



AUSTRALIA

Proxy Voting Guidelines Benchmark Policy Recommendations

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Introduction

These guidelines have been developed as the basis for ISS Australian Benchmark Policy for proxy voting recommendations.

Underlying Principles

The principle underpinning all of ISS' benchmark recommendations is that security holders are the owners of listed entities, and as such, they are entitled to assess every resolution that requires their approval and to understand how it affects their interests as owners. Accountability, transparency and fairness are the overarching goals of the laws, standards and principles in the Australian market.

Shareholders have no decision-making ability in the management of the listed entity. Their main rights in this regard are to receive information about a company's performance and to vote on resolutions put before an annual or, where applicable, extraordinary general meeting.

Under current legislation in Australia, items typically put before a meeting of security holders can be characterized as follows:

- Consideration of the financial statements and reports (not normally a voting item);
- Election or re-election of directors;
- Consideration of the remuneration report and to cast a non-binding (advisory) vote on executive pay practices;
- Issuance of new securities in certain circumstances, including to executives and directors under their employment contracts, or as required under ASX Listing Rules;
- Changes in the Constitution of a company;
- Consideration of certain related party transactions;
- Consideration of an increase in the directors' total fee pool (directors are able to determine the quantum of fees each individual will receive from that pool);
- Consideration of termination payments to executives in excess of a statutory maximum of one year's remuneration; and
- Consideration of mergers, acquisitions, schemes of arrangement, demergers, and capital reconstructions.

The goals of these guidelines are to recognize that:

- The objective of most security holders is to hold and manage their investments with sustainable long-term value creation in mind; and
- Strong corporate governance practices can enhance shareholder value and mitigate risk.

Application of this policy

This policy forms the basis of the ISS benchmark vote recommendations for listed entities in Australia. This document is intended to provide investors with insights into how ISS analyses these entities in the Australian market. However, it is not possible to address every eventuality, and inevitably many issues will need to be considered on a case-by-case basis. ISS will apply this policy as a guideline, but analysts will take a holistic view of the listed entity's situation, and consider any explanation for non-standard practice, when determining voting recommendations.

Investors recognize that appropriate corporate governance practices for listed entities can differ according to the type, location and nature of their business operations. The principles of good corporate governance are generally

applicable to listed entities whatever their size, but ISS recognizes that investors and other market participants have differing expectations for certain market cap segments.

Voting disclosure and response to significant shareholder dissent

Investors expect that information regarding the voting outcomes on the resolutions presented at an AGM will be made available as soon as reasonably practicable after the AGM. The information should include the number of votes for the resolution, the number of votes against the resolution and the number of securities in respect of which the vote was directed to be withheld, and the overall percentages for each group.

Good corporate governance practice suggests that when a sizable proportion of votes have been cast against a resolution at any general meeting, the directors of the entity should explain what actions have been taken to understand the reasons behind the vote result. There is no universal threshold for significant dissent, and market practice is bound to evolve. However, many investors will use the 25 percent figure which represents a "strike" against the remuneration resolution as a threshold for identifying significant issues of concerns. There may be reasons why for some companies a higher or lower level might be more appropriate for other types of resolutions. Some investors may take the view that dissent should be taken to mean both active abstentions and votes against. In Australia, "votes withheld" (abstentions) are not votes in law and companies may wish to consider viewing votes withheld (or in combination with votes against) exceeding 25 percent as indicating a low level of support from investors which they may wish to address. Across other markets globally, ISS sees a consensus emerging with a figure somewhere in the range of 20 percent to 30 percent as a threshold for significant dissent.

Where a company has received a significant level of dissent on a resolution at a general meeting, ISS will consider if and how the company has sought to understand the reasons behind the vote result, and how the company has communicated its response to the dissent. As a starting point, dissent of 25 percent or more will generally be used as the trigger for this case-by-case analysis. In certain circumstances, ISS may recommend a vote against a relevant resolution at a future general meeting if the company has not explained its reaction to the dissent.

Coverage universe

In the Australian market, the core ISS benchmark policy applies to all companies in the S&P ASX300 Index, excluding certain types of investment trusts. The ASX Corporate Governance Council's Principles and Recommendations recognizes that when assessing the practice of a smaller company outside the ASX300, investors should be mindful of the individual circumstances of the business, including its size and complexity. Smaller companies may not have the resources to be able to comply with all the principles and recommendations, and there may be different requirements for these entities. Accordingly, the core ISS policy recognizes these exceptions on a case-by-case basis.

1. General

Constitutional Amendment

- **General Recommendation:** Vote case-by case on proposals to amend the company's constitution.

Proposals to amend the company's constitution are required to be approved by a special resolution (with a 75 percent super majority of votes cast requirement). Proposals range from a general updating of various clauses to reflect changes in corporate law and ASX Listing Rules, to complete replacement of an existing constitution with a new "plain language," and updated, version.

Alteration of the Number of Directors/Board Size in Constitution

- **General Recommendation:** Generally vote against proposals to limit the number of directors on the board.

The Australian Corporations Act requires a minimum of three directors for public companies, and nominees are elected if they receive 50 percent shareholder support. There is no maximum board size limit set out in the Act, although company constitutions may set a maximum limit.

Vote against proposals to alter board size which have the effect of providing the company an ability to invoke "no vacancy" for new nominees seeking election to the board. Such a limitation is not considered to be in the best interests of shareholders, as it prevents a new shareholder nominee from being added to the board unless a board/management nominee is voted down.

Renewal of "Proportional Takeover" Clause in Constitution

- **General Recommendation:** Vote for the renewal of the proportional takeover clause in the company's constitution.

The Australian Corporations Act allows a company to include in its constitution a clause that requires shareholder approval for a proportional (partial) takeover offer to be made. Under this type of clause, a proportional takeover offer cannot proceed to be mailed out to shareholders until after the company has held a general meeting at which shareholders vote on whether to allow the offer to be made. The clause can remain in the constitution for a maximum of three years. It is standard practice among ASX-listed companies to ask shareholders to reinsert the clause into the constitution at every third AGM. If a shareholder meeting to vote on the approval of the making of a proportional bid is not held within 14 days of the bid expiry deadline, then the making of the bid is taken as approved.

Change Company Name

- **General Recommendation:** Vote for proposals to change the company name.

Decisions on the company name are best left to management. Typically, name changes are proposed to align the company name more closely with its primary businesses and activities and/or to simplify the company name. Such changes are usually made without detracting from market recognition of the company's identity and activities.

Authority to Postpone or Adjourn Meeting

➤ **General Recommendation:** Vote case-by-case on proposals to amend the company's constitution to provide the board with the authority to adjourn annual or special meetings, taking into account:

- The board's rationale for proposing the amendment; and
- The board's past practices in acting in the best interests of shareholders.

When adequate explanation for an adjournment or postponement of a company meeting is given (such as to consider an improvement in economic benefit available to shareholders), such discretion of the chairman and board should be supported. However, evidence of the misuse of the authority to adjourn an annual or special meeting may result in recommendations against the re-election of the chairperson, or, if the chairperson is not up for re-election, any non-executive directors up for re-election that were present at the relevant meeting.

Significant Change in Activities

➤ **General Recommendation:** Vote for resolutions to change the nature or scale of business activities (provided the notice of meeting and explanatory statement provide a sound business case for the proposed change.

Financial Statements

➤ **General Recommendation:** Vote for the approval of financial statements and director and auditor reports, unless:

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

Australian companies are not required to submit their annual accounts and reports to a shareholder vote.

