International

Public Fund Proxy Voting Guidelines Updates

2017 Policy Recommendations

Published January 25, 2017

TABLE OF CONTENTS

BOARD OF DIRECTORS - DIRECTOR AND SUPERVISORY BOARD MEMBER ELECTIONS

Election of Minority Nominees (Separate Election)

Current Public Fund Advisory Services Recommendation:

› In Brazil, vote abstain on the election of directors and fiscal council members nominated by non-controlling shareholders presented as a separate voting item if the nominee names are not disclosed in a timely manner prior to the meeting.

Key Changes:

› Improve the policy framework for the analysis of the election of minority nominees presented under separate election proposals, in accordance with the Brazilian Law. The policy update clarifies that Public Fund Advisory Services will prioritize the vote recommendation for the election of minority nominees, when timely disclosure is provided.

New Public Fund Advisory Services Recommendation:

› In Brazil, when a separate election is presented for minority board and/or fiscal council nominees, Public Fund Advisory Services will prioritize support for the election of minority representatives, if timely disclosure is provided. In the absence of timely disclosure regarding minority nominees, a "Do Not Vote" or an "ABSTAIN' recommendation may be issued for the separate minority election proposal. Public Fund Advisory Services will update its report and vote recommendations, as applicable, on a best effort basis, whenever the names and biographical information of minority nominees are disclosed following the publication of the original report.

Rationale for Update:

Brazil is one of the most challenging countries for proxy voting execution. The country has witnessed a significant increase in shareholder activism translated in the effort to increase minority board and fiscal council representations in light of unprecedented corruption investigations, melting stock prices, a push for greater board accountability, and changing regulations. The policy update seeks to provide greater transparency in the event of the election of minority nominees presented under separate election proposals, as allowed under Brazilian law, and clarifies that Public Fund Advisory Services will prioritize the recommendation for the election of minority nominees when timely disclosure is provided.

Overboarding

Current Public Fund Advisory Services Recommendation: In markets where detailed information is generally provided, votes against or withhold votes on individual nominees, key committee members or the entire board can be triggered by one or more of the following concerns:

Directors serving on an excessive number of other boards which could compromise their primary duties. In markets where the number of board appointments is routinely available, an excessive number of boards is defined as:

- For non-executive directors, more than five total non-executive directorships.
- For executive directors, i) more than three total non-executive directorships; or ii) other executive or board chair positions.

  For board chairs, i) more than four total non-executive directorships; or ii) more than two board chair positions; or iii) other executive positions.

Key Changes:

- Amend the wording to provide clarification on the precise number of board seats which can be held under this policy; and
- Update the term "executive directors" with "executive directors or those in comparable roles".

New Public Fund Advisory Services Recommendation: In markets where detailed information is generally provided, votes against or withhold votes on individual nominees, key committee members or the entire board can be triggered by one or more of the following concerns:

Directors serving on an excessive number of other boards which could compromise their primary duties. In markets where the number of board appointments is routinely available, an excessive number of boards is defined as:

- Directors who hold more than five non-chair non-executive director positions.
- A non-executive chairman who, in addition to this role, holds (i) more than three non-chair non-executive director positions, (ii) more than one other non-executive chair position and one non-chair non-executive director position, or (iii) any executive position.
- Executive directors or those in comparable roles holding (i) more than two non-chair non-executive director positions, (ii) any other executive positions, or (iii) any non-executive chair position.

Rationale for Update:

The new wording is intended to remove any confusion regarding what is acceptable under this policy. In particular, the new wording clarifies the total number of directorships viewed as acceptable for an individual holding one or more chair roles. This works on the broad basis that a chair role is equivalent to two non-executive director roles. The amendment also clarifies that the policy applies to executive directors or those in similar positions, meaning executives who are not necessarily members of the board, e.g. in markets with two-tiered board systems.

COMPENSATION

Executive Compensation

Current Public Fund Advisory Services Recommendation: Vote case-by-case on management proposals seeking ratification of a company's compensation policy.

