International

SRI Proxy Voting Guidelines Updates

2016 Policy Recommendations

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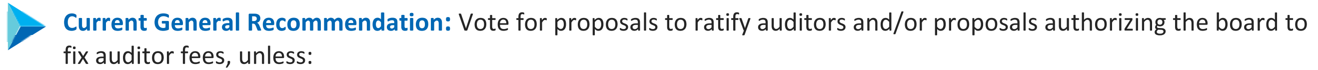
OPERATIONAL ITEMS

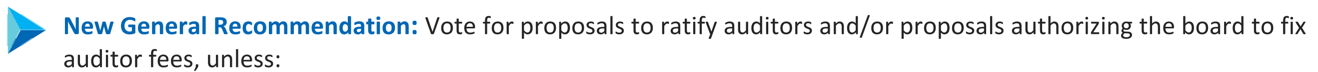
Appointment of Auditors and Auditor Fees



Current General Recommendation: Vote for proposals to ratify auditors and/or proposals authorizing the board to fix auditor fees, unless:

- For companies on the local main index or MSCI-EAFE index, fees for non-audit services exceed either 100 percent of standard audit-related fees or any stricter limit set in local best practice recommendations or law.

Key Changes: Henceforth, the policy will be applied to all widely-held companies.



New General Recommendation: Vote for proposals to ratify auditors and/or proposals authorizing the board to fix auditor fees, unless:

- For widely-held companies, fees for non-audit services exceed either 100 percent of standard audit-related fees or any stricter limit set in local best practice recommendations or law.

Rationale for Update:

Excessive fees generated from non-audit services may pose a potential conflict of interest for the audit firm and interfere with its independent judgment. The proportion of non-audit fees compared to audit fees receives increasingly high scrutiny both from investors and regulators.

This expansion of policy application was already foreseen at the time of introduction of this policy; furthermore, over the past few years, Social Advisory Services has been including warning language in its reports flagging excessive non-audit fees as an area of concern for all core companies.

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ELECTION OF DIRECTORS

Overboarding (Canada)

Current General Recommendation: Generally vote withhold for individual director nominees if:

- Irrespective of whether the company has adopted a majority voting policy, the director is overboarded AND the individual director has attended less than 75 percent of his/her respective board and committee meetings held within the past year without a valid reason for these absences.

Key Changes:

- Change the definition of "overboarded" from more than 2 outside public company boards to more than 1 in the case of CEOs, and from more than 6 total public company boards to more than 4 in the case of non-CEOs.
- This updated definition will be effective commencing with February 1, 2017 meeting dates.

New General Recommendation: Generally vote withhold for individual director nominees if:

- Irrespective of whether the company has adopted a majority voting policy, the director is overboarded[6,1] AND the individual director has attended less than 75 percent of his/her respective board and committee meetings held within the past year without a valid reason for these absences.

Cautionary language will be included in SRI reports where directors are overboarded regardless of attendance.

Rationale for Update:

Directors need sufficient time and energy in order to be effective representatives of shareholders' interests. Directors' responsibilities are increasingly complex as board and key committee memberships demand greater time commitments.

In a 2014 study, 120 board chairs, directors and CEOs across Canada were surveyed regarding their annual time commitment per board on which they served. The survey found that the average annual time commitment per board for a Canadian director was 304 hours. This number was higher for directors of companies with a market cap over $5 billion (388 hours) and also higher for those with a market cap between $1 billion and $5 billion (335 hours). There was also a correlation between the role of a director and average annual time commitment. As expected, being a board chair is the most time consuming role; however, being a committee chair can be almost as time consuming.

While it appears that no comparable studies were conducted for previous years in Canada, according to a 2014-2015 US survey conducted by the National Association of Corporate Directors (NACD), directors of US public companies spent an annual average of 278 hours on board-related matters.

Based on the results of the 2015-16 ISS Global Policy Survey, a plurality of investor responses indicated that four total board seats is an appropriate limit for directors who are not active CEOs, and that a total of two board seats (a CEO's "home board" plus one outside board) is an appropriate limit for directors who are active CEOs.

