

Taiwan

Proxy Voting Guidelines

2017 Benchmark Policy Recommendations

Effective for Meetings on or after February 1, 2017

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1. OVERVIEW

Companies must hold their AGMs within six months of the close of each fiscal year. The following resolutions are commonly seen at a shareholder meeting:

- › Approval of business operations reports and financial statements;
- › Allocation of income or loss offsetting proposals;
- › Amendments to articles of association or other company bylaws;
- › Capital raising requests;
- › Election of directors and supervisors;
- › Release of restrictions on competitive activities of directors;
- › Transact other business.

Other items that may be submitted for shareholder approval include:

- › Capital reduction to offset losses or by distributing cash to shareholders;
- › Equity-based compensation;
- › Merger, consolidation, or split-off.

Policies in this document are presented in the order that generally appears on the ballot.

Vote Requirements:

- › Ordinary resolutions require the approval of a majority of the shareholders present, who represent more than one half of the issued shares.
- › Special resolutions require the approval of a majority of the shareholders present, who represent two-thirds or more of the issued shares. If the attending shareholders represent less than two-thirds of the issued shares, such resolutions may be adopted by a super majority vote (2/3 or more) of the attending shareholders who represent more than one-half of the issued shares.

2. FINANCIAL RESULTS AND BUSINESS OPERATIONS REPORTS

Approval of Financial Statements and Statutory Reports

Resolution Type: Ordinary



General Recommendation: Generally vote for proposals to approve financial results, business operations reports and other statutory reports unless:

- › There are concerns about the accounts presented or audit procedures used; or
- › The company is not responsive to shareholder questions about specific items that should be publicly disclosed.

Discussion

Article 20 of the Company Act requires Taiwanese companies to submit their annual reports, financial statements, surplus earnings distribution or loss offsetting proposals to shareholders for approval after the end of each fiscal year.

External audit is required for the financial statements. Pursuant to Article 36 of the Securities and Exchange Act, audited financial reports shall be prepared and released within three months after the close of each fiscal year.

3. ALLOCATION OF INCOME AND DIVIDENDS

General Recommendation: Generally vote for approval of the allocation of income and dividends.

When distributing earnings and dividends, companies usually provide shareholders one or a combination of the following:

- › Cash dividends from earnings;
- › Cash dividends from capital reserves;
- › New shares from capital reserves;
- › Stock dividends.

When losses are posted for the year, companies are required to submit the loss offsetting proposals, usually included in the statement of profit and loss appropriation, for shareholder approval, along with the business operations reports and financial statements.

Cash Dividends from Earnings

Resolution Type: Ordinary

General Recommendation: Generally vote for distribution of dividends from earnings unless:

- › The dividend payout ratio has been consistently below 30 percent without a adequate explanation;
- › The proposed payout is excessive given the company's financial position.

Discussion

According to Article 112 and 232 of the Company Act, if there are no surplus earnings for the current year, no dividends and bonuses shall be paid out. In addition, before the company could pay out dividends and bonuses, the company shall:

1. Cover its losses and pay all its taxes and dues;
2. Set aside 10 percent of its surplus profit as legal reserve when the amount of legal reserve is less than the authorized capital;
3. Allocate another sum of its surplus profits as special reserve, if special reserve is specified in the Articles of Association or approved by shareholders.

Cash Dividends or New Shares from Capital and Legal Reserves

Resolution Type: Special

General Recommendation: Generally vote for proposals to distribute dividends or new shares from capital and legal reserves.


Discussion

In accordance with Article 241 of the Company Act, when there is no loss incurred, a company may distribute all or part of its legal reserve and capital reserve by cash or by issuing new shares to its existing shareholders based on their

proportionate holdings. If legal reserve is distributed, only the portion of legal reserve which exceeds 25 percent of the paid-in capital may be distributed.


Stock Dividends

Resolution Type: Special

 **General Recommendation:** Generally vote for proposals to distribute stock dividends.

4. CAPITAL REDUCTION TO OFFSET LOSSES OR BY DISTRIBUTING CASH TO SHAREHOLDERS

Resolution Type: Ordinary

 **General Recommendation:** Generally vote for the capital reduction to offset losses or to distribute cash to shareholders unless:


- › The proposed capital reduction is not conducted on a proportionate basis according to the shareholding structure of the company but instead favors certain shareholders; or
- › The proposed cash distribution is expected to negatively affect the company's day-to-day operations.