Reappointment of Auditor, and Authorization for the Directors to Set Auditor's Remuneration

➤ **General Recommendation:** Vote for the appointment of auditors and authorizing the board to fix their remuneration, unless:

- There are serious concerns about the accounts presented or the audit procedures used; or
- Fees for non-audit services ("other fees") are excessive or are routinely in excess of annual audit fees.

Non-audit fees are excessive if non-audit ("other") fees exceeds the aggregate of audit fees, audit-related fees and tax compliance/preparation fees.

Tax compliance and preparation includes the preparation of original and amended tax returns and refund claims and tax payment planning. All other services in the tax category, such as tax advice, planning or consulting, should be included to "other fees". If the breakdown of tax fees cannot be determined, all tax fees would be added to "other fees" for the purpose of considering the extent of excessive non-audit fees compared with audit fees.

In circumstances where "other fees" include fees related to significant one-time capital structure events (such as initial public offerings or demergers) and the company makes public disclosure of the amount and nature of those fees that are an exception to the standard "non-audit fee" category, then such fees may be excluded from the non-audit fees considered in determining the ratio of non-audit to audit/audit-related fees/tax compliance and preparation charges for purposes of determining whether non-audit fees are excessive.

This type of resolution is not required under Australian law, but it will be a ballot item for ASX-listed companies that are incorporated in the United Kingdom, Papua New Guinea, and other countries where annual reappointment of the auditor is a statutory requirement. Refer to [Chapter 3](#). Board of Directors for considerations of voting sanctions in regard to members of an Audit Committee.

Appointment of a New Auditor

- **General Recommendation:** Generally, vote for the appointment of a new auditor, unless there is a compelling reason why the new auditor selected by the board should not be endorsed. A compelling reason might be a past association as auditor during a period of financial trouble.

Whenever an Australian public company changes its auditor during the year, it is required to put the auditor up for election by shareholders at the next AGM. Often a new auditor is selected by the board during the year and may or may not have started work by the time the shareholders vote on its election.

Mergers and Acquisitions

- **General Recommendation:** Vote mergers and acquisitions on a case-by-case basis, review and evaluate the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors taking into account the factors of valuation, market reaction, strategic rationale, conflicts of interest and governance.


When evaluating the merits of a proposed acquisition, merger or takeover offer, ISS focuses on the impact of the proposal on shareholder value, both in the immediate and long term. For every M&A analysis, ISS reviews publicly available information as of the date of the report and evaluates the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors including:

Factor	Approach
Valuation	Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction and strategic rationale.
Market reaction	How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.
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 arm's-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation "wins" can also signify the deal makers' competency. The comprehensiveness of the sales process (e.g., ability for alternate bidders to participate) can also affect shareholder value.

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 company may be more likely to vote to approve a merger than if they did not hold these interests. 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 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.

It is considered incumbent on the board to explain the structure proposed for the combination and in particular why a go-shop period was not incorporated. In a demerger, it is incumbent on the board to explain the rationale for the transaction and determination of the retained shareholding percentage.

Related-Party Transactions

 **General Recommendation:** In evaluating resolutions that seek shareholder approval on related-party transactions (RPT), vote on a case-by-case basis, considering factors including, but not limited to, the following:

- The parties on either side of the transaction;
- The nature of the asset to be transferred/service to be provided;
- The pricing of the transaction (and any associated professional valuation);
- The views of independent directors, where provided;
- The views of an independent financial adviser, where appointed;
- Whether any entities party to the transaction, including advisers, are conflicted; and
- The stated rationale for the transaction, including discussions of timing.


Under the ASX Listing Rules, the listed entity must obtain the approval of its shareholders for certain transactions either beforehand or, if the transaction is conditional on that approval, before it is completed. The company must ensure that the related party does not vote on the relevant resolution and should take all reasonable steps to ensure that the related party's associates do not vote on the relevant resolution.

2. Share Capital

Capital Structure


Capital structures are generally non-contentious in Australia. Each fully-paid ordinary share carries one vote on a poll and equal dividends. Partly-paid shares, which are rare, normally carry votes proportional to the percentage of the share paid-up. Companies may also issue redeemable shares, preference shares, and shares with special, limited, or conditional voting rights. Shares with differing amounts of votes constitute different classes of shares, but, in practice, shares with limited or enhanced voting rights are seldom, if ever, seen in Australia outside of a handful of externally managed infrastructure entities.

Multiple Voting Rights

 **General Recommendation:** Vote against proposals to create a new class of shares with superior voting rights.

Shareholders' rights are typically eroded in dual-class proposals because they contribute to the entrenchment of management and allow for the possibility of management acquiring superior voting shares in the future. Empirical evidence also suggests that companies with simple capital structures also tend toward higher valuation because they are easier for investors to understand.


Non-Voting Shares

 **General Recommendation:** Vote against proposals to create a new class of non-voting or sub-voting shares. Only vote for if:

- It is intended for financing purposes with minimal or no dilution to current shareholders; or
- It is not designed to preserve the voting power of an insider or significant shareholder.

Generally, vote for the cancellation of classes of non-voting or sub-voting shares.


Reduction of Share Capital: Cash Consideration Payable to Shareholders

 **General Recommendation:** Generally, vote for the reduction of share capital with the accompanying return of cash to shareholders.

A company's decision to reduce its share capital, with an accompanying return of funds to shareholders, is usually part of a capital-management strategy or scheme of arrangement (including upon a demerger transaction). It is commonly an alternative to a buyback or a special dividend.


Such a reduction is typically effected proportionately against all outstanding capital, and therefore would not involve any material change relative to shareholder value.

Reduction of Share Capital: Absorption of Losses

 **General Recommendation:** Vote for reduction of share capital proposals with absorption of losses, as they represent routine accounting measures.

This type of capital reduction does not involve any funds being returned to shareholders. A company may take this action if its net assets are in danger of falling below the aggregate of its liabilities and its stated capital.

Buybacks/Repurchases

 **General Recommendation:** Generally, vote for requests to buyback or repurchase shares, unless:


- There is clear evidence available of past abuse of this authority; or
- It is a selective buyback, and the notice of meeting and explanatory statement does not provide a sound business case for it.

Consider the following conditions in buyback plans:

- Limitations on a company's ability to use the plan to repurchase shares from third parties at a premium;
- Limitations on the exercise of the authority to thwart takeover threats; and
- A requirement that repurchases be made at arms-length through independent third parties.

Some shareholders object to companies repurchasing shares, preferring to see extra cash invested in new businesses or paid out as dividends. However, when timed correctly, buybacks are a legitimate use of corporate funds and can add to long-term shareholder returns.

Issue of Shares (Placement): Advance Approval


 **General Recommendation:** Vote case-by-case on requests for the advance approval of issue of shares.

The ASX Listing Rules contain a general cap on non-pro rata share issues of 15 percent of total equity in a rolling 12-month period. ASX Listing Rule 7.1. limits the number of shares that can be issued without prior shareholder approval in any 12-month period to 15 percent of the entity's existing ordinary capital. . If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15-percent-in-12-months cap for the company.

