United States

SRI Proxy Voting Guidelines Updates

2017 Policy Recommendations

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BOARD OF DIRECTORS- VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

Restricting Binding Shareholder Proposals

Current Social Advisory Services Recommendation: None

Key Changes:

- Adoption of a new policy under Director Accountability where shareholders do not have the ability to amend the bylaws.

New Social Advisory Services Recommendation: Generally vote against or withhold from members of the governance committee if:

The company's charter imposes undue restrictions on shareholders' ability to amend the bylaws. Such restrictions include, but are not limited to: outright prohibition on the submission of binding shareholder proposals, or share ownership requirements or time holding requirements in excess of SEC Rule 14a-8. Vote against on an ongoing basis.

Rationale for Update:

Shareholders' ability to amend the bylaws is a fundamental right. Under SEC Rule 14a-8, shareholders who have held shares valued at $2,000 or more for one year are permitted to submit shareholder proposals, both precatory and binding, to amend the bylaws. Some states permit companies to restrict this right in their charters. These prohibitions amount to a material diminution of shareholder rights. Although some companies have offered management proposals as alternatives, these often have greater ownership or holding period requirements and have typically not been well received by the shareholders of non-controlled companies.

Client feedback indicates that these prohibitions flew under the radar until relatively recently. Over the last several years, shareholders have submitted precatory proposals seeking the right to amend the bylaws at a number of companies that do not provide this right to shareholders. A number of these campaigns were contentious and generated interest on the topic among members of the wider investor community.

Unilateral Bylaw/Charter Amendments - IPO Companies

Current Social Advisory Services Recommendation: For newly public companies, gernerally 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 adopted bylaw or charter provisions materially adverse to shareholder rights, considering the following factors:

- The level of impairment of shareholders' rights caused by the provision;
- The disclosed rationale for adopting the provision;
- The ability to change the governance structure in the future (e.g., limitations on shareholders' 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.

Key Changes:

- The heading will be amended to read: Unilateral Bylaw/Charter Amendments and Problematic Capital Structures;
- Adverse vote recommendations for director nominees will generally be warranted if a company completes its public offering with a multi-class capital structure in which the classes do not have identical voting rights;
- A vote by shareholders within 3 years will be insufficient; a sunset provision will be necessary.

New Social Advisory Services Recommendation: 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 adopted bylaw or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights considering the following factors:

- The level of impairment of shareholders' rights;
- The disclosed rationale;
- The ability to change the governance structure (e.g., limitations on shareholders' 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;
- Any reasonable sunset provision; and
- Other relevant factors.

Unless the adverse provision and/or problematic capital structure is reversed or removed, vote case-by-case on director nominees in subsequent years.

Rationale for Update:

There has been an increase in the number of companies completing initial public offerings with multi-class capital structures:

Year	# of IPO companies with multi-class structures
2006	8
2007	6
2008	9
2009	2
2010	4
2011	6
2012	11
2013	12
2014	21
2015	18
2016 (as of Aug. 30)	17

The 2016 – 2017 policy survey results indicate that a majority of investor respondents are in favor of issuing adverse vote recommendations for director nominees when a company completes its initial public offering with a multi-class structure or a multi-class structure with no sunset provision for unequal voting rights.

Overboarded Directors

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

- Sit on more than six public company boards; with respect to annual meetings on or after Feb. 1, 2017[1], 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[2].

Key Changes:

- The one-year transition period from six to five public company boards is ending.

New Social Advisory Services Recommendation: Generally vote against or withhold from individual directors who:

- 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[2].

Rationale for Update:

The transition period for the implementation of the new overboarding vote recommendations is coming to an end.

1 This policy change includes a 1-year transition period to allow time for affected directors to address necessary changes if they wish.
2 Although all of a CEO's subsidiary boards will be counted as separate boards, Social Advisory Services will not recommend a withhold vote for 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.