Discussion

According to Article 168 of the Company Act, a company shall not cancel its shares unless a resolution on capital reduction has been adopted by its shareholders' meeting and capital reduction shall be effected based on the percentage of shareholding of the shareholders pro rata, unless otherwise provided for in this Act or any other governing laws.

Taiwanese companies sometimes may propose to offset cumulative losses by reducing their capital. On the other hand, cash may be given to shareholders when they have extra cash on hand and there is no significant investment foreseen in the near future. The total number of the outstanding shares will then be reduced. A smaller share base will result in higher earnings per share and return on net assets.

5. AMENDMENTS TO COMPANY ARTICLES/BYLAWS

 **General Recommendation:** Vote case-by-case on amendments to company bylaws.

Proposals to amend company bylaws are commonly seen at shareholder meetings. Companies usually disclose the details of the proposed amendments in their meeting circulars. Amendments are nearly always bundled together as a single voting resolution, and ISS' general approach is to oppose article amendments as a whole when they include changes we oppose.

Articles of Association

The following are some of the most common or significant types of changes.

Increase in authorized capital

- ▶ **General Recommendation:** Vote case-by-case on increase in authorized capital if the company explicitly provides reasons for the increase. Otherwise, vote for this change, unless:
- › The increase in authorized capital exceeds 100 percent of the currently authorized capital; or
 - › The increase leaves the company with less than 30 percent of the proposed authorized capital outstanding; or
 - › The increase is intended for a poison pill, which ISS opposes.

Establishment of an audit committee to replace supervisors

- ▶ **General Recommendation:** Generally vote for the establishment of an audit committee.

Adoption of the nomination system for the election of directors and supervisors

- ▶ **General Recommendation:** Generally vote for the adoption of the nomination system for the election of directors.

Change of board size

Resolution Type: Special

- ▶ **General Recommendation:** Generally vote for the change of board size unless it is used as an anti-takeover mechanism or to alter board structure or size in the context of a fight for control of the company or the board.

Other Company Bylaws

Resolution Type: Ordinary

- ▶ **General Recommendation:** Vote case-by-case on other bylaw proposals.

Other company bylaws include but are not limited to:

- › Procedures Governing the Acquisition or Disposal of Assets;
- › Rules and Procedures Regarding Shareholder's Meeting;
- › Rules and Procedures for Election of Directors and Supervisors;
- › Rules and Procedures Regarding Board of Directors' Meeting;
- › Procedures for Lending Funds to Other Parties;
- › Procedures for Endorsement and Guarantees;
- › Trading Procedures Governing Derivatives Products.

6. CAPITAL RAISING

- ▶ **General Recommendation:** Generally vote for general authority to issue shares if:
- › A general share issuance mandate that includes a private placement as one of the financing channels if the resulting dilution is limited to no more than 10 percent.
 - › A general mandate for public share issuance if the issue size is limited to no more than 20 percent of the existing issued share capital.

Vote case-by-case on requests to issue shares for a specific purpose such as the financing of a particular project, an acquisition, or a merger.

Discussion

There are four capital raising channels that require shareholder approval in Taiwan:

- › Issuance of new ordinary shares via a private placement;
- › Issuance of convertible bonds via a private placement;
- › Public issuance of new ordinary shares via book building;
- › Participation in global depositary receipt (GDR) issuance.

Taiwanese companies normally seek authority to raise capital through one or a combination of the abovementioned channels, with the authority lasting for one year. This is, in essence, a general issuance mandate allowing companies to issue shares, convertible bonds, or participate in GDR issuance up to a preapproved limit. The specific capital raising channel and usage of raised proceeds will be determined by the board should the board decide to exercise this authority.

Additionally, the vast majority of Taiwanese boards have minimal or no independent representation. Given the prevalence of insider-dominated boards in Taiwan, ISS believes that stricter limits should be placed on a general mandate that allows for issuance by way of a private placement so as to reduce the risk of a abuse by insiders for their own benefit.

Private placement of new shares and convertible bonds are special resolutions. Public issuance of new shares via book building and participation in GDR issuance are ordinary resolutions.

7. EQUITY-BASED COMPENSATION

Resolution Type: Special

 **General Recommendation:** Vote case-by-case on restricted stock awards (RSA). Vote against the RSA plan if one or two of the following features are not met:

- › Existing substantial shareholders are restricted in participation;
- › Presence of challenging performance hurdles if restricted stocks are issued for free or at a deep discount; or
- › Reasonable vesting period (at least two years) is set.