In acknowledging Listing Rule 7.1, ISS would generally support a request for the issuance of shares without pre-emptive rights for up to 15 percent of the issued share capital. However, vote case-by-case on all requests taking into consideration:

- Dilution to shareholders (10 percent is considered high and consideration of other factors listed below will be important in supporting such resolutions);
- Discount/premium in the issue price to investors;
- Use of proceeds;
- The fairness opinion presented in an independent expert's report;
- Any resultant change in control;
- Other financing or strategic alternatives explored by the company (including any entitlement offers made to shareholders);
- Arms-length negotiations; and
- Conversion rates on convertible equity (if applicable).

Issue of Shares (Placement): Retrospective Approval

 **General Recommendation:** Vote case-by-case on retrospective approval of issue of shares.


ASX Listing Rule 7.4 allows shareholders to vote to carve out from the 15-percent-in-12-months cap an issue of shares made some time in the previous 12 months. If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15-percent in-12-months cap for the company.

ISS would generally support a ratification under Listing Rule 7.4 up to 15 percent. However, vote case-by-case on all requests taking into consideration:

- Dilution to shareholders (10 percent is considered high and consideration of other factors listed below will be important in supporting such resolutions);
- Discount/premium in the issue price to investors;
- Use of proceeds;
- The fairness opinion presented in an independent expert's report;
- Any resultant change in control;
- Other financing or strategic alternatives explored by the company (including any entitlement offers made to shareholders);
- Arms-length negotiations; and
- Conversion rates on convertible equity (if applicable).

3. Board of Directors

Director Age Limits

-  **General Recommendation:** Generally, vote against age limits for directors. Vote for resolutions to remove age limitations in company constitutions.

The Australian Corporations Act no longer includes an age limit for directors of public companies. Companies submit resolutions seeking to remove the age limitation contained in companies' constitutions in order to bring them in line with the Australian Corporations Act.

Age should not be the sole factor in determining a director's value to a company. Rather, each director's performance should be evaluated on the basis of his or her individual contribution and experience.

Independence of Directors

ISS classifies directors as executive, non-independent non-executive, or independent non-executive. ISS' definition of an independent director closely reflects the definition used by the ASX Corporate Governance Council:

- Is not a substantial shareholder (or an executive or associate of a substantial shareholder) of the company;
- Has not within the last three years been employed by the company in an executive capacity, or been a director after ceasing to hold any such employment;
- Has not within the last three years been a principal or employee of a material professional adviser or material consultant to the corporate group;
- Is not a material supplier/customer of the corporate group (or an executive or associate of a material supplier/customer);
- Does not have a material contractual relationship with the corporate group; and
- Is free from any other interest and any business or other relationship with the corporate group.

ISS' definition of independence is as follows:

ISS Classification of Directors – Australia

Executive Director

- Employee or executive of the company.

Non-Independent Non-Executive Director (NED)

A non-executive director who is:

- Classified as non-independent in the company's annual report;
- A former executive of the company or of another group member if there was less than a three year period between the cessation of employment and board service;
- A major shareholder, partner, or employee of a material¹ adviser/supplier/customer;
- A substantial shareholder² of the company;
- A founder of the company, even if no longer a substantial shareholder;
- A relative (or a person with close family ties) of a substantial shareholder or of a current or former executive;
- A designated representative of a substantial shareholder, or a director of a substantial shareholder which is not a public portfolio investor;
- A director who has served for 12 or more years on the board;
- A director with any material³ relationship to the company, other than a board seat; and
- A director holds cross-directorships or has significant links with other directors through involvement in other companies or boards.

Independent Non-Executive Director

A non-executive director who is not classified as non-independent according to the factors above. To clarify, this may include:

- A nominee proposed for election to a board by a shareholder but otherwise not affiliated to that shareholder.

Footnotes:

¹ The materiality threshold for transactions is A\$50,000 per annum. These thresholds are assessed by looking at transactions during the three most recent financial years.

² A substantial shareholder is a shareholder controlling 5 percent or more of the voting rights in the company. At the point a person is no longer a substantial shareholder (or representative of a substantial shareholder), they may be reclassified as independent by the company. However, for the purposes of ISS' director independence classification, this threshold looks back to the three most recent financial years.

³ For purposes of ISS' director independence classification, "material" will be defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders. This looks back at the three most recent financial years.

Voting on Director Nominees

When voting on director nominees, take into consideration:

- The overall composition of the board;

- The composition of the audit, remuneration, risk (if applicable), and nomination committees;
- Skills of the individual directors;
- Individual directors' attendance records; and
- Service on other public company boards.

As a matter of best practice, the board of a listed entity should also have a committee or committees to oversee risk. Under the recent ASX Corporate Governance Council recommendations, the risk committee could be a stand-alone risk committee, a combined audit and risk committee or a combination of board committees addressing different elements of risk. ISS will include the level of disclosure related to a risk committee in our reports as additional information to institutional investors. Under certain circumstances, ISS may consider such disclosure in our vote recommendations on election of directors, as warranted.

In addition, ISS will include the disclosure provided by the company in a Skills Matrix of the board's composition. The skills matrix need not be prospective; instead it could be retrospective; which may alleviate commercial confidentiality issues around disclosure. Generally, the skills matrix will identify the gaps in skills of the board to address the company's business strategy. ISS will include such disclosure in our reports as additional information to institutional investors. Under certain circumstances, ISS may consider such disclosure in our vote recommendations on election of directors, as warranted.

Voting on Director Nominees in Uncontested Elections



General Recommendation: Generally, vote for director nominees in uncontested elections. However, vote against nominees in the following circumstances:

Attendance:

- Attended less than 75 percent of board and committee meetings over the fiscal year without a satisfactory explanation.

Generally, vote against the chairman or deputy chairman if no disclosure of board and/or committee attendance is provided. Subject to section 300(10) of the Corporations Act an Australian listed company must include in its annual report information about each director's attendance at board and committee meetings.

Overboarding (unless exceptional circumstances exist):

- Sits on more than a total of five listed boards (a chair as equivalent to two board positions); or
- An executive director holding more than one non-executive director role with unrelated listed companies.

When applying this policy, ISS will consider the nature and scope of the various appointments and the companies concerned, and if any exceptional circumstances exist. Exceptional circumstances include entities outside the S&P/ASX 300 index and are:

- Research, development, exploration and/or non-operating companies; or
- Externally managed funds.

For the avoidance of doubt, exceptions do not apply to entities included in the S&P/ASX 300 index.

Independence Considerations:

- Is an executive and board chair, and no "lead director" has been appointed from among the independent directors or other control mechanisms are in place. Exception may be made for company founders who are integral to the company or if other exceptional circumstances apply;

- Where an executive is a member of the audit or remuneration committee, vote against the executive and the chairman of the board and/or the chairman of the relevant committee;
- A former partner or employee of the company's auditor who serves on the audit committee; and
- A director who is a former partner of the company's audit firm and receives post-employment benefits.

Board Independence:

If the board is not majority¹ independent under [ISS' classification](#), generally vote against nominees who are:

- Executive directors (except for the CEO and founders integral to the company); or
- A non-independent NED whose presence causes the board not to be majority independent without sufficient justification, except if the non-independent director represents a substantial shareholder owning at least 15 percent of the company's shares and whose percentage board representation is proportionate to its ownership interest in the company.

Combined Chair/CEO

The ASX Corporate Governance Council ("CGC") calls for the separation of the roles of stewardship and management. Recommendation 2.5 of the ASX CGC states that "the chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity".

Generally vote against a director who combines the CEO and chairman roles, unless the company provides strong justification as to why this non-standard governance arrangement is appropriate for the specific situation of the company. Exceptional circumstances may include a limited timeframe for the combined role upon departure of the CEO, or a non-operating, research, development or exploration company.