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[1] Starting February 1, 2017, "overboarded" will be defined as: a CEO of a public company who sits on more than 1 outside public company board in addition to the company of which he/she is CEO (withholds would only apply on outside boards these directors sit on), OR the director is not a CEO of a public company and sits on more than 4 public company boards in total.

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ISS also obtained feedback in one-on-one discussions with institutional investors, the results of which indicate that a majority of those canvassed support maximum limits of four and two total board seats for non-CEO directors and CEO directors, respectively. These limits are reasonable in light of the "double-trigger" approach of jointly evaluating both number of board seats and attendance under Canadian policy.

Externally-Managed Issuers (EMIs) –TSX and TSXV

Current General Recommendation: None.

Key Changes:

Provide a framework for reviewing board accountability at EMIs, in cases where disclosure is limited or insufficient with respect to the management services agreement and how senior management is compensated.

New General Recommendation: Vote case-by-case on say-on-pay resolutions where provided, or on individual directors, committee members, or the entire board as appropriate, when an issuer is externally-managed and has provided minimal or no disclosure about their management services agreements and how senior management is compensated. Factors taken into consideration may include but are not limited to:

- The size and scope of the management services agreement;
- Executive compensation in comparison to issuer peers and/or similarly structured issuers;
- Overall performance;
- Related party transactions;
- Board and committee independence;
- Conflicts of interest and process for managing conflicts effectively;
- Disclosure and independence of the decision-making process involved in the selection of the management services provider;
- Risk mitigating factors included within the management services agreement such as fee recoupment mechanisms;
- Historical compensation concerns;
- Executives' responsibilities; and
- Other factors that may reasonably be deemed appropriate to assess an externally-managed issuer's governance framework.

Rationale for Update:

Externally-managed issuers (EMIs) typically pay fees to outside firms in exchange for management services. In most cases, some or all of the EMI's executives are directly employed and compensated by the external management firm.

EMIs typically do not disclose details of the management agreement in their proxy statements and only provide disclosure on the aggregate amount of fees paid to the manager, with minimal or incomplete compensation information.

Say-on-pay resolutions are voluntarily adopted in Canada, and none of the currently identified Canadian EMIs had a say-on-pay resolution on ballot this past year. Additionally, all non-controlled TSX-listed issuers are required to adopt majority voting director resignation policies which could result in a director being required to resign from a board if he or she receives more 'withhold' than 'for' votes at the shareholders' meeting. Some investor respondents to ISS' 2015-16 ISS Global Policy Survey indicated that in cases where an externally managed company does not have a say-on-pay proposal (i.e., 'withhold' votes may be recommended for individual directors), factors other than disclosure should be considered, such as performance, compensation and expenses paid in relation to peers, board and committee

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independence, conflicts of interest, and pay-related issues. Policy outreach sessions conducted with Canadian institutional investors resulted in identical feedback.

Director Independence - Classification of Directors- Middle East and Africa (MEA)

Current Classification: Social Advisory Services does not currently provide independence classification of directors of companies incorporated in Middle East and African (MEA) markets.

Key Changes:

Establish criteria for the independence classification of directors at widely-held companies incorporated in MEA markets.

New Classification: Included the following footnotes under Classification of Directors – International Policy 2015

...

[6] For purposes of independence classification of directors incorporated in the Middle East and Africa region, this criterion will be taken into account in accordance with market best practice and disclosure standards and availability.

[7] For MEA markets, directors' past services as statutory auditor/partner of the statutory audit firm will be taken into account, with cooling-off periods in accordance with local market best practice.

Rationale for Update:

Director independence is a major concern in Middle East and African (MEA) markets. This is due to the prevalence in the region of companies with concentrated ownership. A substantial number of local market corporate governance codes and regulations set requirements on the minimum number or proportion of independent directors on boards and key committees, reflecting a tightening of governance requirements in several markets in the region during recent years.

The update is intended to reflect the improving governance and disclosure frameworks. Social Advisory Services' analysis will focus on the most relevant non-independence criteria in light of the level of stringency of local governance guidelines on director independence, as well as local corporate disclosure standards on directors' background, directorships, and affiliations.

Cumulative Voting – Middle East and Africa (MEA)

Current General Recommendation: Cumulative voting in MEA is not currently addressed in the current Election of Directors policy.

