2018 GOVERNANCE PRINCIPLES SURVEY

Summary of Results

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Overview

A key part of ISS' annual global benchmark policy development process is a survey open to institutional investors, corporate executives, board members and all other interested constituencies. As in 2017, this year's survey has two parts: (1) a high-level Governance Principles Survey covering a limited number of topical corporate governance areas; and (2) three detailed regional surveys that seek feedback on more specific policy application questions. This document summarizes the findings of the Governance Principles Survey, which opened on July 30, 2018, and closed on Aug. 28, 2018. The supplemental surveys will remain open until Sept. 21, at 5 PM (EDT).

In total, ISS received 669 responses to this year's Governance Principles Survey, from 638 different organizations. The total number of responses represents an 11 percent increase from the total number of responses received in last year's Governance Principles survey.

Responses were received through the online survey from 109 individual investor representatives. That included 107 institutional investor respondents, representing 105 organizations, and an additional two responses from organizations that represent or provide services to institutional investors. Of the institutional investor respondents, 76 percent represented asset managers, 22 percent represented asset owners, and two percent represented both. Two institutional investor provided responses to ISS after the survey's deadline bringing the total investor responses to 111. These responses were considered but not aggregated in the results. For purposes of this report, survey results are based on 109 "investor" responses.

Responses were also received from a total of 554 non-investors from 525 organizations to the online survey, several of which submitted multiple responses from different individuals. At 469, responses from corporations were the most prevalent, followed by 40 from consultants/advisors to companies, 36 corporate directors, and, finally, a handful from academics, trade associations, and other organizations. Four non-investors did not take the online survey but provided responses to ISS via e-mail bringing the total non-investor responses to 558. These responses were considered but not aggregated in the results. For purposes of this report, survey results are based on 554 non-investor responses.

As in past years, the bulk of the respondents – more than 400 in all – represented organizations based in the United States. Europe and the U.K. (with 94 respondents) and Canada (with 53 respondents) were well-represented as well. Responses came in from at least 20 organizations based in Asia, seven based in Latin America, and five based in Africa. Responses were also received from organizations in, but not limited to, Australia, New Zealand, and Russia. Most respondents have a market focus that goes beyond their own home country.

PRIMARY MARKET OF FOCUS	INVESTOR	NON-INVESTOR
Global (including most or all of the regions below)	61%	19%
U.S.	25%	57%
Continental Europe	6%	5%
Canada	4%	7%
Asia-Pacific	2%	5%
U.K.	2%	3%
Developing/emerging markets generally	2%	1%
Latin America	0%	1%
Other (includes Australia, Africa, or combination of two other markets)	0%	3%

The breakdown of investors by the size of their assets owned or assets under management is as follows:

ASSET SIZE	% OF INVESTOR RESPONDENTS
Under $100 million	1%
$100 million - $500 million	5%
$500 million - $1 billion	3%
$1 billion - $10 billion	15%
$10 billion - $100 billion	32%
Over $100 billion	39%
Not applicable	6%

Some of the respondents answered every survey question; others skipped one or more questions. Throughout this report, response rates are calculated as percentages of the valid responses received on each particular question from investors and from non-investor respondents, excluding blank responses. Survey participants who filled out the "Respondent Information" but did not answer any of the policy questions were excluded from the analysis and are not part of the count or breakout of respondents above.

Key Findings

Auditors and Audit Committees

The role of auditors and audit committees captured increased focus recently in the wake of the collapse of Carillion, a U.K. company, after a clean bill of health from its auditor and the high level of shareholder opposition to ratifying General Electric's long-tenured auditor after unexpected accounting charges and an SEC investigation. In a number of developed markets around the world, investors and regulatory bodies have started to focus on additional indicators of audit quality or auditor independence.

ISS asked respondents to identify the audit-related factors (other than fees paid to the auditor for non-audit services) that they consider in evaluating the independence and performance of external auditors. Investor respondents most often cited regulatory fines or other penalties on the auditor for weaknesses or errors in audit practices as a significant matter of interest. The second most popular response was significant audit controversies. The investor respondents' third most favored factor was the identity of the audit partner and any links he or she has to the company or its management.

Non-investors' most frequently cited factor response was considering the identity of the audit partner and any links he or she has to the company or its management, followed by regulatory fines or other penalties on the company related to financial disclosure practices or weaknesses not identified in the audit report. Regulatory fines or other penalties on the auditor for weaknesses or errors in audit practices generated the third most frequent response rate among non-investor respondents.