In some circumstances an executive chair may be considered to effectively combine the chair and CEO roles, notwithstanding the presence of another director on the board with the title of CEO. In assessing this situation, ISS will have regard for the disclosure surrounding the split of responsibilities and their comparative pay levels.

Diversity

Generally, vote against the chair of the nomination committee or chairman of the board (or other relevant directors on a case-by-case basis) if there are no women on the board. Mitigating factors include:

- A commitment to appoint at least one female director as disclosed in the company's meeting documents or in an announcement to the ASX;
- The presence of a female director on the board during the preceding year; or
- Other relevant factors.

Problematic Remuneration Practices

Generally, vote against members of the remuneration committee if the remuneration resolution at the previous general meeting received support of less than 75 percent of votes cast, taking into account:

- The company's response in addressing specific concerns, engagement with institutional investors, and other compensation practices;
- The company's ownership structure;
- Whether the issues are considered to be recurring or isolated;

¹ "Majority independent" is defined as over 50 percent independent.

- Whether the director has served on a remuneration committee of a non-associated company which has demonstrated problematic remuneration practices; and
- Whether the level of support was less than 50 percent.

Problematic Risk and Audit-Related Practices

Generally, vote against members of the risk committee who were in place if:

- A material failure in audit and risk oversight by directors is identified through regulatory investigation, enforcement or other manner; or
- There are significant adverse legal judgments or settlements against the company, directors or management.

Generally, vote against members of the audit committee as constituted in the most recently completed fiscal year if:

- The entity receives an adverse opinion of the entity's financial statements from the auditor; or
- Non-audit fees (Other Fees) paid to the external audit firm exceed audit and audit-related fees and tax compliance/preparation fees.

Tax compliance and preparation include the preparation of original and amended tax returns and refund claims and tax payment planning. All other services in the tax category, such as tax advice, planning or consulting, would be added to "other" fees. If the breakdown of tax fees cannot be determined, all tax fees would be added to "other" fees.

In circumstances where "other" fees include fees related to significant one-time capital structure events (such as initial public offerings) and the company makes public disclosure of the amount and nature of those fees that are an exception to the standard "non-audit fee" category, then such fees may be excluded from the non-audit fees considered in determining the ratio of non-audit to audit/audit-related fees/tax compliance and preparation for purposes of determining whether non-audit fees are excessive.

Shareholder Nominees

Generally, vote against shareholder-nominated candidates who lack board endorsement and do not present conclusive rationale to justify their nomination, including unmatched skills and experience, or other reason. Vote for such candidates if they demonstrate a clear ability to contribute positively to board deliberations.

Governance Failures

Generally vote against the chairman of the board if there is evidence of long-running, systemic issues regarding governance failures, or board and committee composition which are not adequately addressed, given the chairman retains responsibility for the board's corporate governance arrangements.

Generally vote against directors individually, committee members, or the entire board, due to:

- Failure to act, take reasonable steps, or exercise a director's duty to make proper enquiries of events, actions or circumstances of the company and those involved in management or higher, in the best interests of all shareholders;

- Material failures of governance, stewardship, risk oversight², or fiduciary responsibilities at the company (objectively coming to light in legal proceedings, regulatory investigation or enforcement, or other manner which takes place in relation to the company, directors or management);
- Failure to replace management as appropriate;
- Significant involvement with a failed company, or egregious actions or circumstances related to a director'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; or
- Service on other boards where any of the above matters and facts have subsequently emerged.

Upholding governance is the responsibility of each director and together as a board of directors. Shareholders expect "collective accountability" of directors and boards of companies which have experienced governance failures, irrespective of whether directors consider themselves as not being directly responsible for actions of the company or those involved in it.

When applying this policy, ISS will consider the nature and scope of the various appointments and the companies concerned, and if any exceptional circumstances exist. A stricter view may apply for directors who serve on the boards of complex companies, those in highly regulated sectors, or directors who chair a number of key committees.

Voting on Director Nominees in Contested Elections



General Recommendation: Assess contested director elections on a case-by-case, considering the following factors in particular:

- 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; and
- Whether minority or majority representation is being sought.

When analyzing a contested election of directors, which may include the election of shareholder nominees or the dismissal of incumbent directors, ISS will generally focus on two central questions:

- Whether the dissidents have proved that board change is warranted; and
- If yes, whether the dissident board nominees seem likely to bring about positive change and maximize long-term shareholder value.

² Examples of failure of risk oversight include but are not limited to: bribery; criminal conduct; large or serial fines, sanctions or enforceable undertakings from regulatory bodies; demonstrably poor risk oversight of environmental and social issues, including climate change; significant adverse legal judgments or settlements against the company, directors, or management; hedging of company stock; or significant pledging of company stock.

4. Remuneration

Underlying all evaluations of remuneration structure and practices are five global principles that most investors expect companies to adhere to in designing and administering executive and director remuneration plans:

- *Maintain appropriate pay-for-performance alignment, with emphasis on long-term shareholder value*: This principle encompasses overall executive pay practices, which must be designed to attract, retain, and appropriately motivate the key employees who drive shareholder value creation over the long term. It will take into consideration, among other factors, the link between pay and performance; the mix between fixed and variable pay; performance goals; and equity-based plans;
- *Avoid arrangements that risk “pay for failure”*: This principle addresses the appropriateness of long or indefinite contracts, excessive severance packages, guaranteed remuneration, or excessive fixed remuneration;
- *Maintain an independent and effective compensation committee*: This principle promotes oversight of executive pay programs by directors with appropriate skills, knowledge, experience, and a sound process for remuneration decision-making (e.g., including access to independent expertise and advice when needed);
- *Provide shareholders with clear, comprehensive remuneration disclosures*: This principle underscores the importance of informative and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly;
- *Avoid inappropriate pay to non-executive directors*: This principle recognizes the interests of shareholders in ensuring that compensation to outside directors does not compromise their independence and ability to make appropriate judgments in overseeing executive pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

Discussion

Remuneration should motivate executives to achieve the company's strategic objectives, while ensuring that executive rewards reflect returns to long-term shareholders. Pay should be aligned to the long-term strategy, and companies are encouraged to use the statement by the chairman of the remuneration committee to outline how their chosen remuneration approach aligns with the company's strategic goals and key performance indicators (KPIs). The remuneration committee should also closely examine the behaviour that the design of a remuneration package will promote.

A good performance target is aligned with company strategy, future direction, performance and shareholder value creation, without promoting or rewarding disproportionate risk-taking or impacting negatively on corporate reputation. Targets should be challenging but realistic and should closely reflect a company's ongoing business expectations. Where non-financial objectives are used as part of the performance conditions, ISS expects the majority of the payout to be triggered by the financial performance conditions. There should also be a clear link between the objectives chosen and the company's strategy.

Pay should not be excessive and remuneration committees should exercise due caution when considering pay increases. Any increases in total remuneration for executives should not be out of line with general increases in the market and at the company. Remuneration committees are discouraged from market benchmarking for pay reviews, unless it is applied infrequently (at no more than three-to-five-year intervals). One-off pay awards to address concerns over the retention of an executive have frequently been shown to be ineffective and are therefore not typically supported by ISS.

