International

Proxy Voting Guidelines Updates

2017 SRI Policy Recommendations

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ELECTION OF DIRECTORS (CONTINENTAL EUROPE)

Non-Contested Director Elections- Independence

Current Social Advisory Services Recommendation:

The following policies would be applied to all widely held companies[1], unless there is a majority shareholder:

- For all markets (except Greece or Portugal), vote against the election or reelection of any non-independent directors (excluding the CEO) if:
  - Fewer than 50 percent of the board members elected by shareholders would be independent, or
  - Fewer than one-third of board members, including those who, in accordance with local law(s) requiring their mandatory board membership, are not elected by shareholders, would be independent.

- In Italy, at least half of the board should be independent (50 percent). Issuers with a controlling shareholder will be required to have a board consisting of at least one-third independent members (33 percent). This applies to individual director appointments (co-options). In the case of complete board renewals that are regulated by the Italian slate system ("voto di lista"), board independence will be one of the factors for determining which list of nominees Social Advisory Services considers best suited to add value for shareholders.

- For companies incorporated in Portugal or Greece, at least one-third of the board will be required to be independent. Social Advisory Services will recommend a vote against the entire slate of candidates (in the case of bundled elections), or a vote against the election of any non-independent directors (in the case of unbundled elections) if board independence level does not meet the minimum recommended one-third threshold.

Key Changes: Add "excluding employee shareholder representatives" to the first bullet point -- For France, employee shareholder representatives would be excluded when calculating the 50% threshold (currently they are included).

New Social Advisory Services Recommendation:

The following policies would be applied to all widely held companies[1], unless there is a majority shareholder:

- For all markets (except Greece or Portugal), vote against the election or reelection of any non-independent directors (excluding the CEO) if:
  - Fewer than 50 percent of the board members elected by shareholders, excluding, where relevant, employee shareholder representatives, would be independent, or
  - Fewer than one-third of all board members, including those who, in accordance with local law(s) requiring their mandatory board membership, are not elected by shareholders, would be independent.

- In Italy, at least half of the board should be independent (50 percent). Issuers with a controlling shareholder will be required to have a board consisting of at least one-third independent members (33 percent). This applies to individual director appointments (co-options). In the case of complete board renewals that are regulated by the

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[1] Widely held companies are interpreted as:
- Generally, based on their membership in a major index and/or the number of clients holding the securities;
- For Sweden, Norway, Denmark, Finland, and Luxembourg: based on local blue chip market index and/or MSCI EAFE companies;
- For Portugal, based on their membership in the PSI-20 and/or MSCI-EAFE index.

Italian slate system ("voto di lista"), board independence will be one of the factors for determining which list of nominees Social Advisory Services considers best suited to add value for shareholders.

› For companies incorporated in Portugal or Greece, at least one-third of the board will be required to be independent. Social Advisory Services will recommend a vote against the entire slate of candidates (in the case of bundled elections), or a vote against the election of any non-independent directors (in the case of unbundled elections) if board independence level does not meet the minimum recommended one-third threshold.

Rationale for Update:

French law requires the presence of so-called Employee Shareholder Representatives (ESRs) on the board of directors of any company whose employees collectively hold an interest of more than 3 percent of the share capital. Unlike employee representatives that sit on boards in France and in many other European markets, ESRs are subject to election by the general meeting of shareholders.

In principle, ESRs – as employees of the company -- can be broadly defined as non-independent directors. However, in light of the fact that the presence of ESRs on French boards of directors constitutes a legal requirement, the AFEP-MEDEF Code and the AFG (the French Association of Asset Managers) exclude ESRs when defining the level of independence that boards should maintain. In other words, under the approach favored by the AFEP-MEDEF Code and AFG Guidelines, ESRs should not be counted when calculating the percentage of independent directors on a company's board. Social Advisory Services currently applies a similar exception for employee representatives and other board members not subject to shareholder election (e.g. government representatives), based on the same principle that such directors are legally required to be on the board.

The policy amendment reflects the guidance of the AFEP-MEDEF Code and AFG, and will mean that ESRs will effectively be treated the same as (non-shareholder elected) employee representatives under the policy. This means that ESRs will not be counted when calculating the overall level of independence of board members elected by shareholders, but will be counted when calculating the overall independence of all board members.

