. 31, 2014, for example, found that 69 percent of these firms went public with classified boards and nearly three-quarters had supermajority vote requirements in place.[1] A separate law firm analysis of large IPOs at 46 non-controlled companies for the Sept. 1, 2001, to Oct. 31, 2013, period, found that 70 percent of the boards had staggered terms and 70 percent of the firms required supermajority votes to amend their bylaws.[2]

PROXY CONTESTS/PROXY ACCESS — VOTING FOR DIRECTOR NOMINEES IN CONTESTED ELECTIONS

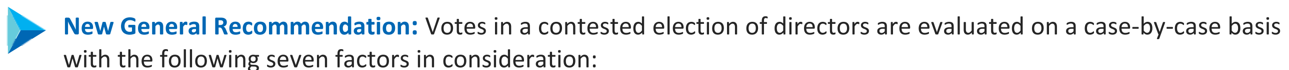


Current General Recommendation: Votes in a contested election of directors are evaluated on a case-by-case basis with the following seven factors in consideration:

- Long-term financial performance of the target company relative to its industry;
- Management's track record;
- Background to the proxy contest;
- Qualifications of director nominees (both slates);
- 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.

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: Votes in a contested election of directors are evaluated on a case-by-case basis with the following seven factors in consideration:

- 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).

[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.

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Rationale for Update:

This policy revision provides an analytical framework for evaluating candidates nominated pursuant to proxy access. Public Fund 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, Public Fund 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, Public Fund 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

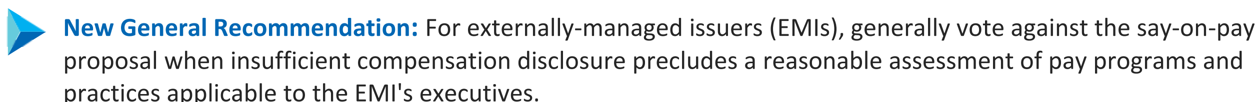
Advisory Votes on Executive Compensation— Problematic Pay Practices

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 Public Fund Advisory Services policy. Absent any other significant concerns identified, Public Fund Advisory Services has generally not issued adverse say-on-pay recommendations on this basis. Public Fund 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 Compensation Practices 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.

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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, Public Fund 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.

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