CAPITAL

Stock Distributions: Splits and Dividends

Current Social Advisory Services Recommendation: Vote for management proposals to increase the common share authorization for a stock split or share dividend, provided that the increase in authorized shares is equal to or less than the allowable increase calculated in accordance with Social Advisory Services' Common Stock Authorization policy.

Key Change:

- Increase is being modified to the effective increase.

New Social Advisory Services Recommendation: Generally vote for management proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase in authorized shares is equal to or is less than the allowable increase calculated in accordance with Social Advisory Services' ' Common Stock Authorization policy.

Rationale for Update:

A clarification of the policy as it pertains to forward stock splits and stock dividends is relevant because proposals to increase authorized common shares may be tied to the implementation of a planned stock split or stock dividend.

COMPENSATION

Equity-Based and Other Incentive Plans

Current Social Advisory Services Recommendation: Vote case-by-case on certain equity-based compensation plans[3] depending on a combination of certain plan features and equity grant practices, where positive factors may counterbalance negative factors, and vice versa, as evaluated using an "equity plan scorecard" (EPSC) approach with 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:**
  - Automatic single-triggered award vesting upon a change in control (CIC);
  - Discretionary vesting authority;
  - Liberal share recycling on various award types;
  - Lack of minimum vesting period for grants made under the plan.

- **Grant Practices:**
  - The company's three year burn rate relative to its industry/market cap peers;
  - Vesting requirements in most recent CEO equity grants (3-year look-back);
  - The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years);
  - The proportion of the CEO's most recent equity grants/awards subject to performance conditions;
  - Whether the company maintains a claw-back policy;
  - Whether the company has established post exercise/vesting share-holding requirements.

Generally vote against the plan proposal if the combination of above factors indicates that the plan is not, overall, in shareholders' interests, or if any of the following egregious factors apply:

- Awards may vest in connection with a liberal change-of-control definition;
- The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it – for NYSE and Nasdaq listed companies -- or by not prohibiting it when the company has a history of repricing – for non-listed companies);
- The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances; or
- Any other plan features are determined to have a significant negative impact on shareholder interests.

Key Changes:

- Add dividends payable prior to vesting as a plan feature.

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[3] Proposals evaluated under the EPSC policy generally include those to approve or amend (1) stock option plans for employees and/or employees and directors, (2) restricted stock plans for employees and/or employees and directors, and (3) omnibus stock incentive plans for employees and/or employees and directors.

New Social Advisory Services Recommendation: Vote case-by-case on certain equity-based compensation plans[3] depending on a combination of certain plan features and equity grant practices, where positive factors may counterbalance negative factors, and vice versa, as evaluated using an "equity plan scorecard" (EPSC) approach with 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:**
  - Automatic single-triggered award vesting upon a change in control (CIC);
  - Discretionary vesting authority;
  - Liberal share recycling on various award types;
  - Lack of minimum vesting period for grants made under the plan;
  - Dividends payable prior to award vesting.

- **Grant Practices:**
  - The company's three-year burn rate relative to its industry/market cap peers;
  - Vesting requirements in most recent CEO equity grants (3-year look-back);
  - The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years);
  - The proportion of the CEO's most recent equity grants/awards subject to performance conditions;
  - Whether the company maintains a claw-back policy;
  - Whether the company has established post-exercise/vesting share-holding requirements.

Generally vote against the plan proposal if the combination of above factors indicates that the plan is not, overall, in shareholders' interests, or if any of the following egregious factors apply:

- Awards may vest in connection with a liberal change-of-control definition;
- The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it – for NYSE and Nasdaq listed companies -- or by not prohibiting it when the company has a history of repricing – for non-listed companies);
- The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances; or
- Any other plan features are determined to have a significant negative impact on shareholder interests.

Rationale for Update:

In addition to minor changes to various factor weightings, the updated policy includes an additional factor: an evaluation of the payment of dividends on unvested awards. From an incentive and retention perspective, dividends on unvested awards should be paid only after the underlying awards have been earned and not during the performance/service vesting period. Under this new factor, full points will be earned if the equity plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award (however, accrual of dividends payable upon vesting is acceptable). No points will be earned if this prohibition is absent or incomplete (i.e. not applicable to all award types). A company's general practice (not enumerated in the plan document) of not paying dividends until vesting will not suffice.