Key Changes:

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- Supplement current policy to address director elections through cumulative voting in MEA, whether the number of nominees is equal to the number of board seats or not. In the context of director elections by cumulative voting, shareholders do not vote against any nominee, but rather support some of the nominees. This is an important distinction, as, in some cases, shareholders may choose to support not all, but rather a limited number of nominees.
- These criteria may also apply to other types of election processes (such as majority voting), in cases where the number of nominees up for (re)election exceeds the number of available board seats.

New General Recommendation:

For MEA markets, in cases where:

- Directors are proposed for (re)election through a cumulative voting system, or
- Director elections do not take place through a cumulative voting system, but the number of nominees up for (re)election exceeds the number of board vacancies,

Social Advisory Services will recommend a vote on a case-by-case basis, considering additional factors, for the purpose of identifying the best suited nominees to add value for shareholders. Positive vote recommendations will be issued preferentially in favor of the following categories of candidates:

- Candidates who can be identified as representatives of minority shareholders of the company, or independent candidates, namely:
  - Candidates who can be classified as independent according to Social Advisory Services' policy, or, failing that,
  - Candidates explicitly classified as independent per the company's director classification.

- Candidates whose professional background may have the following benefits:
  - Increasing the diversity of incumbent directors ' professional profiles and skills (thanks to their financial expertise, international experience, executive positions/directorships at other listed companies, or other relevent factors.
  - Bringing to the current board of directors relevant experience in areas linked to the company's business, evidenced by current or past board memberships or management functions at other companies.

- Incumbent board members and candidates explicitly supported by the company's management.

Rationale for Update:

A cumulative voting system is recommended under a number of local corporate governance regulations in the MEA region. Under a cumulative voting system, each share represents a number of votes equal to the size of the board that will be elected. These votes may be apportioned equally among the candidates, or, if a shareholder wishes to exclude some nominees, among the desired candidates.

The new policy is primarily to help shareholders benefit from the cumulative voting system by favoring the (re)election, when possible, of the board candidates who are more likely to act in the best interest of all shareholders or to add value to the board.

CAPITAL STRUCTURE

Share Issuance Requests

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Singapore – Real Estate Investment Trusts

Current General 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.

Key Changes:

Establish a policy specifically for share issuances by Real Estate Investment Trusts.

New General Recommendation: 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 all Singapore companies, with the exception of Catalist-listed companies and Real Estate Investment Trusts.

For Singapore 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. For Real Estate Investment Trusts, generally vote for a general issuance of equity or equity-linked securities without preemptive rights when the unit issuance limit is not more than 20 percent of its issued unit capital and 50 percent with preemptive rights.

Rationale for Update:

Singapore-incorporated companies routinely seek shareholder approval of a general mandate for the issuance of ordinary shares with or without preemptive rights. This policy update clarifies the applicable policy for these companies, including Singapore-incorporated companies that are listed offshore.

Currently, there are 33 Real Estate Investment Trusts (REITs) listed in Singapore. REITs in Singapore are required by the country's Inland Revenue Authority to distribute at least 90 percent of distributable income to unitholders, in order to enjoy tax-exempt status. Given the required percentage of distribution, the current Social Advisory Services policy for non-preemptive unit issuance limit of 10 percent is deemed to be too restrictive to the REITs' growth in terms of acquisition of properties.

In October 2014, the Monetary Authority of Singapore issued a consultation paper *Enhancements to the Regulatory Regime Governing REITs and REIT Managers*. The initiative was meant to provide REIT managers with increased operational flexibility while imposing measures to better protect unitholders and strengthen accountability.

Market players generally welcome the suggestion of giving greater operational flexibility to REIT managers, although some respondents raised concerns over potential changes in the risk profile of REITs. In view of the regulator's consultation proposal and the market response, Social Advisory Services' limit on REIT unit issuance under the general mandate is being aligned with relevant code provisions, in an attempt to promote operational flexibility for REIT managers while keeping intact the risk profile of such trusts.

Malaysia

Current General Recommendation: Generally vote for issuance requests with preemptive rights to a maximum of 100 percent over currently issued capital.

