

Taiwan Policy – Director Elections

Background and Overview

ISS policy for director elections in Taiwan currently only considers the election system that a company adopts. A supportive vote recommendation will be warranted generally for elections that are conducted via the nomination system, under which the board of directors reviews the qualifications of each candidate nominated by either the board itself or any shareholder holding one percent or more of the company's outstanding shares, and then provides the final roster of candidates together with their profiles to shareholders prior to the meeting. By law, companies must use the nomination system for all independent directors' elections.

In contrast, a negative vote recommendation will be issued generally to those elected via the non-nomination system, under which any shareholder can nominate any person of legal age to the board. Companies are not obliged to provide a roster of candidates and their profiles before the meeting, and many firms disclose candidate names and profiles at the meeting or only a few days beforehand. Further, whether the candidates are supported by management or not is often not disclosed. Such widely adopted system in the election of non-independent directors in Taiwan results in non-disclosure that limits ISS' capability to conduct any meaningful analysis across a company's board.

A minimum requirement of two independent directors to be elected via the nomination system has been phasing in since 2013 and will be fully effective in 2017. Assessment of independent director candidates will become not only possible but necessary, considering that they are critical for the check and balance in company boards, especially in view of the lack of disclosure of non-independent director elections under the so-called "non-nomination system" in Taiwan.

Most of the assessment criteria applicable to peer markets in the Asia-Pacific Region, such as attendance and number of public board positions held, among others, will be applied to independent director candidates. In order to review the board's composition and compliance with the independence requirements stipulated under local regulations, such assessment criteria may also be applied to non-independent directors elected through the nomination system at a later stage.

Key Changes Under Consideration

Currently, ISS generally recommends votes for all candidates to be elected via the nomination system, including all independent directors who are mandated to be elected via the nomination system, and against all candidates to be elected via the non-nomination system.

New policy language is proposed as below:

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

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

- The nominee is deemed non-independent under ISS classification

- The nominee is a legal entity or a representative of a legal entity¹
- The nominee has attended less than 75 percent of board and key committee meetings over the most recent fiscal year, without a satisfactory explanation. The calculation of director attendance (or that of the representatives appointed by a legal entity which serves as a corporate director in the company) will not include meetings attended by alternate directors (or the proxy of those representatives). Acceptable reasons for director absences are generally limited to the following:
 - Medical issues/illness;
 - Family emergencies;
 - The director (or the representative) has served on the board for less than a year; and
 - Missing only one meeting (when the total of all meetings is three or fewer);
- The nominee sits on more than six public company boards² (ISS will consider a commitment by an overboarded director to step down from one or more boards at the next annual meeting of the company or companies in question, if that will bring the total number of boards to no more than six. Such commitment should be made in relevant meeting materials, such as meeting notice, circular, or annual report, and disclosed prior to the AGM.)
- The nominee has been a partner of the company's auditor within the last three years³, and serves on the audit committee

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

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

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

Intent and Impact

The update of the policy for the election of directors aims to incorporate the legal requirements introduced in Taiwan into ISS' voting guidelines and to better align the guidelines applied to Taiwanese companies with those of their peers in the Asia Pacific region.

A random sample of 50 director elections (14 percent of the total number of director elections covered by ISS in 2016 proxy season) has been reviewed to assess the potential impacts of the policy changes. Thirty-nine of these companies (78%) conducted independent director elections in 2016 (appointment of independent directors was yet to be mandatory for all companies in 2016).

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

² Any independent directors shall not sit on more than three public boards as independent director, according to Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies under the Securities and Exchange Act.

³ Pursuant to Securities and Exchange Act, all independent directors will automatically become the members of the company's audit committee, if any, which should be 100-percent independent.

Taking all the assessment criteria into account, in contrast to the 100-percent pass rate under the current approach:

- 8 independent director nominees from seven companies (14%) will receive an against recommendation due to low attendance (<75 percent attendance rate at board and key committee meetings).
- No independent director nominees will be opposed due to overboarding (holding more than six board seats or three independent directorships which is a limit stipulated by law).

Request for Comment

- In case there is discrepancy between ISS regional benchmark policy and local market regulations, should ISS' new voting guidelines on Taiwanese director election follow (i) ISS regional benchmark policy, (ii) local regulations, or (iii) the more stringent of the two?
- In what timeframe or under what circumstances would it be considered suitable for the proposed assessment criteria to be applied to non-independent director candidates, whose election is not legally required to be presented under the nomination system?
- All Taiwanese company boards are also required to be at least 20 percent independent by 2017; in what timeframe or under what circumstances would it be considered suitable for ISS to put in place such independence level requirements – potentially recommending a vote against non-independent directors in case the minimum independence level is breached – in the voting guidelines?