Modifications were also made to the minimum vesting factor. First, an equity plan must specify a minimum vesting period of one year for all award types under the plan in order to receive full points for this factor. Second, no points will be earned if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement.

Amending Cash and Equity Plans (including Approval for Tax Deductibility (162(m))

(formerly "Incentive Bonus Plans and Tax Deductibility Proposals (OBRA-Related Compensation Proposals)"

Current Social Advisory Services Recommendation: Generally vote for proposals to approve or amend executive incentive plans if the proposal:

- Is only to address administrative features;
- Places a cap on the annual grants any one participant may receive to comply with the provisions of Section 162(m);
- Adds performance goals to existing compensation plans to comply with the provisions of Section 162(m) unless they are clearly inappropriate; or
- Covers cash or cash and stock plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Section 162(m) if no increase in shares is requested.

Vote against such proposals if:

- The compensation committee does not fully consist of independent outsiders, per Social Advisory Services' Categorization of Directors; or
- The plan or proposal contains excessive problematic provisions.

Vote case-by-case on such proposals if:

- In addition to seeking 162(m) tax treatment, the amendment may cause the transfer of additional shareholder value to employees (*e.g.*, by requesting additional shares, extending the option term, or expanding the pool of plan participants). Evaluate the Shareholder Value Transfer in comparison with the company's allowable cap; or
- A company is presenting the plan to shareholders for Section 162(m) favorable tax treatment for the first time after the company's initial public offering (IPO). Perform a full standard as applicable.

Key Changes:

- The policy has been renamed and reorganized to more clearly differentiate the evaluation framework applicable to the various types of amendment proposals.

New Social Advisory Services Recommendation: Vote case-by-case on amendments to cash and equity incentive plans.

Generally vote for proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- Addresses administrative features only; or
- Seeks approval for Section 162(m) purposes <u>only</u>, and the plan administering committee consists entirely of independent outsiders, per Social Advisory Services' Categorization of Directors. Note that if the company is presenting the plan to shareholders for the first time after the company's initial public offering (IPO), or if the proposal is bundled with other material plan amendments, then the recommendation will be case-by-case (see below).

Vote against proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- Seeks approval for Section 162(m) purposes only, and the plan administering committee does not consist entirely of independent outsiders, per Social Advisory Services' Categorization of Directors.

Vote case-by-case on all other proposals to amend cash incentive plans. This includes plans presented to shareholders for the first time after the company's IPO and/or proposals that bundle material amendment(s) other than those for Section 162(m) purposes.

Vote case-by-case on all other proposals to amend equity incentive plans, considering the following:

- If the proposal requests additional shares and/or the amendments may potentially increase the transfer of shareholder value to employees, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of the amendments.
- If the plan is being presented to shareholders for the first time after the company's IPO, whether or not additional shares are being requested, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of any amendments.
- If there is no request for additional shares and the amendments are not deemed to potentially increase the transfer of shareholder value to employees, then the recommendation will be based entirely on an analysis of the overall impact of the amendments, and the EPSC evaluation will be shown for informational purposes.

Rationale for Update:

This update is intended to clarify Social Advisory Services' approach for evaluating the different types of proposals involving amendments to cash and equity incentive plans. Specifically, this update more clearly differentiates the evaluation framework applicable to amendment proposals presented for Section 162(m) purposes only, or those involving multiple bundled amendments, amendments with or without new share requests, amendments potentially increasing cost, etc.

DIRECTOR COMPENSATION

Shareholder Ratification of Director Pay Programs

Current Social Advisory Services Recommendation: None.

Key Changes:

- Codify the evaluation framework applied to newly-seen U.S. ratification of non-employee director pay programs.