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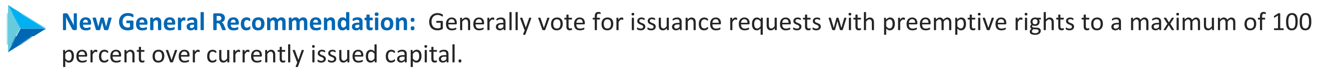
Vote for issuance requests without preemptive rights to a maximum of 20 percent of currently issued capital.

Key Changes:

For Malaysia, the cap for general share issuance mandates will be reduced from 20 percent to 10 percent of currently issued capital, except for real estate investment trusts (REITs) which will remain at 20 percent of currently issued capital.



New General Recommendation: Generally vote for issuance requests with preemptive rights to a maximum of 100 percent over currently issued capital.

Vote for issuance requests without preemptive rights to a maximum of 20 percent of currently issued capital.

Malaysia:

For companies listed on the Main Market and ACE Market of the Bursa Malaysia Securities Bhd (Exchange), vote for issuance requests without preemptive rights to a maximum of 10 percent of currently issued capital.

For real estate investment trusts (REITs), vote for issuance requests without preemptive rights to a maximum of 20 percent of currently issued capital.

Rationale for Update:

The policy change is to align the general share issuance mandate policy with local regulations. Section 132D of the Companies Act, 1965 prohibits share issuances, except with shareholder approval. Such approval is valid until the conclusion of the next annual general meeting (AGM). In addition, Chapter 6.03 Part C of the Listing Requirements of the Exchange prohibits share issuances which, when aggregated with issuances during the preceding 12 months, exceed 10 percent of currently issued capital. Any share issuance exceeding 10 percent of currently issued capital requires separate shareholder approval of the specific terms and condition of such issue.

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COMPENSATION (CANADA)

Equity Compensation Plans –TSX

Current General Recommendation: Vote case-by-case on equity-based compensation plans. Vote against the plan if any of the following factors applies:

- **Cost of Equity Plans:** The total cost of the company's equity plans is unreasonable;
- **Dilution and Burn Rate:** Dilution and burn rate are unreasonable, where the cost of the plan cannot be calculated due to lack of relevant historical data.
- **Plan Amendment Provisions:** The provisions do not meet Social Advisory Services guidelines regarding those amendments that should require shareholder approval..
- **Non-Employee Director Participation:** Participation of directors is discretionary or unreasonable.
- **Pay for performance:** There is a disconnect between CEO pay and the company's performance.
- **Repricing Stock Options:** The plan expressly permits the repricing of stock options without shareholder approval and the company has repriced options within the past three years.
- **Problematic Pay Practices:** The plan is a vehicle for problematic pay practices.

Key Changes:

Similar to the model introduced in the United States for the 2015 proxy season, Social Advisory Services is adopting a "scorecard" model (Equity Plan Scorecard – "EPSC") for Canadian TSX equity plans that considers a range of positive and negative factors to evaluate equity incentive plan proposals. In concert with Social Advisory Services' longstanding Canadian policies for TSX equity plans (relating to non-employee director participation, amendment provisions, and repricing without shareholder approval), the total EPSC score will determine whether Social Advisory Services recommends for or against the proposal.

EPSC factors will fall under three categories ("EPSC pillars"): Plan Cost, Plan Features, and Grant Practices.

As part of the new approach, the updated policy will:

- Utilize two index groups to determine certain thresholds and factor weightings: [2]
  - S&P/TSX Composite Index; and
  - Non-Composite TSX-listed Issuers.
- Utilize individual scorecards for both index groups, as well as Special Cases versions of these scorecards where certain historic data are unavailable;
- Measure plan cost (Shareholder Value Transfer or SVT) through both of the following:
  - The company's total new and previously reserved equity plan shares plus outstanding grants and awards ("A+B+C shares"); and
  - Only the new request plus previously reserved but ungranted shares ("A+B shares");
- Incorporate a wide range of new factors for consideration, both positive and negative, in determining how to recommend for a given equity plan.

[2] Additional Special Cases versions of both models will also be developed for companies that have recently IPO'd or emerged from bankruptcy and where the burn-rate factor would therefore not apply.