Non-Contested Director Elections- Overboarded directors

Current Social Advisory Services Recommendation:

In **Austria**, **Belgium**, **France**, **Germany**, **Italy**, **Luxembourg**, the **Netherlands**, **Spain**, and **Switzerland**, at widely held companies, Catholic Advisory Services will generally recommend a vote against a candidate when s/he holds an excessive number of board appointments, as referenced by the more stringent of the provisions prescribed in local law or best practice governance codes, or the following guidelines:

› Executive directors are expected not to hold other executive or chairmanship positions. They may, however, hold up to two other non-executive directorships.
› Non-executive chairmen are expected not to hold executive positions elsewhere or more than one other chairmanship position. They may, however, hold up to three other non-executive directorships.
› Non-executive directors who do not hold executive or chairmanship positions may hold up to four other non-executive directorships.

An adverse vote recommendation will not be applied to a director within a company where he/she serves as CEO or chair; instead, any adverse vote recommendations will be applied to his/her additional seats on other company boards.

Social Advisory Services will take into account board positions held in global publicly listed companies.

For directors standing for (re)election at French companies, Social Advisory Services will take into account board appointments as censors in French publicly listed companies.

Key Changes: The amended version of the policy (i) clarifies the definition of what constitutes an overboarded director under the policy, (ii) replaces the term "executive director" with "executive directors or those in comparable roles", (iii) eliminates the safe harbor for non-executive chairman in certain scenarios, (iv) clarifies that, when calculating a director's total number of outside directorships, the total number of directorships at global publicly listed companies outside the same group will be counted, and (v) adds a carve-out for executives of investment holding companies.

New Social Advisory Services Recommendation:

In **Austria**, **Belgium**, **France**, **Germany**, **Italy**, **Luxembourg**, the **Netherlands**, **Spain**, and **Switzerland**, at widely held companies, Social Advisory Services will generally recommend a vote against a candidate when s/he holds an excessive number of board appointments, as referenced by the more stringent of the provisions prescribed in local law or best practice governance codes, or as defined by the following guidelines:

- 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.

An adverse vote recommendation will not be applied to a director within a company where he/she serves as CEO; instead, any adverse vote recommendations will be applied to his/her additional seats on other company boards. The same is also valid for non-executive chairmen, except (i) where they exclusively hold other non-executive chair and/or executive positions or (ii) where they are elected as non-executive chairman for the first time.

Social Advisory Services will take into account board positions held in global publicly listed companies outside the same group, defined as group of companies in which a common parent company controls at least 50 percent + 1 share of equity capital, alone or in concert.

For directors standing for (re)election at French companies, Social Advisory Services will take into account board appointments as censors in French publicly listed companies.

Executive directors or those in comparable roles within investment holding companies will generally be treated similar to non-executive directors when applying this policy.

Rationale for Update:

The amendments clarify several passages in the current policy including the definition of what constitutes an overboarded director, as well as the fact 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.

The amended policy also clarifies that, when calculating a director's total number of directorships, positions in globally listed companies outside the same group are taken into account. This means that multiple directorships in listed companies within a single group (defined as a group of companies in which the parent company controls at least 50 percent + 1 share of the equity capital, alone or in concert) are considered to cumulatively constitute a single mandate, rather than multiple mandates.

The amended policy also clarifies that negative voting recommendations may be issued in cases where an overboarded director only holds non-executive chairman mandates, meaning effectively three or more non-executive chairmanships. While a safe harbor for non-executive chairman is still considered appropriate generally, this closes a loophole in the policy which currently precludes the application of a voting sanction in these (rather anomalous) cases. The amended policy would also clarify that a negative recommendation applies when a director is being elected as chairman for the first time (i.e. when the nominee's initial election as board chairman causes him/her to exceed the allowable threshold of total board mandates defined in the policy).

Finally, the amended policy foresees exceptional treatment for executives of investment holding companies. This change recognizes that, for investment holding company executives, the participation on portfolio company boards is oftentimes integral to their role.