ISS also asked survey respondents to identify information that shareholders should consider when evaluating a company's audit committee. Overall, investor and non-investor responses showed alignment with respect to the highest-favored to least-favored factors.

Of investor respondents, the highest number cited the skills and experience of audit committee members (including number of financial experts, if applicable), followed by significant financial reporting or audit controversies and the quality of the company’s financial reporting (e.g., number of restatements; nature of restatements) as the second- and third-highest favored factors, respectively.

Non-investor respondents also most commonly cited skills and experience of audit committee members; however, the next highest non-investor response was on the quality of the company’s financial reporting followed by significant financial reporting or audit controversies.

Of the respondents who selected "other" information to be considered when evaluating audit committees, the level of independent directors on the audit committee was a factor considered by several investor respondents. A joint response on behalf of both an investor and non-investor respondent indicated that the audit committee's charter be an additional factor for consideration commenting that "Audit committees that are empowered – and held accountable – by robust charters are more likely to be able and motivated to promote effective internal control, high quality financial reporting, and reliable auditing."

Director Accountability and Track Records

If an individual director has failed in his or her boardroom oversight responsibilities at one company and this has resulted in a negative ISS vote recommendation, ISS asked respondents if they would consider it appropriate and useful to note this information in the proxy research of other companies where that director serves on the board. A significant majority of investor respondents (84 percent) answered "yes, my organization would like to consider any identified oversight shortfalls by the director on other boards where he or she serves." Notably, only three percent responded "No, my organization considers a director's service on each board on which he or she serves on a standalone basis;" and 13 percent responded, "it depends." Of the investor respondents who selected "it depends" as their response, several indicated that the oversight failure would need to be significant to merit noting.

Among non-investor respondents, the responses were nearly evenly split with 41 percent responding "yes" to the question and 40 percent responding "no." Twenty percent responded, "it depends." Of the non-investor respondents selecting "it depends" as their response, many of them commented that it depends on the circumstances or the nature of the oversight shortfall.

As a follow-up question, respondents were asked to select the types of oversight shortfalls would be relevant to the assessment in such a situation. Investor and non-investor responses showed general alignment when ranking the most relevant to least relevant types of oversight shortfalls. Both investor and non-investor respondents showed the strongest support for citing risk oversight failures relating to fraud or other forms of corporate malfeasance.

For investor respondents, oversight failures regarding the protection of shareholder rights or shareholder value and risk oversight failures related to business operations (such as cybersecurity) ranked as the second and third most relevant types of oversight shortfalls, respectively.

For non-investor respondents, oversight failures regarding protection of shareholder rights or shareholder value and pattern of poor stewardship of compensation practices were the second and third most relevant types of oversight shortfalls, respectively. Additionally, "risk oversight failures related to business operations (such as cybersecurity)" was also deemed somewhat relevant with the number of non-investor responses slightly lower than the number of responses on the pattern of poor stewardship of compensation practices.

Respondents were also asked what would be considered an appropriate look-back period for such oversight shortfalls. A significant majority of investor respondents appeared to favor a longer timeframe with 30 percent choosing five years and 39 percent choosing no time limit as their respective responses. Only 2 percent of investors chose one year and 16 percent chose three years.

On the other hand, a majority of non-investor respondents appeared to favor a shorter timeframe with 44 percent selecting three years and 13 percent selecting one year as their respective responses. Only nine percent selected no time limit and 22 percent selected five years.

An equal percentage (13 percent) of both investor and non-investor responses selected "other" look-back period as their response with many of these respondents indicating that it depends on the severity of the oversight shortfall.

Gender Diversity on Boards

Investor attention to gender board diversity continues to be intense. As of June 30, 2018, 16 percent of Russell 3000 companies in the U.S. had no female board directors, compared to 21 percent at the end of 2017. In the S&P 500, less than one percent of companies had all-male boards as of August 30, 2018. In each of Canada, the UK and Australia, the number of mid-to-large public companies with no female directors dropped to under four percent this year. In Japan, the number of companies with no female representation is considerably higher at 34 percent this year but has been improving rapidly over the past few years.

ISS asked respondents in 2017's policy survey if they considered it problematic if there were zero female directors on a public company board. This year, ISS revisited the same questions to identify year-over-year changes, if any, in views on this topic.