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New General Recommendation: Vote case-by-case on equity-based compensation plans using an "equity plan scorecard" (EPSC) approach. Under this approach, certain features and practices related to the plan[3] are assessed in combination, with positively-assessed factors potentially counterbalancing negatively-assessed factors and vice-versa. Factors are grouped into three pillars:

- **Plan Cost**: The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
  - SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
  - SVT based only on new shares requested plus shares remaining for future grants.

- **Plan Features:**
  - Absence of problematic change-in-control (CIC) provisions, including:
    - Single-trigger acceleration of award vesting in connection with a CIC; and
    - Settlement of performance-based equity at target or above in the event of a CIC-related acceleration of vesting regardless of performance.
  - No financial assistance to plan participants for the exercise or settlement of awards;
  - Public disclosure of the full text of the plan document; and
  - Reasonable share dilution from equity plans relative to market best practices.

- **Grant Practices:**
  - Reasonable three-year average burn rate relative to market best practices;
  - Meaningful time vesting requirements for the CEO's most recent equity grants (three-year lookback);
  - The issuance of performance-based equity to the CEO;
  - A clawback provision applicable to equity awards; and
  - Post-exercise or post-settlement share-holding requirements (S&P/TSX Composite Index only).

Generally vote against the plan proposal if the combination of above factors, as determined by an overall score, indicates that the plan is not in shareholders' interests. In addition, vote against the plan if any of the following unacceptable factors have been identified:

- Discretionary or insufficiently limited non-employee director participation;
- An amendment provision which fails to adequately restrict the company's ability to amend the plan without shareholder approval;
- A history of repricing stock options without shareholder approval (three-year look-back);
- The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances; or
- Any other plan features that are determined to have a significant negative impact on shareholder interests.

[3] In cases where certain historic grant data are unavailable (e.g. following an IPO or emergence from bankruptcy), Special Cases models will be applied which omit factors requiring these data.

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Rationale for Update:

As issues around cost transparency and best practices in equity-based compensation have evolved in recent years, Social Advisory Services has determined to update its Equity Plans policy for Canada in order to provide for a more nuanced consideration of equity plan proposals.

Currently, the policy for Canadian equity plans comprises a series of pass/fail tests relating to plan cost and to three key concerns of Canadian investors:

- Non-employee director participation;
- Plan amendment provisions; and
- Repricing without shareholder approval.

While the three policy cornerstones above will continue to be overriding negative factors under the new policy, the pass/fail test for plan cost will be replaced with a scorecard approach designed to provide a robust overview of an equity plan's strengths and weaknesses.

Feedback obtained through ongoing consultation with institutional investors indicates strong support for the new approach, which incorporates the following key goals:

1. Consider a range of factors, both positive and negative, in determining vote recommendations;
2. Select factors based on institutional investors' concerns and preferences and on best practices within the Canadian market established through regulation, disclosure requirements, and best practice principles;
3. Establish factor thresholds and weightings which are cognizant of the Canadian governance landscape (separate scorecards for the S&P/TSX Composite Index and the broader TSX);
4. Ensure that key concerns addressed by policy continue to hold paramount importance (institution of overriding negative factors).

The EPSC policy for equity plan proposals significantly iterates Social Advisory Services' current policy by providing a full-spectrum overview of plan cost, plan features, and historic grant practices. This allows shareholders greater insight into rising governance concerns, such as the implementation of risk-mitigating mechanisms, the strength of vesting provisions, and the use of performance-based equity, while also providing added assessments of longstanding concerns relating to equity plans such as burn rate and dilution.

By assessing these factors in combination, the EPSC is designed to facilitate a more holistic approach to vote recommendations. For example, a plan where cost is nominally higher than a company's allowable cap may receive a favourable recommendation if sufficient positive factors are present. Conversely, a plan where cost is nominally lower than the allowable cap may ultimately receive a negative recommendation if a preponderance of scorecard factors demonstrates adverse qualities. Plans will, however, continue to be subject to the scrutiny of overriding negative factors reflecting Social Advisory Services' current policies regarding problematic non-employee director participation, insufficient plan amendment provisions, repricing without shareholder approval, and other egregious practices. Plans permitting these unacceptable practices will continue to receive an "against" recommendation.

A scorecard approach will enable the evaluation of equity plan proposals in consideration of a range of best practices. Weightings for the three scorecard pillars applicable to S&P/TSX Composite Index constituents and non-Composite TSX-listed issuers are shown below, along with the factors within each pillar.