Discussion

RSAs were first introduced in Taiwan in 2012, following the new amendments to the Regulations Governing the Offering and Issuance of Securities by Securities Issuers promulgated by the Financial Supervisory Commission (FSC). The amount of restricted stocks to be issued is capped at 5 percent of the number of shares outstanding under the law, and the restricted shares can be granted free of charge. In addition, companies are mandated to make the following disclosure on their RSA proposals:

- › Issue amount;
- › Issue conditions (including issue price, vesting conditions, type of stocks, arrangements when the employees fail to meet the vesting conditions);
- › Qualifications of employees to be eligible for RSAs and the number of shares to be granted;
- › Rationale for implementing the RSA program;
- › Estimated accounting cost to the company, dilution effect on the company's EPS, and other shareholder rights.

8. ELECTION OF DIRECTORS AND SUPERVISORS

Voting for Director Nominees in Uncontested Elections

- ▶ **General Recommendation:** Vote against all directors and supervisors where the company employs the non-nomination system for election.

When the company employs the nomination system, generally vote for all non-independent director and supervisor candidates. Generally vote for the independent director nominees, unless:

- › The nominee is deemed non-independent under ISS classification;
- › The nominee is a legal entity or a representative of a legal entity¹;
- › The nominee has attended less than 75 percent of board and key committee meetings over the most recent fiscal year, without a satisfactory explanation. The calculation of director attendance (or that of the representatives appointed by a legal entity which serves as a corporate director in the company) will not include meetings attended by alternate directors (or the proxy of those representatives). Acceptable reasons for director absences are generally limited to the following:
 - › Medical issues/illness;
 - › Family emergencies;
 - › The director (or the representative) has served on the board for less than a year; and
 - › Missing only one meeting (when the total of all meetings is three or fewer);
- › The nominee sits on more than six² public company boards³; or
- › The nominee has been a partner of the company's auditor within the last three years⁴, and serves in the audit committee.

Under extraordinary circumstances, vote against directors or supervisors, members of a committee, or the entire board, due to:

- › Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company;
- › Failure to replace management as appropriate; or
- › Egregious actions related to a director's or supervisor's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

In making any of the above recommendations on the election of directors, ISS generally will not recommend against the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value.

Discussion

The election of directors and supervisors in Taiwan is unique. One notable characteristic is that legal entities such as governmental organizations and corporations, not just natural persons, can serve as non-independent directors and

¹ Pursuant to Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies under the Securities and Exchange Act, a legal entity can only serve as non-independent director in a company.

² A commitment to reduce the number of boards to six or fewer by the next annual meeting will be considered. The commitment would need to be disclosed prior to the AGM in the relevant meeting materials, such as the meeting notice, circular, or an annual report.

³ Any independent directors shall not sit on more than three public boards as independent director, according to Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies under the Securities and Exchange Act.

⁴ Pursuant to Securities and Exchange Act, all independent directors will automatically become the members of the company's audit committee, if any, which should be 100-percent independent.

supervisors. Legal entities can either appoint individuals as candidates or run for election themselves and then appoint representatives to perform the fiduciary duties. As a result, it is not uncommon in Taiwan to see only the name of the legal entity being nominated for a board seat and not the identity of the actual individual who will serve on the board to represent that entity's interest.


Another notable characteristic in Taiwan is that, only the independent directors are elected by the standard nomination system. The election of non-independent directors and supervisors, on the other hand, may use a traditional election system which is commonly referred to as the "non-nomination system". Under this non-nomination system, any shareholder can nominate any person of legal age to the board. Companies are not obliged to provide a roster of candidates and their profiles before the meeting, and many firms disclose candidate names and profiles at the meeting or only a few days beforehand. Further, whether the candidates are supported by management or not is often not disclosed.

Election by the non-nomination system poses a great challenge to investors, particularly overseas investors voting by proxy who must cast their votes well in advance of the meeting. The non-nomination system disenfranchises minority shareholders and greatly limits their ability to cast an informed vote. In contrast, under the nomination system, the board of directors reviews the qualifications of each candidate nominated by either the board itself or any shareholder holding one percent or more of the company's outstanding shares, and then provides the final roster of candidates together with their profiles to shareholders prior to the meeting.