This time around, both investors and non-investors were more likely to respond that a lack of gender diversity on corporate boards would indicate a problem in the board recruitment process. Over 80 percent of investors indicated that they considered it to be problematic. That was up from 69 percent last year. Specifically, 45 percent of investors replied "Yes, the absence of at least one female director may indicate problems in the board recruitment process," while 37 percent replied "Yes, but concerns may be mitigated if there is a disclosed policy/approach that describes the considerations taken into account by the board or the nominating committee to increase gender diversity on the board."

Very few investors replied "No, directors are best-suited to determining the composition of the board." Only three percent of investors replied that a lack of diversity was not problematic, down from eight percent last year.

Non-investors also migrated a little to the "yes" from a "maybe" response category and moved more decisively away from "no." This year, over 60 percent of non-investors replied "yes" in some form, up from 54 percent last year. This year, "Yes, the absence of at least one female director may indicate problems in the board recruitment process" was the most popular response for non-investors with one-third picking this response. "Yes, but concerns may be mitigated with a policy" received 30 percent of the non-investor response. Thirteen percent of non-investors responded that a lack of gender board diversity was not problematic, down from 19 percent last year.

Of the investor respondents who indicated that the lack of female directors on a public board is or could be problematic, the highest number cited engagement with the board and/or management as the most appropriate response, as was the case last year. Considering support for a shareholder proposal aimed at increasing diversity was the second most popular response again this year, with very similar response rates.

This year, considering voting against the chair of the board's nominating or governance committee moved into third place in terms of investors' action of choice given a lack of gender board diversity, overtaking "consider supporting shareholder-nominated candidate." Supporting a shareholder-nominated candidate and considering voting against all members of the nominating committee tied for fourth place this year. Voting against the chair of the board or lead director was sixth and voting against Reports and Accounts where available was seventh.

At least one investor commented that, after engagement, their organization would consider voting against the chair of the board. One investor said that they vote against all incumbent members of the board if it had no gender diversity.

Like the investor respondents, non-investors' most commonly preferred investor action in response to a lack of gender diversity was engagement with the board and management, followed by supporting a shareholder proposal aimed at increasing diversity and voting against the chair of the nominating or governance committee. The ranking of these factors based on the non-investor responses was similar to last year.

One-Share, One-Vote Principle

The "one-share, one-vote principle" is increasingly in focus as some emerging companies have sought to access public capital markets while insulating themselves and their management teams from perceived short-term pressures through unequal voting rights.

When asked if ISS should provide vote results where possible to show what the vote results would have been if all votes were counted equally, respondents overwhelmingly responded in favor of receiving such information. Ninety-two percent of investors and 59 percent of non-investors responded that they would like to see such information displayed. Only 4 percent of investors responded that they would not like to have that information noted. Thirty-one percent of non-investors replied that ISS should not provide that information.

When asked if ISS should use adjusted vote results to measure board responsiveness to shareholder vote results in the following year, investors were largely in favor, but non-investors were roughly split. Seventy-two percent of investors replied that adjusted vote results should be used for making responsiveness determinations, whereas 17 percent responded that it was not appropriate. For non-investors, the numbers were 42 percent and 46 percent, respectively.

Some respondents noted in their comments that use of such data should be on a case-by-case basis depended on the situation, including factors such as the share structure, ownership structure, and existence of a sunset provision for the multi-class shares.

When asked about the appropriate timeframe for sunset provisions on unequal voting rights structures, investors and non-investors responded very similarly. In both cases, 46 percent picked either "one to three years" or "four to six years” as their responses.

A significant minority of both types of respondents replied that the appropriate timeframe depended on the situation. They noted that some factors that investors should take into account include the level of involvement of family or original founders, the share structure and the difference in voting rights, the maturity of the company, the industry, company size, company governance, and shareholder engagement.

Appendix - Detailed Survey Responses

Survey results are based on 109 investor responses (primarily asset managers and asset owners) and 554 responses from non-investors (primarily corporate issuers), reflecting more than one response from some organizations.

For questions that allowed multiple answers, rankings are based on the number of responses for each answer choice. Percentages for other questions may not equal 100 percent due to rounding.