Many investors are concerned that remuneration has become too complex and question its effectiveness in motivating management. Thus, remuneration committees are encouraged to adopt simpler remuneration structures. In particular, the introduction of new or additional short-term incentives or long-term incentive share award schemes on top of existing plans is likely to be viewed skeptically. Remuneration arrangements should be

clearly disclosed, and sufficient detail should be provided about the performance conditions adopted to allow shareholders to make their own assessment of whether they are appropriate. Benchmarking remuneration into line with accepted good market practice should not be used as justification for any substantial increase in the size of the overall package.

Remuneration committees should have the flexibility to choose a pay structure which is appropriate for the company's strategy and business needs. When forming a view on such arrangements, ISS will pay particular attention to the following points:

- How consistent the remuneration practices are with the good practice principles set out in these voting guidelines;
- The linkage between the remuneration practices and the company's strategic objectives;
- Whether or not there is an appropriate long-term focus;
- The extent to which the proposals help simplify executive pay; and
- The impact on the overall level of potential pay. Any proposal which provides for a greater level of certainty regarding the ultimate rewards should be accompanied by a material reduction in the overall size of awards.

Boards must avoid rewarding failure or poor performance; for this reason, ISS does not support the re-testing of performance conditions or the re-pricing of share options under any circumstances. Implementing a tax-efficient mechanism that favours the participants should not lead to increased costs for the company, including the company's own tax liabilities.

Engagement initiated by remuneration committees is expected to be in the form of a meaningful, timely and responsive consultation with shareholders prior to the finalisation of the remuneration package; it should not just be a statement of changes already agreed by the remuneration committee.

Remuneration Report



General Recommendation: Vote case-by-case on the remuneration report, taking into account the pay of executives and non-executive directors, including where applicable:

- The quantum of total fixed remuneration and short-term incentive payments relative to peers;
- Whether any increases, either to fixed or variable remuneration, for the year under review or the upcoming year were well-explained and not excessive;
- The listed entity's workforce;
- Financial performance and alignment with shareholder returns;
- The adequacy and quality of the company's disclosure generally;
- The appropriateness and quality of the company's disclosure linking identified material business risks and pre-determined key performance indicators (KPIs) that determine annual variable executive compensation outcomes;
- The existence of appropriate performance criteria against which vesting and the quantum of cash and equity bonuses are assessed prior to any payment being made;
- Whether appropriate targets for incentives, including in the STI or LTI, are in place and are disclosed with an appropriate level of detail;
- Whether performance measures and targets for incentives, including in the STI and LTI, are measured over an appropriate period and are sufficiently stretching;
- Any special arrangements for new joiners were in line with good market practice;
- The remuneration committee exercised discretion appropriately, and such discretion is appropriately explained; and
- The alignment of CEO and executive pay with the company's financial performance and returns for shareholders based on the ISS Quantitative Pay-for-Performance Evaluation.

Where a remuneration report contains multiple areas of non-compliance with good practice, the vote recommendation will reflect the severity of the issues identified. A small number of minor breaches may still result in an overall qualified recommendation of a “For”, whereas a single, serious deviation may be sufficient to justify an “Against” vote recommendation.

In cases where a serious breach of good practice, or departure from accepted market standards and shareholder requirements, is identified and typically where issues have been raised by shareholders over one or more years, the chair of the remuneration committee (or, where relevant, another member of the remuneration committee) may also receive a negative voting recommendation.

Pay-for-Performance Evaluation³

ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the S&P ASX300, this analysis considers the following:

1. Peer Group⁴ Alignment:

- **Relative Degree of Alignment (RDA).** This relative measure compares the percentile ranks of a company’s CEO pay and TSR performance, relative to an industry-and-size derived comparison group (i.e., ISS Peer Group), over a three-year period.
- **Multiple of Median (MoM).** This relative measure expresses the prior year’s CEO pay as a multiple of the median pay of its comparison group for the same period.

2. Absolute Alignment:

- **Pay-TSR Alignment (PTA).** This absolute measure compares the trends of the CEO’s annual pay and the value of an investment in the company over the prior five-year period.

The Australian Securities and Investment Commission (ASIC) released Regulatory Guide (RG) 247 on 27 March 2013 to give guidance to companies on their compliance to disclosure under section 299A of the Corporations Act 2001 (Cth) (the Act) – Annual directors' report – additional and general requirements for listed entities. Specifically sub sections (1) – (a) to (c) of section 299A of the Act. RG 247 sets out the required disclosure in the Operating and Financial Review (OFR) in terms of the company's prospects for *future financial years* in terms of the company's business strategies and material business risks. Investors seek to ascertain from the OFR if the company has linked, in the remuneration report, the management of its material business risks to its key performance indicators (KPI) in determining remuneration for key management personnel (KMP).

Remuneration Considerations

The remuneration report serves as a way for shareholders to make their views known on the company's pay practices during the year under review. The elements of the report which ISS considers are described in more detail in the following section:

³ A one-year transition period will apply to the fiscal year ending 30 June 2018 prior to incorporating greater emphasis of the Pay-For-Performance Evaluation Methodology in the analysis of the remuneration report.

⁴ The peer group is generally comprised of 11-24 companies that are selected using market cap, revenue (or assets for certain financial firms), and GICS industry group, with size constraints, via a process designed to select peers that are comparable to the subject company in terms of revenue/assets and industry, and also within a market-cap bucket that is reflective of the company's.

Report component	Good market practice
Base Pay	<p>Remuneration committees are required to justify salary levels and increases in base pay.</p> <p>Annual increases are expected to be low and in line with general increases across the broader workforce. Post-freeze 'catch-up' salary increases or benchmarking-related increases are not generally supported. Exceptions may be made for promotions and increases in responsibilities. Changes in pay levels should take into account the pay and conditions across the company. Where remuneration committees seek to increase base pay, such increases should not be approved purely on the basis of benchmarking against peer companies.</p>
Superannuation, pension contributions and benefits	<p>Superannuation and pension contribution payments for executives should be clearly disclosed. Any compensation to executives for changes in the tax treatment of pensions is not considered to be acceptable.</p> <p>Companies must describe the benefits provided to executives and directors, which are expected to be in line with market practice and which should not be excessive. The maximum participation level should be stated, and not be uncapped. Companies must give a clear explanation of pension-related benefits, including the approach taken to making payments in lieu of retirement benefits.</p>
Short term incentive (STI)	<p>The STI earned for the year under review should be explained in a fashion which allows shareholders to clearly link performance with pay. Any increases in the maximum from one year to the next should be explicitly justified. The lowering of targets should generally be accompanied by a reduction in the bonus potential.</p> <p>There is an expectation among investors that STI bonus targets will be disclosed retrospectively. Targets for both financial and non-financial metrics should be disclosed in an appropriate level of detail, preferably with a full target range (e.g. threshold, target and maximum) set out.</p> <p>If a remuneration committee believes that STI bonus target disclosure – even on a retrospective basis – is difficult for reasons of commercial sensitivity, it should clearly explain the rationale for its decision, when such considerations will fall away and provide a commitment to disclosure at that time. ISS may recommend a vote against a remuneration report where bonus targets are not disclosed retrospectively, and there is no commitment to disclosure in the future. It is now standard market practice for retrospective disclosure to be provided no more than one year after the end of the relevant performance year.</p> <p>Where consideration of commercial sensitivities may prevent a fuller disclosure of specific short-term targets at the start of the performance period, shareholders expect to be informed of the main performance parameters, both corporate and personal.</p> <p>Deferral of a portion of STI awards is now common and expected in the market by shareholders. Typically, STI deferral is in the form of restricted equity for periods of one to five years. The terms of any STI deferral should be fully disclosed and the rationale for any deferral should align with the medium-term objectives of the company. Often companies seek shareholder approval for such equity grants. Various aspects of long-term equity grants should be considered, such as malus/clawback provisions, treatment on termination and change of control and minimum shareholding requirements.</p> <p>The payment of a 'one-off' special bonus, outside the variable remuneration arrangements</p>