Public Fund Advisory Services believes that seeking annual shareholder approval of a company's compensation policy is a positive corporate governance provision, and considers the following compensation best practices in evaluating shareholder votes on corporate compensation practices:

- Appropriate pay-for-performance alignment with emphasis on long-term shareholder value;
- Avoidance of arrangements that risk "pay for failure";
- Independent and effective compensation committees;
- Provision of clear and comprehensive compensation disclosures to shareholders; and
- Avoidance of inappropriate pay to non-executive directors.

Key Changes:

- Include a definition of Public Fund Advisory Services' European Pay-for-Performance methodology (EP4P) and introduce a reference to the use of EP4P whenever relevant; and
- The term "pay-for-performance alignment" is being updated to "pay structure".

New Public Fund Advisory Services Recommendation: Vote case-by-case on management proposals seeking ratification of a company's compensation policy. For certain European companies, Public Fund Advisory Services will take into account the European Pay for Performance model[1] outcomes within a qualitative review of a company's remuneration practices.

Public Fund Advisory Services believes that seeking annual shareholder approval of a company's compensation policy is a positive corporate governance provision, and considers the following compensation best practices in evaluating shareholder votes on corporate compensation practices:

- Appropriate pay structure with emphasis on long-term shareholder value;
- Avoidance of arrangements that risk "pay for failure";
- Independent and effective compensation committees;
- Provision of clear and comprehensive compensation disclosures to shareholders; and
- Avoidance of inappropriate pay to non-executive directors.

---

[1] **Definition of Pay-for-Performance Evaluation:**

- Public Fund Advisory Services annually conducts a pay-for-performance analysis to measure the alignment between pay and performance over a sustained period. With respect to companies in the European Main Indices, this analysis considers the following:
- Peer Group Alignment:
  - ✓ The degree of alignment between the company's annualized TSR rank and the CEO's annualized total pay rank within a peer group, each measured over a three-year period.
  - ✓ The multiple of the CEO's total pay relative to the peer group median.
- Absolute Alignment – the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – i.e., the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

Rationale for Update:

After having introduced the pay-for-performance methodology for US companies in 2012, the demand for a similar methodology for European companies from clients and investors in general became evident. The 2014 policy survey results revealed that 83 percent of investors who responded had indicated that a European pay for performance quantitative methodology (EP4P), including the use of peer group comparisons, would be useful as a factor in such evaluations. A methodology was developed for European companies in 2015 and introduced in 2016.

Already this year, Public Fund Advisory Services referred to the quantitative pay-for-performance assessment in its reports on certain European companies. However, the current guidelines do not explicitly refer to the EP4P methodology. During the 2016 proxy season, this methodology was successfully implemented and feedback from the 2016 policy survey indicates that a majority (92 percent) of investor respondents support the use of the EP4P model outcome as a contributing factor within the current holistic approach. Therefore, an explicit reference in the Public Fund International policy would further clarify the guidelines and ensure global consistency.

Non-Executive Director Compensation

Current Public Fund Advisory Services Recommendation: Vote against proposals that provide for the granting of stock options or similarly structured equity-based compensation to non-executive directors.

Key Changes: The term "similarly structured equity-based compensation" would be changed to "performance based equity compensation, including stock appreciation rights and performance-vesting restricted stock, and performance-based cash".

New Public Fund Advisory Services Recommendation: Vote against proposals that provide for the granting of stock options, performance-based equity compensation (including stock appreciation rights and performance-vesting restricted stock), and performance-based cash to non-executive directors.

Rationale for Update:

The proposed amendments would mean that, henceforth, Public Fund Advisory Services will generally recommend against all forms of performance-based remuneration to non-executive directors.

Grants of performance-based cash and performance-based equity compensation to non-executive directors are relatively rare among publicly listed companies, as these practices are widely viewed by investors as being potentially compromising of director independence. Notably, the ICGN and a number of prominent European codes of best practice recommend against these practices. Also, many Public Fund Advisory Services clients based in continental Europe have customized voting policies that oppose the grant of performance-based compensation of all forms to non-executive directors.

Moreover, the proposed amendment concerning the grant of performance-based equity compensation to non-executive directors reflects client views expressed in the 2015-2016 policy survey. The survey results indicated that a majority of institutional investors believe the grant of stock options or performance-based equity are inappropriate forms of compensation for non-executive directors.

The Global Leader In Corporate Governance

www.issgovernance.com