Auditors and Audit Committees

A periodic vote on auditor ratification allows shareholders to assess and express their views on a number of audit-related topics – for example, whether they consider the auditors have been responsibly examining the company's financial statements, that their reports have adequately expressed any legitimate concerns, and whether the auditor is considered sufficiently independent of the company's management. In a number of developed markets around the world, investors and regulatory bodies have started to focus on additional indicators of audit quality and auditor independence. Auditor ratification, appointment, disclosure and rotation requirements differ widely by market, but nonetheless ISS would like to assess investor and other market participants' views in this area.

ISS voting guidelines often consider non-audit services and fees as one factor when assessing the independence of the external auditor. In principle, what other audit-related factors could be considered in evaluation of the independence and performance of the external auditor? (Check all that apply)

	INVESTORS' RANK*	NON-INVESTORS' RANK*
Regulatory fines or other penalties on the auditor for weaknesses or errors in audit practices	1 (89)	3 (247)
Significant audit controversies	2 (88)	4 (222)
Identity of audit partner and any links to the company or its management	3 (87)	1 (329)
Regulatory fines or other penalties on the company related to financial disclosure practices or weaknesses not identified in the audit report	4 (82)	2 (255)
Audit firm tenure	5 (72)	6 (183)
Audit partner tenure	6 (60)	5 (215)
Other	7 (14)	7 (33)

*Rankings are based on number of responses for each answer choice

What information should be considered by shareholders in evaluating the company's Audit Committee? (Check all that apply)

	INVESTORS' RANK*	NON-INVESTORS' RANK*
Skills and experience of audit committee members (including number of financial experts, if applicable)	1 (104)	1 (475)
Significant financial reporting or audit controversies	2 (93)	3 (320)
Quality of the company's financial reporting (e.g., number of restatements; nature of restatements)	3 (88)	2 (376)
The level of disclosure of factors used in the audit committee's assessment of the external auditor's independence, tenure, qualifications and work quality	4 (68)	5 (142)
Frequency of audit committee meetings	5 (53)	4 (174)
Frequency of audit committee refreshment	6 (48)	6 (65)
Other	7 (15)	7 (31)

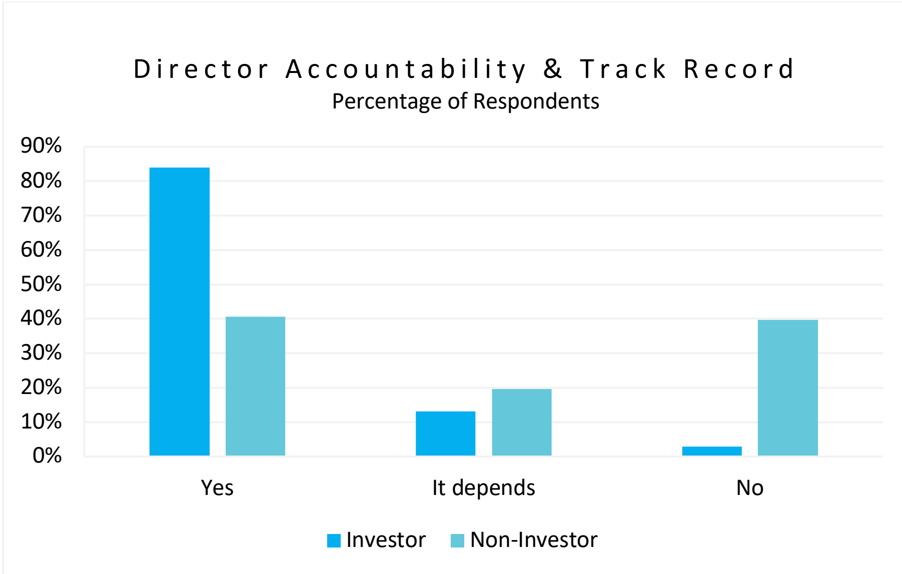
*Rankings are based on number of responses for each answer choice

Director Accountability and Track Records

Some institutional investors are interested in tracking individual directors who have been involved in controversies with respect to one or more of their past or present directorships, particularly where concerns have been raised about shortfalls in oversight. Where identified, such concerns about oversight shortfalls may trigger negative recommendations under current ISS policy for directors who held boardroom leadership roles or served on committees with direct responsibility for overseeing the activities that triggered the controversy.

If ISS assesses that an individual director has failed in his or her oversight responsibilities at one company and this has resulted in a negative ISS vote recommendation, do you consider it appropriate and useful for shareholders for ISS to note this in the proxy research of other companies where that director serves on the board?