	<p>already in place, is likely to attract a negative vote recommendation given that transaction-related bonuses are not typically supported.</p>
Long-term incentive (LTI)	<p>Under the resolution to approve the remuneration report, ISS considers both the LTI awards granted and those vested or lapsed during the year under review.</p> <p>When assessing the awards which vested, ISS will have regard for outcomes that are out of line with the overall performance of the company, its future prospects or shareholder returns over the performance period. The definition of any performance measurement should be clearly disclosed.</p> <p>For awards granted in the year under review, ISS will have regard for disclosure by companies of the potential value of awards to individual scheme participants on full vesting, expressed by reference to the face value of shares and expressed as a multiple of base salary/fixed remuneration.</p> <p>The lowering of targets should generally be reflected in a reduction of the amount that can vest and, similarly, any increase in award size should be linked to more challenging targets.</p>
Dilution limits	<p>The operation of share incentive schemes should not lead to dilution in excess of the limits acceptable to shareholders.</p> <p>The rules of a scheme must provide that commitments to issue new shares, when aggregated with awards under all of the company's other schemes, must not exceed 10 percent of the issued ordinary share capital, adjusted for share issuance and cancellation.</p>
Malus and / or clawback	<p>Malus means to forfeit some or all of a variable remuneration award before it has vested, while clawback allows the company to recover payments already made through the STI or LTI.</p> <p>When designing schemes of performance-related remuneration, good market practice is that schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which the remuneration committee considers it would be appropriate to do so. Investors expect that such provisions should not be restricted solely to material misstatements of the financial statements.</p>
Good leavers	<p>Where individuals choose to terminate their employment before the end of the performance period, or in the event that employment is terminated for cause, good market practice is that any unvested options or share-based awards should lapse.</p> <p>In other circumstances of cessation of employment, some portion of the award may remain "on foot" and be subject to the achievement of the relevant performance criteria and with an appropriate reduction in award size to reflect the shortened period between grant and vesting. In general, the originally stipulated performance measurement period should continue to apply. If it is the opinion of the remuneration committee that some early vesting is appropriate, or where it is otherwise necessary, awards should vest by reference to performance criteria achieved over the period to date.</p>
Change of control	<p>Investors expect that there will be no automatic waiving of performance conditions in the event of a change of control. Any early vesting as a consequence of a change of control should take into account the vesting period that has elapsed at the time of the change of control, with a consequent reduction in the size of the awards which vest. ISS does not support special one-off payments to executives on a change of control event.</p>

Shareholding requirement	There is an expectation of investors that executives and directors should hold a minimum number of shares. Unvested holdings in share-based incentives do not count towards fulfilment of the requirement.
Executive' service contracts, including exit payments	<p>Executives should have service contracts in place with notice periods set at one year or less. All termination payments should be subject to phased payment and mitigation. Exit payments to departing executives should not go beyond one years' base pay, being the statutory cap set out in the Corporations Act. However, an executive may also have an entitlement under the terms of his or her service contract or the rules of the relevant incentive plan.</p> <p>Ex gratia or special payments on termination are not supported. "Good leaver" treatment should only apply to those who are genuinely good leavers. Appropriate pro-rating should be applied to outstanding long-term share-based awards.</p>
Arrangements for new joiners	For new joiners, where an executive is appointed at an 'entry-level' salary-point which the remuneration committee expects to increase to a higher level once the individual has proved him or herself in the role, the roadmap for increases should be disclosed at the time of appointment. In general, ISS does not support special awards for new joiners (e.g. sign-on bonuses or one-off share awards) except in exceptional situations and only if accompanied by an appropriate explanation.
Discretion	<p>In cases where a remuneration committee uses its discretion to determine payments, it should provide a clear explanation of its reasons, which are expected to be clearly justified by the financial results and the underlying performance of the company.</p> <p>It is relatively rare that a remuneration committee chooses to amend the targets used for either the STI or LTI following the start of the performance period, but where this has occurred, it is good practice for the company to demonstrate how the revised targets are in practice no less challenging than the targets which were originally set.</p>
Non-executive director fees	<p>Additional remuneration, other than fees, including participation in a share option scheme, pension scheme (excluding compulsory superannuation contributions) and/or performance-related pay is likely to impair a NED's independence, and for that reason it is usually looked upon unfavourably by ISS.</p> <p>Any increases to NED fees during the year under review will be considered alongside pay increases to executives and the broader workforce.</p> <p>The remuneration report must name any person who provided material advice or services to the company or a relevant committee in the year and set out additional details.</p>
All-employee schemes	ISS generally supports all-employee schemes, such as Share Incentive Plans (SIPs) as a way of promoting employee ownership and alignment with shareholders.

Remuneration of Executive Directors: Share Incentive Schemes




General Recommendation: Vote case-by-case on share-based incentives for executive directors.

Share-based incentives in Australia usually provide for "performance rights," "performance shares," "conditional rights," or similar derivative instruments, all of which are economically zero exercise price options (ZEPOs).

Following the change in Australian taxation law regarding options effective 1 July 2015, the use of traditional share options may also be seen in executive incentive plans.

There are also a smaller number of share incentive schemes which are structured as loan-funded share plans, pursuant to Australian Securities & Investments Commission guidelines. These are effectively option-like structures and are considered on a case-by-case basis.


Remuneration of Executives: Long-Term Incentives and Share-Based Payments

 **General Recommendation:** Vote case-by-case on long-term incentive and share-based grants for executives. Vote against plans and proposed grants under plans if:

- Exercise price, or valuation of share-based grants, is excessively discounted;
- Vesting period is insufficiently long to reflect an appropriate long-term horizon (i.e. less than three years);
- Long term performance criteria are removed;
- Performance targets to be achieved which determine the quantum of vesting of share-based grants are not sufficiently demanding;
- Retesting of performance criteria is permitted over an extended time period where the original performance targets are not met in the initial testing period;
- Plan provides for excessive dilution; or
- Company fails to disclose adequate information regarding any element of the scheme.

In Australia, there is no statutory or ASX listing rule requirement for companies to put long-term incentive plans before shareholders for approval. Some companies choose to seek shareholder approval of equity-based plans under the exception provided in ASX Listing Rule 7.2, so that equity instruments issued under the plan do not count towards the “15 percent in 12 months” dilution cap (refer to “Issue of Shares (Placement): Advance Approval” above).

Remuneration of Executives: Awards of Long-Term Incentives and Share-Based Payments

 **General Recommendation:** Generally, vote against the remuneration report if a company utilizes the ASX Listing Rule 10.14 carve-out, and fails to put the proposed long-term incentive or share-based grant to a shareholder vote.

Under ASX Listing Rule 10.14, companies must seek shareholder approval for any grant of equity awards to a director. However, there is a carve-out for grants of shares where shares are to be purchased on-market rather than being newly issued. This carve-out was introduced in a controversial amendment to Listing Rule 10.14 in October 2005. Many institutional investors in Australia regard the carve-out as inappropriate and long-term incentive grants of shares to executive directors should be subject to a vote of shareholders, regardless of whether the shares are newly issued or purchased on-market.