COMPENSATION

CANADA

Director Compensation- TSX

Current Social Advisory Services Recommendation: None

Key Changes:

- Introduce a policy for TSX-listed companies to identify significant problematic non-employee director compensation practices that would result in a negative vote recommendation at the board level in addition to, or in the absence of, the ability to register a negative vote for the problematic award or payment or plan under which it is made.

New Social Advisory Services Recommendation: On a case-by-case basis, generally vote withhold for members of the committee responsible for director compensation (or, where no such committee has been identified, the board chair or full board) where director compensation practices which pose a risk of compromising a non-employee director's independence or which otherwise appear problematic from the perspective of shareholders have been identified, including:

- Excessive (relative to standard market practice) inducement grants issued upon the appointment or election of a new director to the board (consideration will be given to the form in which the compensation has been issued and the board's rationale for the inducement grant);
- Performance-based equity grants to non-employee directors which could pose a risk of aligning directors' interests away from those of shareholders and toward those of management; and
- Other significant problematic practices relating to director compensation.

Rationale for Update:

As non-employee director compensation schemes increase in quantum and complexity, this policy is intended to identify highly problematic practices relating to director compensation which would result in a negative vote recommendation. The issuance of excessive inducement grants to non-employee directors can create problematic incentives which may compromise an otherwise independent director's judgement or foster divergent incentives between those directors who have recently received such awards and those who have not. Similarly, the issuance of performance-based equity awards (e.g. performance share units or PSUs) to non-employee directors may increase the risk of misaligning directors' interests away from the interests of shareholders.

Based on discussions with institutional investors, this policy is intended to highlight and oppose these and other highly problematic non-employee director compensation practices and to reflect best practices within the Canadian market as outlined by the Canadian Coalition for Good Governance's 2011 *Director Compensation Principles*.

CONTINENTAL EUROPE

Executive Compensation-Related Proposals

Current Social Advisory Services Recommendation: Social Advisory Services will evaluate management proposals seeking ratification of a company's executive compensation-related items on a case-by-case basis, and will generally recommend a vote against a company's compensation-related proposal if such proposal fails to comply with one or a combination of several of the global principles and their corresponding rules:

…

2. Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value.

…

3.1 The board shall demonstrate good stewardship of investors' interests regarding executive compensation practices.

Key Changes: A reference to the European Pay-for-Performance Methodology (EP4P) will be added in the introductory section of the policy. In addition, a definition of EP4P will be included in Principle 3.1 of the policy. Finally, Principle 2 of the policy will be amended to change the term "pay-for-performance alignment" to "pay structure".

New Social Advisory Services Recommendation: Social Advisory Services will evaluate management proposals seeking ratification of a company's executive compensation-related items on a case-by-case basis, and, where relevant, will take into account the European Pay for Performance model[2] outcomes within a qualitative review of a company's remuneration practices. Social Advisory Services will generally recommend a vote against a company's compensation-related proposal if such proposal fails to comply with one or a combination of several of the global principles and their corresponding rules:

…

2. Maintain appropriate pay structure with emphasis on long-term shareholder value:

…

3.1. The board shall demonstrate good stewardship of investor's interests regarding executive compensation practices (principle being supported by Pay for Performance Evaluation[2])

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

- › Social 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.

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, Social 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 Social Advisory International policy would further clarify the guidelines and ensure global consistency.

Non-Executive Director Compensation

Current Social Advisory Services Recommendation: Social Advisory Services will generally recommend a vote for proposals to award cash fees to non-executive directors, and will otherwise:

Recommend a vote against where:

…..

› Proposals 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 Social Advisory Services Recommendation: Social Advisory Services will generally recommend a vote for proposals to award cash fees to non-executive directors, and will otherwise:

Recommend a vote against where:

…..

› Proposals 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-

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- 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.

executive directors.

Rationale for Update:

The proposed amendments would mean that, henceforth, Social Advisory Services will generally recommend against all forms of performance-based remuneration to non-executive directors at continental European companies.

Grants of performance-based cash and performance-based equity compensation to non-executive directors are relatively rare among publicly listed companies in most continental European markets, 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 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 proposed amendments would therefore bring the guidelines in line with the prevailing practice among public companies in most continental Europe, as well as investor views.

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