	INVESTORS	NON-INVESTORS
Yes, my organization would like to consider any identified shortfalls by the director on other boards where he or she serves	84%	41%
It depends (please specify)	13%	20%
No, my organization considers a director's service on each board on which he or she services on a standalone basis	3%	40%



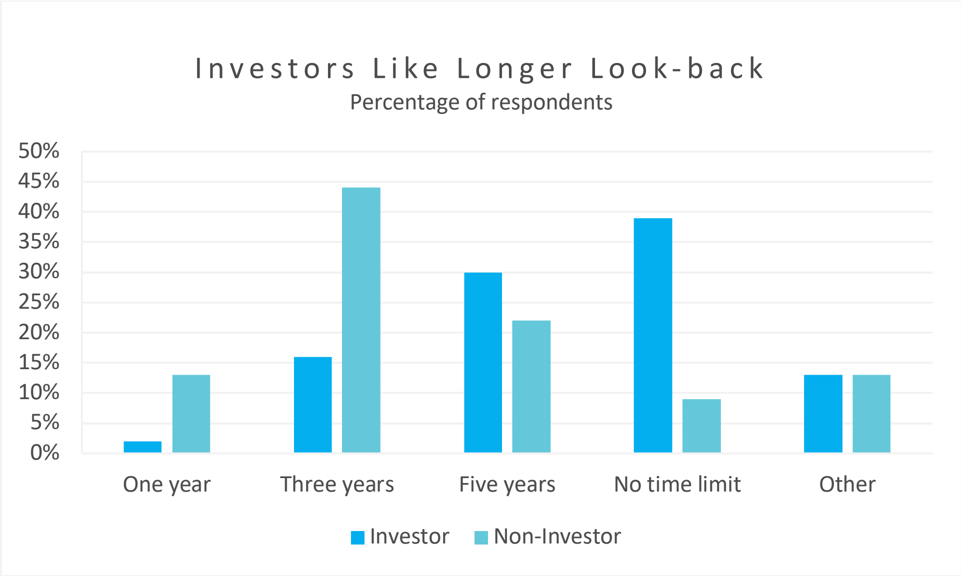
What types of oversight shortfalls would you consider to be relevant to the assessment in such a situation? (Check all that apply)

	INVESTORS' RANK*	NON-INVESTORS' RANK*
Risk oversight failures relating to fraud or other forms of corporate malfeasance	1 (100)	1 (350)
Oversight failures regarding protection of shareholder rights or shareholder value	2 (90)	2 (215)
Risk oversight failures related to business operations (such as cybersecurity)	3 (87)	4 (172)
Pattern of poor stewardship of compensation practices	4 (80)	3 (178)
Other	5 (10)	5 (63)

*Rankings are based on number of responses for each answer choice

What do you consider is an appropriate look-back period for such oversight shortfalls?

	INVESTORS	NON-INVESTORS
One year	2%	13%
Three years	16%	44%
Five years	30%	22%
No time limit	39%	9%
Other	13%	13%