Long Term Incentive Plan and Share-Based Grant Considerations

The elements of the long-term incentive plan (and proposed grants of equity awards) are evaluated by ISS according to the following criteria:

Options

- Two different types of options should be distinguished:

- Grants of market-exercise-price options ("traditional options") have an in-built share price appreciation hurdle, where the share price must increase above its "strike price" at the grant date for the executive to have an incentive to exercise, and
- Grants of zero exercise price options ("ZEPOs") have no exercise price and the executive pays nothing to the company on exercising these rights.

Exercise Price

- Option exercise prices should not be at a discount to the prevailing market price at the grant date. (Many Australian companies now issue performance rights or performance shares, which are ZEPOs. These are not treated as "discounted" rights, but the requirements regarding vesting period, performance criteria, etc., apply equally.)
- Plans should not allow the repricing of out-of-the-money options.
- The allocation of ZEPOs should not be based on a discounted price of a company's securities (or "fair value"), which has the effect of increasing the number of equity awards which are granted, and could exponentially increase the value of the incentive or share-based payment received by the executive upon any vesting.

Vesting Period

- There should be appropriate time restrictions before rights can be exercised (if securities can vest in a timeframe which is less than three years, this is not considered to be an appropriate representation of a shareholder's long-term horizon for an ASX listed entity).

Performance Hurdles

- Generally, a hurdle that relates to total shareholder return (TSR) is viewed favourably by many shareholders compared to a hurdle that specifies an absolute share price target or an insufficient accounting measure of performance (such as earnings per share (EPS)).
- Where a relative hurdle is used (comparing the company's performance against a group of peers or against an index), no vesting should occur at below-median performance, and the peer group should be appropriate and defensible (e.g. the peer group is not to be unacceptably small, or "cherry picked").
- A sliding-scale hurdle is required, under which the percentage of rights that vest increases according to a sliding scale of performance (whether absolute or relative) - a hurdle under which 100 percent of the award vests once a single target is achieved (i.e. no "cliff vesting") - is not considered appropriate given that it may act as a disincentive to performance if it subsequently becomes difficult to achieve, or if it is easily achieved.
- Where an absolute share-price target is used, executives can be rewarded by a rising market even if their company performs relatively poorly. In addition, even if a share-price hurdle is set at a significantly higher level than the prevailing share price, then the hurdle may not be particularly stretching if the option has a long life or there are generous re-testing provisions.
- Accounting-related hurdles do not necessarily involve shareholder value creation before an incentive or share-based grant vests. An accounting-based performance hurdle may allow incentives to vest, and executives to be rewarded, without any medium to long-term improvement in total shareholder return having been delivered. Growth in EPS may, but does not always, translate into an improved share price and increased dividends over the medium to long term. Accordingly,
 - An EPS hurdle can lead to executive reward without any increase in shareholder return in the case of ZEPOs, which may not be the same if incorporated with traditional options.
 - An EPS hurdle can more readily be supported if used with traditional options, rather than with ZEPOs, although the use of traditional options in the Australian market is quite limited.
- An EPS target must be sufficiently demanding, or stretching, such that a hurdle should require a substantial cumulative growth rate in EPS. In order to assess whether an EPS hurdle is sufficiently demanding, ISS will consider EPS forecasts published by analysts and any earnings guidance provided by management. If a sliding-

scale EPS hurdle is used, a significant proportion of the options are to vest only for EPS performance that exceeds consensus analyst forecasts.

- Operational hurdles are non-market and non-financial targets which are generally accompanied by unclear disclosure and often difficult to assess. Examples may include delivery of strategic projects, production targets, or discovery of mining reserves. ISS will assess these hurdles on a case-by-case basis, in order to establish if the hurdle is sufficiently demanding and capable of creating longer term shareholder value. These would more generally be accepted when used in conjunction with traditional options to align more closely with a tangible increase in shareholder value in excess of the strike price.

Re-testing

- A re-test is where the performance hurdle has not been achieved during the initial vesting period, and the plan permits further testing of the performance hurdle on a later date or dates. Many investors, in markets like the U.K., do not support re-testing of performance criteria on share options or other share-based incentive awards, on the basis that retesting undermines the incentive value of such awards. Such provisions have not been uncommon in the Australian market. However, as companies have moved toward annual grants of awards that mitigate the concerns over “cliff-vesting,” and the increasingly held view among institutional investors that re-testing does not constitute best practice, companies have now moved to a minimal number of re-tests, or they have eliminated re-testing altogether.
- In cases where re-testing exists, ISS will evaluate the type of re-testing, either fixed-base or rolling, and the frequency of the re-testing. (Fixed-base testing means performance is always tested over an ever-increasing period, starting from grant date. This is less concerning than re-testing from a rolling start date.) Where a company has a particularly generous re-testing regime, and has not committed to significantly reduce the number of re-tests, vote against a resolution to approve the plan in question, or a grant of rights under the plan. This may also warrant a vote against the remuneration report, depending on other aspects of executive and non-executive remuneration practices. In the case of new plans, as a best practice, companies should not include re-testing provisions, but evaluate on a case-by-case approach basis.

Transparency

- Methodology for determining exercise price should be disclosed.
- Sufficient information should be presented to demonstrate that the scheme will reward superior future performance.
- Proposed volume of securities which may be issued should be disclosed to enable shareholders to assess the dilutionary impact.
- Time restrictions before options can be exercised should be disclosed.
- Any restrictions on disposing of shares received should be disclosed.
- Full cost of options to the company should be disclosed.
- Method used to calculate the cost of options should be disclosed, including the discount applied to account for the probability of equity incentives not vesting.
- Method of purchase or issue of shares on exercise of options should be disclosed.

Dilution of Existing Shareholders' Equity

- Aggregate number of all shares and options issued under all employee and executive incentive schemes should not exceed 10 percent of issued capital.

Level of Reward

- Value of options granted (assuming performance hurdles are met) should be consistent with comparable schemes operating in similar companies.

Eligibility for Participation in the Scheme


- Scheme should be open to all key executives.
- Scheme should not be open to non-executive directors.

Other

- Plans should include reasonable change-in-control provisions (i.e. pro rata vesting and size of awards).
- Plans should include "good leaver"/"bad leaver" provisions to minimize excessive and unearned payouts (see below for a discussion of the approach to resolutions seeking approval for termination benefits to executives generally and under equity plans).

Where the plan contains multiple areas of non-compliance with good practice, the vote recommendation will reflect the severity of the issues identified. A small number of minor breaches may still result in an overall recommendation of a qualified 'For', with the qualification noting the breaches which investors would expect to be addressed by the remuneration committee in the future, whereas a single, serious deviation may be sufficient to justify an "Against" vote recommendation.


Remuneration of Executives: Long-Term Incentive Plan Amendments

 **General Recommendation:** Vote case-by-case on amendments to long-term incentive plans.

ISS will evaluate amendments to existing plans initially using the long-term incentive plan guidelines (above), and determine if the amendment is improving/removing negative features or if it is exacerbating such features.

If the amendment is eliminating negative features, the amendment could potentially be supported. However, if the amendment is neutral, vote against the amendment to express dissatisfaction with the underlying terms of the plan.