Taking into consideration that the nomination system for non-independent director election is yet to be made mandatory by law, most of the assessment criteria, such as attendance and public boards held, among others, which are applicable to peer markets in the Asia-Pacific Region, will only be applied to independent director candidates who must be elected via the nomination system. In order to better evaluate non-independent director nominees' suitability in the long run, such assessment criteria could be phasing in and adopted in the review of non-independent director nominees in the near future.

Voting requirement: Cumulative voting is mandatory for all elections. There is no majority vote requirement.

Voting for Director Nominees in Contested Elections


 **General Recommendation:** Vote case-by-case on the election of directors in contested elections, including election of shareholder nominees or the dismissal of incumbent directors. For shareholder nominees, ISS places the persuasive burden on the nominee or the proposing shareholder to prove that they are better suited to serve on the board than management's nominees. Serious consideration of shareholder nominees will be given only if there are clear and compelling reasons for the nominee to join the board. These nominees must also demonstrate a clear ability to contribute positively to board deliberations; some nominees may have hidden or narrow agendas and may unnecessarily contribute to divisiveness among directors.

The major decision factors are:

- › Company performance relative to its peers;
- › Strategy of the incumbents versus the dissidents;
- › Independence of directors/nominees;
- › Experience and skills of board candidates;
- › Governance profile of the company;
- › Evidence of management entrenchment;
- › Responsiveness to shareholders;
- › Whether a takeover offer has been rebuffed.

9. RELEASE OF RESTRICTIONS ON COMPETITIVE ACTIVITIES OF DIRECTORS

Resolution Type: Special

-  **General Recommendation:** Vote against release of restrictions on competitive activities of directors if:
- › There is lack of disclosure on the key information including identities of the directors in question, current positions in the company, and outside boards they are serving on⁵; or
 - › The non-nomination system is employed by the company for the director election;


Discussion

Article 209 of the Company Act states that: "a director who does anything for himself or on behalf of another person that is within the scope of the company's business, shall explain to the meeting of shareholders the essential contents of such an act and secure its approval". Therefore, this request is frequently seen at Taiwanese AGMs, mostly in conjunction with director elections.

As is so defined in the Company Act, a director's service on a non-wholly owned subsidiary triggers this restriction as it is considered a separate legal entity operating within the same industry, even though the entity is a subsidiary of the company in question. As a result, without this waiver, many directors will not be able to serve concurrently on subsidiaries' boards, which may limit the company's ability to monitor the conducts of these subsidiaries. Therefore, the release of restrictions is acknowledged as instrumental at large conglomerates that need the flexibility to spread board expertise and transact business throughout companies within the group. However, the lack of a proper protection mechanism against a abusive usage of this permission, particularly the absence of a strong corporate governance structure, calls for a detailed disclosure including the identity of the directors in question, current positions in the company, and the outside boards they are serving on in order to analyze each individual case.

10. MERGERS & ACQUISITIONS

Resolution Type: Special

-  **General Recommendation:** Vote case-by-case on mergers and acquisitions, taking into consideration the following factors:
- › Valuation - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? If a fairness opinion has been prepared, it provides an initial starting point for assessing valuation reasonableness, but ISS also places emphasis on the offer premium, market reaction, and strategic rationale.
 - › Market reaction - How has the market responded to the proposed deal? A negative market reaction will cause ISS to scrutinize a deal more closely.
 - › Strategic rationale - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
 - › Negotiations and process - Were the terms of the transaction negotiated at arms-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders.
 - › Conflicts of interest - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the


⁵ If the company fails to disclose all outside directorships held by a director in question or those outside directorships that are being waived from the non-compete requirement, then it is deemed as lack of sufficient disclosure.

company may be more likely to vote to approve a merger than if they did not hold these interests. ISS will consider whether these interests may have influenced these directors and officers to support or recommend the merger.

- › Governance - Will the combined company have a better or worse governance profile than the respective current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

Shareholders who dissent from the merger or acquisition have the right to require the company to buy back their shares at the prevailing fair price, which is also commonly known as "appraisal right of dissenting shareholders".

11. TRANSACT OTHER BUSINESS

 **General Recommendation:** Vote against resolutions to transact other businesses.

Discussion

Taiwan companies allow the board and shareholders to raise issues not contained in the meeting agenda for shareholder approval during the shareholder meetings. Pursuant to Article 172 of the Company Act, election or dismissal of directors or supervisors, amendments to the Articles of Association, and other special resolutions, shall not be brought up as extemporary motions.

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