Gender Diversity on Boards

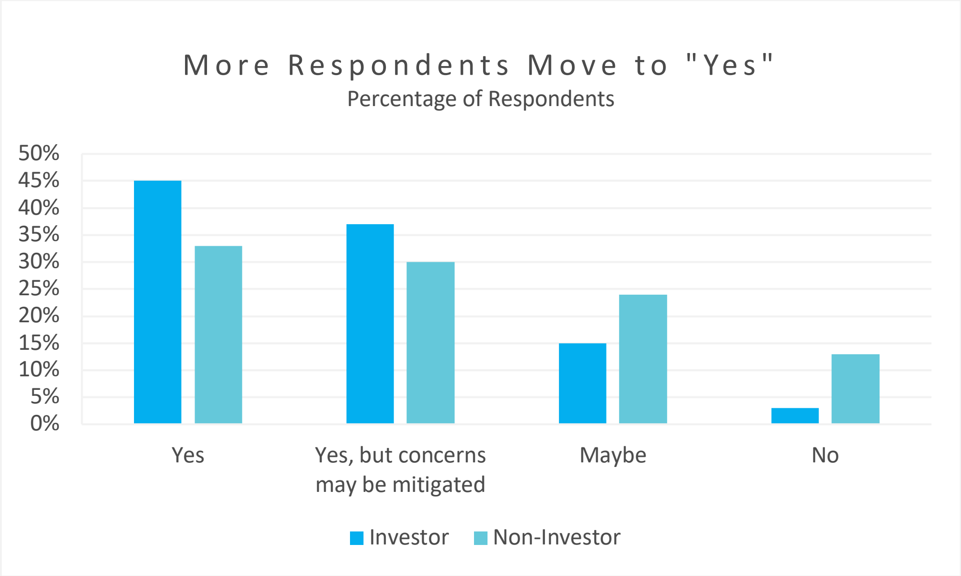
The focus on increasing gender diversity in corporate boardrooms has soared in recent years. Many markets have implemented enhanced disclosure requirements, best practice recommendations and/or regulatory quotas to drive increased female representation on public company boards, and many institutional investors have publicly supported initiatives to increase board gender diversity. However, there has been limited progress in increasing the number of female directors on boards in some markets, and many institutional investors continue to express frustration with a perceived lack of progress in increasing gender diversity on individual boards, in certain markets or in certain industry sectors. ISS asked respondents in last year's policy survey if they considered it problematic if there are zero female directors on a public company board. More than two-thirds (69 percent) of investor respondents said "yes". A significant proportion of investor respondents (43 percent) said they considered that the absence of female directors could indicate problems in the board recruitment process, while 26 percent of investor respondents said that although a lack of female directors would be problematic, their concerns may be mitigated if the company had a disclosed policy/approach that describes the considerations taken into account by the board or the nominating committee to increase gender diversity on the board.

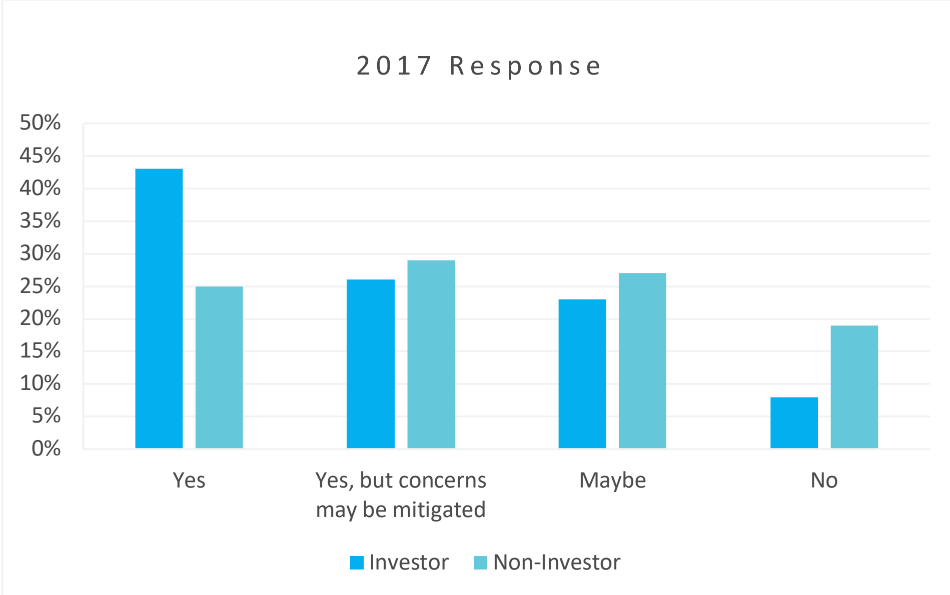
As of June 30, 2018, 16 percent of Russell 3000 companies in the U.S. had no female board directors, compared to 21 percent at the end of 2017. In each of Canada, the UK and Australia, the number of mid-to-large public companies with no female directors dropped to under four percent this year. In Japan, the number of companies with no female representation is considerably higher at 34 percent this year but has been improving rapidly over the past few years.

ISS is revisiting the same questions we asked in last year's policy survey with respect to gender diversity on boards to identify changes, if any, in investor and non-investor views on this topic.

Does your organization consider it to be problematic if there are zero female directors on a public company board?