New Social Advisory Services Recommendation: Vote case-by-case on management proposals seeking ratification of non-employee director compensation, based on the following factors:

- If the equity plan under which non-employee director grants are made is on the ballot, whether or not it warrants support; and
- An assessment of the following qualitative factors:
- The relative magnitude of director compensation as compared to companies of a similar profile;
- The presence of problematic pay practices relating to director compensation;
- Director stock ownership guidelines and holding requirements;
- Equity award vesting schedules;
- The mix of cash and equity-based compensation;
- Meaningful limits on director compensation;
- The availability of retirement benefits or perquisites; and
- The quality of disclosure surrounding director compensation.

Rationale for Update:

There have been a number of recent high profile lawsuits regarding excessive non-employee director ("NED") compensation that reflect increasing shareholder scrutiny on the topic. In response, some companies have put forth advisory proposals seeking shareholder ratification of their NED pay programs. Social Advisory Services evaluated several director pay proposals during the 2016 proxy season, and we expect to see more submitted to a shareholder vote. Accordingly, a policy framework to evaluate such proposals is necessary. The new policy incorporates the same qualitative factors that Social Advisory Services' will use under its updated policy to evaluate NED equity plans.

Equity Plans for Non-Employee Directors

Current Social Advisory Services Recommendation: Vote case-by-case on compensation plans for non-employee directors, based on:

- 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) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants;
- The company's three year burn rate relative to its industry/market cap peers; and
- Certain plan features.

On occasion, director stock plans that set aside a relatively small number of shares will exceed the plan cost or burn rate benchmark when combined with employee or executive stock compensation plans. In such cases, vote for the plan if all of the following qualitative factors in the board's compensation are met and disclosed in the proxy statement:

- Director stock ownership guidelines with a minimum of three times the annual cash retainer;
- Vesting schedule or mandatory holding/deferral period:
  - A minimum vesting of three years for stock options or restricted stock; or
  - Deferred stock payable at the end of a three-year deferral period.
- Mix between cash and equity:
  - A balanced mix of cash and equity, for example 40% cash/60% equity or 50% cash/50% equity; or
  - If the mix is heavier on the equity component, the vesting schedule or deferral period should be more stringent, with the lesser of five years or the term of directorship.
- No retirement benefits, or perquisites provided to non-employee directors; and
- Detailed disclosure provided on cash and equity compensation delivered to each non-employee director for the most recent fiscal year in a table. The column headers for the table may include the following: name of each non-employee director, annual retainer, board meeting fees, committee retainer, committee-meeting fees, and equity grants.

Key Changes:

- Clarify and broaden the various factors considered when assessing the reasonableness of non-employee director ("NED") equity plans.
- Update the list of factors by including new factors (including relative pay magnitude and meaningful pay limits) and simplifies the language for the factors already considered.

New Social Advisory Services Recommendation: Vote case-by-case on compensation plans for non-employee directors, based on:

- 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) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants;
- The company's three-year burn rate relative to its industry/market cap peers; and
- The presence of any egregious plan features (such as an option repricing provision or liberal CIC vesting risk).

On occasion, director stock plans will exceed the plan cost or burn rate benchmarks when combined with employee or executive stock plans. In such cases, vote case-by-case on the plan taking into consideration the following qualitative factors:

- The relative magnitude of director compensation as compared to companies of a similar profile;
- The presence of problematic pay practices relating to director compensation;
- Director stock ownership guidelines and holding requirements;
- Equity award vesting schedules;
- The mix of cash and equity-based compensation;
- Meaningful limits on director compensation;
- The availability of retirement benefits or perquisites; and
- The quality of disclosure surrounding director compensation.

Rationale for Update:

In addition to broadening the factors considered, the updated policy clarifies that when a NED equity plan is determined to be relatively costly, Social Advisory Services' vote recommendation will be case-by-case, looking holistically at all of the factors, rather than requiring that all enumerated factors meet certain minimum criteria. This updated policy aligns the considered factors with the same ones provided under Social Advisory Services' new policy on proposals seeking ratification of non-employee director pay programs.

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