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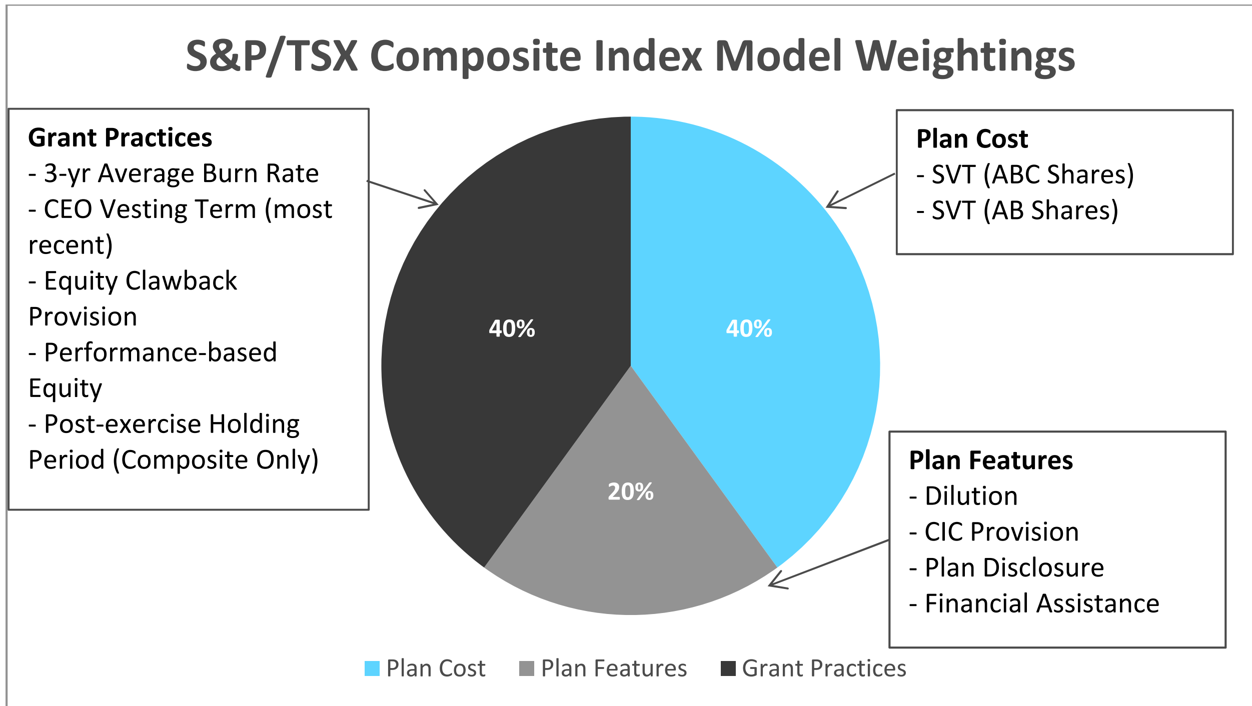

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ANTITAKEOVER MECHANISMS (FRANCE)

Current General Recommendation: Vote against all antitakeover proposals, unless they are structured in such a way that they give shareholders the ultimate decision on any proposal or offer.

Key Changes:

The current policy will be expanded to all French companies listed on a regulated market.

New General Recommendation: Vote against all antitakeover proposals, unless they are structured in such a way that they give shareholders the ultimate decision on any proposal or offer.

As of Feb. 1, 2016, for French companies listed on a regulated market, generally vote against any general authorities impacting the share capital (i.e. authorities for share repurchase plans and any general share issuances with or without preemptive rights, including by capitalization of reserves) if they can be used for antitakeover purposes without shareholders' prior explicit approval.

Rationale for Update:

Following the Florange Act which took effect in 2015, French boards are now permitted by law to utilize any type of shareholder-approved capital issuance authority for the purpose of issuing shares as a takeover defense, unless either (i) the company's articles contain an opt-out provision stipulating that capital issuance authorities cannot be utilized for antitakeover purposes unless shareholders specifically approve the use of share authorities for such purpose, or (ii) the terms of the specific share authority preclude its use for antitakeover purposes.

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