	INVESTORS	NON-INVESTORS
Yes, the absence of at least one female director may indicate problems in the board recruitment process	45%	33%
Yes, but concerns may be mitigated if there is a disclosed policy/approach that describes the considerations taken into account by the board or the nominating committee to increase gender diversity on the board	37%	30%
Maybe, but the level of concern is based on a case-by-case determination (e.g., it depends on the country; type of company; industry sector or other factors)	15%	24%
No, directors are best suited to determining the composition of the board	3%	13%





If your organization answered "Yes" or "Maybe" to the preceding question, what actions do you consider may be appropriate for shareholders to take at a company that lacks any gender diversity on the board, and/or has not disclosed a policy on the issue? (Check all that apply)

	INVESTORS' RANK*	NON-INVESTORS' RANK*
Engage with the board or management	1 (91)	1 (378)
Consider supporting a shareholder proposal aimed at increasing diversity	2 (82)	2 (114)
Consider voting against the chair of the nominating/governance committee	3 (53)	3 (72)
Consider supporting a shareholder-nominated candidate to the board	4 (47)	4 (69)
Consider voting against all members of the nominating/governance committee	4 (47)	5 (53)
Consider voting against the chair of the board or the lead director	6 (36)	6 (46)
Consider voting against the Reports & Accounts (in markets where this is an option) reflecting poor disclosure of gender diversity	7 (23)	8 (6)
Other	8 (10)	7 (20)

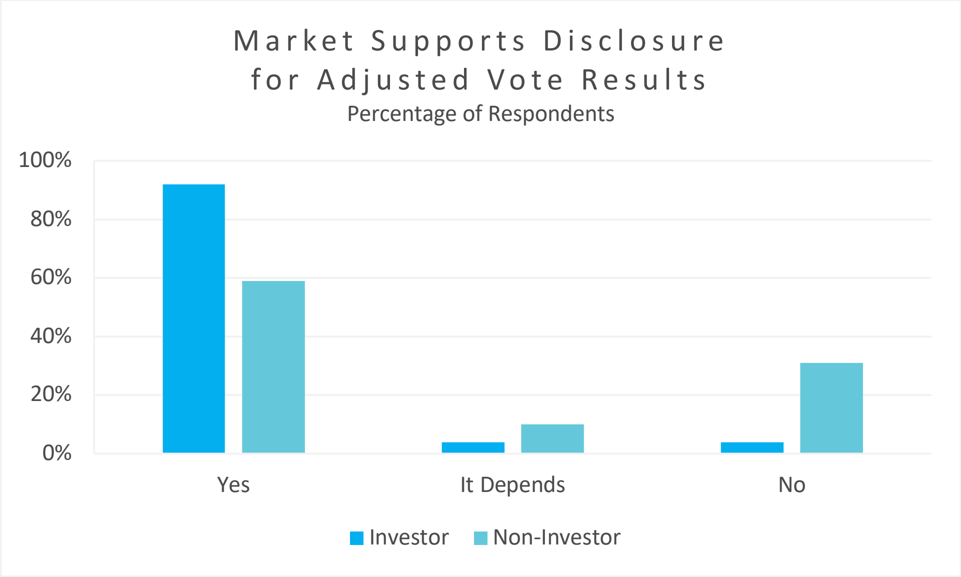
*Rankings are based on number of responses for each answer choice

One-Share, One-Vote Principle

Adjusted Vote Results. The "one-share, one-vote principle" – the idea that shareholders and long-term shareholder value is best protected by a capital structure in which voting power corresponds to each shareholder's ownership stake and at-risk capital commitment – has been challenged as some companies have accessed public capital markets with significant differential voting rights. In such cases, and for the purposes of determining board responsiveness to shareholder vote results, ISS is considering whether to provide in the future an adjusted analysis of shareholder vote results to show what the results would have been if all votes had been counted under the one-share, one-vote principle. For example, in 2018, Facebook received a shareholder proposal asking it to issue a report on the risks posed by content management controversies. The company reported that the proposal received 10.2 percent shareholder support. If the Class B shares (which are currently entitled to ten votes for each share held) were counted only as one vote each (and assuming all the Class B shareholders voted against the proposal), the proposal would have received 31 percent shareholder support.