Remuneration of Executives: Termination Benefit Approvals

 **General Recommendation:** Vote case-by-case on termination benefits.

Amendments to the Australian Corporations Act in November 2009 provide a cap on allowable "termination benefits" to senior executives of 12 months' base pay (i.e. without shareholder approval). Formerly the Corporations Act required shareholder approval only where the termination payment was in excess of seven times total remuneration.

Companies can seek shareholder approval for termination payments in advance, including benefits from unvested equity grants on termination. This also includes general approval for vesting of equity incentives on termination under a specific equity plan.

Generally, vote against resolutions seeking approval of termination payments to executives in excess of the statutory maximum (i.e. 12 months' base pay), except where there is clear evidence that the termination payment would provide a benefit to shareholders.

In cases where shareholder approval is sought for termination benefits under any equity plan, which provides for termination benefits in excess of 12 months' base salary, vote 'For' the resolution if the approval is sought for

three years or less and there is no vesting of awards without satisfaction of sufficiently demanding performance hurdles.

Non-Executive Director Perks/Fringe Benefits

➤ **General Recommendation:** Where a company provides fringe benefits to non-executive directors in addition to directors' board and committee fees, vote case-by-case on:

- The remuneration report;
- Proposals to increase the non-executive directors' aggregate fee cap; and/or
- The election of the chairman of the board, chairman of the remuneration committee, or any member of the remuneration committee standing for re-election.

Fringe benefits may include payments made, or services provided without charge, by the company. Examples may include, but are not limited to, additional "travel time fees", which may be charged by the director by the hour, for the time taken in travelling to board or company meetings either domestically or overseas.

Also, vote against when post-employment fringe benefits are paid to non-executive directors, which are often represented as an entitlement per year of service on the board of the company. Given that the same or similar benefits are generally not offered to shareholders or employees, such benefits are not considered good market practice, and they represent a potential conflict of interest to incentivize longevity on the board which may not be in the best interests of board succession planning or shareholders. These fringe benefits may be offered to non-executive directors as a cash payment (for example, retirement benefits) or in services provided or procured by the company.

Remuneration of Non-Executive Directors: Increase in Aggregate Fee Cap

➤ **General Recommendation:** Vote case-by-case for an increase in the maximum aggregate level of fees payable to the company's non-executive directors. It is a requirement of the ASX Listing Rules for companies to obtain shareholder approval for any increase in the fee cap.

ISS will take into account:

- The size of the proposed increase;
- The level of fees compared to those at peer companies;
- The explanation the board has given for the proposed increase;
- Whether the company has discontinued retirement benefits;
- Whether there is sufficient capacity within the previously approved aggregate fee cap to accommodate any proposed increases in director's fees;
- The company's absolute and relative performance over (at least) the past three years based on measures such as (but not limited to) share price, earnings per share and return on capital employed;
- The company's policy and practices on non-executive director remuneration, including equity ownership;
- The number of directors presently on the board and any planned increases to the size of the board;
- The level of board turnover.

Vote against the increase if the company has an active retirement benefits plan for non-executive directors. Vote against where a company is seeking an increase after a period of poor absolute and relative performance, where the same board (or largely the same board) has overseen this period of poor performance and where the fee cap increase is not sought for the purposes of board renewal.

Remuneration of Non-Executive Directors: Approval of Share Plan

- **General Recommendation:** Generally, vote for the approval of NED share plans which are essentially salary-sacrifice structures and have the effect of increasing directors' shareholdings and alignment with investors.

This type of resolution seeks shareholder approval for the company's non-executive directors to receive some of their fees in the form of shares rather than cash. The reason for the resolution is that listed companies can only issue equity securities to directors if shareholders approve such issuances in advance (Listing Rule 10.14).

All three key sets of guidelines in Australia (ASX Corporate Governance Council, FSC, and those of the Australian Council of Super Investors) support companies taking steps to encourage non-executive directors to acquire a material shareholding in their companies in order to achieve a greater alignment with shareholder interests.


5. Environmental and Social Issues

Voting on Shareholder Proposals on Environmental, Social, and Governance (ESG) Matters

In Australia, the implications for non-binding ESG shareholder proposals have been established in legal precedent in the 1980s in *NRMA Ltd v Parker* (1986) 6 NSWLR 517 and upheld in *ACCR v CBA* [2015] FCA 785. The authority allows a board to refuse to put a non-binding shareholder proposal to a vote at a general meeting and makes clear that such resolutions infringe upon the 'division of powers' doctrine between the board and the general meeting and do in fact usurp the board's authority. Accordingly, many boards have relied upon this precedent to deny consideration of such shareholder proposals at a general meeting.

In the recent past, a number of shareholder proponents of such resolutions have proposed a "first leg" to the agenda by seeking an amendment to the company's constitution to allow non-binding resolutions to be considered at a general meeting. To date, the generality of such constitutional amendments has caused these not to gain sufficient shareholder support, and therefore ESG resolutions have not proceeded to a vote of shareholders.

Globally, ISS applies a common approach to evaluating social and environmental proposals, which cover a wide range of topics including consumer and product safety, environment and energy, labor standards and human rights, workplace and board diversity, and corporate political issues. While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short term or long term.

 **General Recommendation:** Generally, vote on all environmental and social proposals on a case-by-case basis, examining primarily whether implementation of the proposal is likely to enhance or protect shareholder value. The following factors will be considered:

- If the issues presented in the proposal are more appropriately or effectively dealt with through legislation or government regulation;
- If the company has already responded in an appropriate and sufficient manner to the issue(s) raised in the proposal;
- Whether the proposal's request is unduly burdensome (in terms of scope, timeframe, or cost) or overly prescriptive;
- The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
- Whether there are significant controversies, fines, penalties, or litigation associated with the company's environmental or social practices;
- If the proposal requests increased disclosure or greater transparency, whether or not reasonable and sufficient information is currently available to shareholders from the company or from other publicly available sources; and
- If the proposal requests increased disclosure or greater transparency, whether or not implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

If the items listed above are considered reasonable and would ordinarily warrant shareholder support of the ESG resolution, whereas the Board seeks to deny the vote of shareholders at a meeting, this could be regarded as a negative factor when considering a vote on the re-election of the Chairman, or any other relevant directors. When evaluating a non-binding ESG shareholder proposal, ISS will consider the nature and extent of engagement with the shareholder proponent and any undertakings given by the board in addressing the matters raised in the shareholder proposal.

There is legal precedent which permits the chairman of a general meeting to deny a non-binding or advisory vote on an environmental or social shareholder proposal. Instead, shareholders expect companies to disclose the proxy votes cast ahead of a meeting for each environmental or social proposal in the vote results announced to the ASX.

Board Diversity

Diversity on boards is an important topic for many shareholders. ISS will examine board diversity, including gender, skills, ethnicity and age as part of board refreshment and succession planning, in order to provide our clients with sufficient information from which to base informed engagement and voting decisions.

Proxy research reports on each company will include whether:

- There is a disclosed diversity policy;
- There are disclosed and measurable objectives in promoting gender diversity, amongst others;
- The company reports on progress against those measurable objectives;
- The company reports on the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the company has defined “senior executive” and various management positions, for these purposes);
- The company is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act; and
- The company uses Box 1.5 of the ASX Guidelines 3rd ed. to create the company’s diversity policy.

Economic, Environmental, and Sustainability Risks

Where appropriate, ISS will report on the quality of the company's disclosure of economic, environmental, and sustainability risks and how it regards these risks.

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