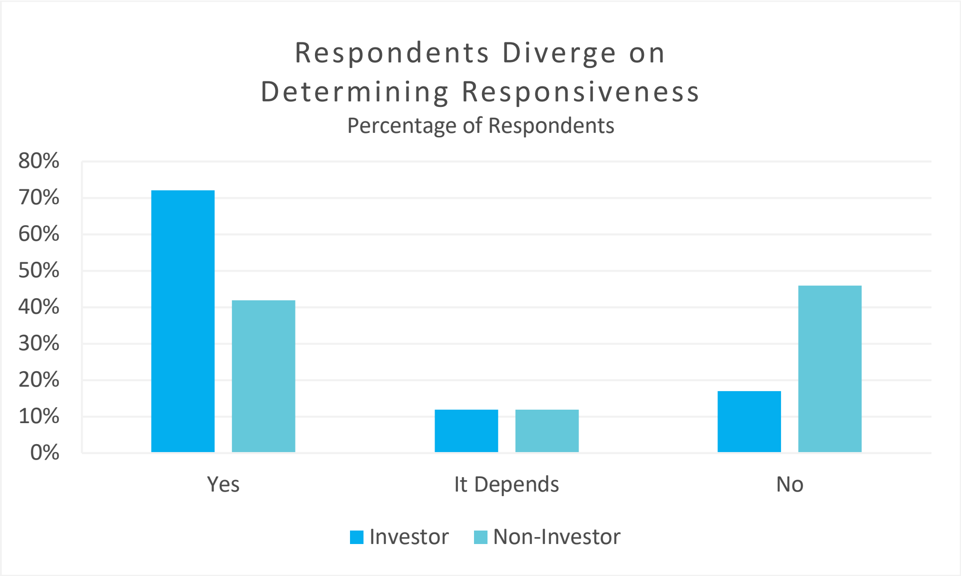
At companies with multi-class capital structures with unequal voting rights, should ISS in the future provide such adjusted vote results where possible to do so?

	INVESTORS	NON-INVESTORS
Yes	92%	59%
It depends	4%	10%
No	4%	31%



Does your organization consider that ISS should use such adjusted vote results to determine the need for board responsiveness to shareholder vote results in the following year?

	INVESTORS	NON-INVESTORS
Yes	72%	42%
It depends	12%	12%
No	17%	46%



Sunset Provisions: A significant minority of investors (43 percent) who responded to ISS's 2017 policy survey said that unequal voting rights structures may be appropriate in limited circumstances if they are subject to automatic sunset requirements.

Triggers to sunset multi-class capital structures are usually either based on:

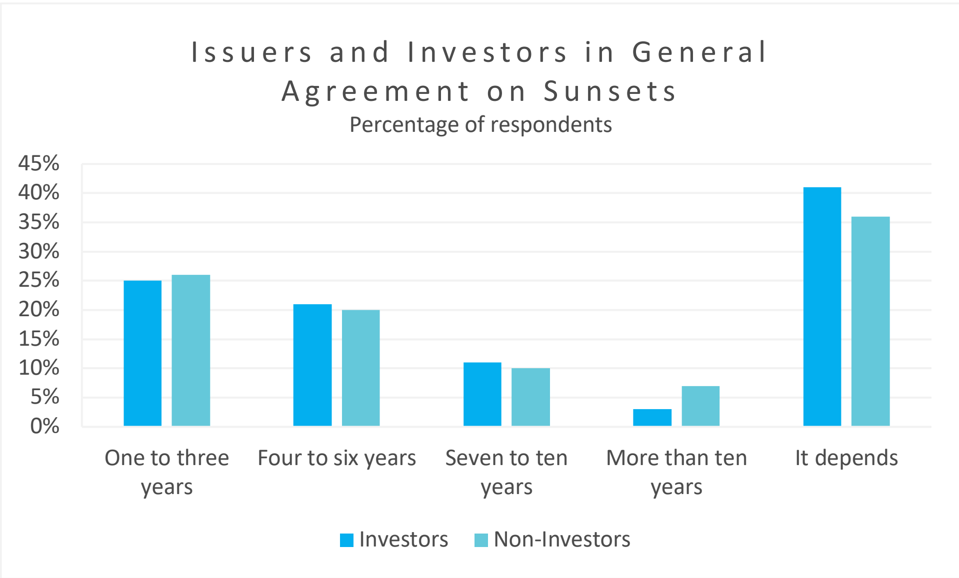
-- (i) the passage of a set amount of time, or

-- (ii) aggregate ownership level of insiders and/or the superclass falling below a certain threshold.

Alternatively, some sunset provisions utilize a combination of time and ownership triggers, usually based on whichever occurs earliest.

What does your organization consider is an appropriate timeframe for sunset provisions for multi-class capital structures with unequal voting rights?

	INVESTORS	NON-INVESTORS
One to three years	25%	26%
Four to six years	21%	20%
Seven to ten years	11%	10%
More than ten years	3%	7%
It depends	41%	36%



ABOUT ISS

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