



# United Kingdom and Ireland Proxy Voting Guidelines

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2015 Benchmark Policy Recommendations

**Effective for Meetings on or after February 1, 2015**

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## INTRODUCTION

2015 will be the first year that ISS has operated a standalone policy for the United Kingdom (UK) and Ireland. Previously we have used the National Association of Pension Funds' (NAPF) Corporate Governance Policy and Voting Guidelines<sup>1</sup> as our standard reference. However, with the RREV formal agreement between ISS and the NAPF ending in 2014, we have taken the opportunity to produce an ISS UK and Ireland Policy to codify and refresh our approach. The NAPF guidelines remain at the heart of our approach, and the ISS policy is compliant with the NAPF guidelines. Additionally, where market practice has developed, notably around remuneration, we also refer to other good practice standards relevant to the UK market.

Whilst the formal relationship with the NAPF came to an end in June 2014, both parties share a common belief in the importance of effective corporate governance arrangements. It is the intention of ISS to continue to reflect the NAPF's Corporate Governance Policy & Voting Guidelines (updated as of December 2014) within our UK and Ireland standard benchmark policy in order to continue to align with what both parties consider to be best practice. It is important to emphasise that this policy is not intended to result in a materially different approach during the 2015 AGM season than was applied in 2014. However, an additional discussion of investors' expectations with regard to good practice has been included where we feel this would be helpful.

The "comply or explain" approach is the foundation of corporate governance in the UK and Ireland. While ISS operates a policy-based approach, we recognise that in certain cases there may be a good reason why non-standard corporate governance arrangements fit a company's particular circumstances. When assessing the quality of a company's explanation, ISS follows the guidance provided by the Financial Reporting Council (FRC) in the UK Corporate Governance Code<sup>2</sup> (the Code.)

The principle underpinning the ISS approach is that shareholders are the owners of listed companies. To that end, ISS designs its proxy voting guidelines to enhance shareholders' long-term economic interests. ISS' Benchmark proxy voting guidelines serve as a tool to assist institutional investors in meeting their responsibilities with respect to voting by promoting shareholder value creation and risk mitigation at their portfolio firms. ISS also manages fully custom voting policies and implements voting recommendations for clients who want to vote their proxies according to their own specific guidelines and philosophies.

Shareholders are entitled to assess every resolution that seeks their approval in terms of how it affects their long-term interests as the owners of the company. ISS' Global Voting Principles<sup>3</sup> include four key tenets, accountability, stewardship, independence and transparency, which underlie our approach to developing recommendations on both management and shareholder proposals at publicly traded companies. How we interpret this is described below:

**Accountability** - Boards should be accountable to shareholders, the owners of the companies, by holding regular board elections, by providing sufficient information for shareholders to be able to assess directors and board composition, and by providing shareholders with the ability to remove directors. Directors should respond to investor input such as that expressed through vote results on management and shareholder proposals and other shareholder communications. Shareholders should have meaningful rights on structural provisions, such as approval of or amendments to the corporate governing documents and a vote on takeover defenses. In addition, shareholders' voting rights should be proportional to their economic interest in the company; each share should have one vote. In general, a simple majority vote should be required to change a company's governance provisions or to approve transactions.

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<sup>1</sup> <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>2</sup> <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>3</sup> <http://www.issgovernance.com/policy-gateway/iss-global-voting-principles/>

**Stewardship** - A company's governance, social, and environmental practices should meet or exceed the standards of its market regulations and general practices and should take into account relevant factors that may impact significantly the company's long-term value creation. Issuers and investors should recognize constructive engagement as both a right and responsibility.

**Independence** - Boards should be sufficiently independent so as to ensure that they are able and motivated to effectively supervise management's performance and remuneration, for the benefit of all shareholders. Boards should include an effective independent leadership position and sufficiently independent committees that focus on key governance concerns such as audit, compensation, and the selection and evaluation of directors.

**Transparency** - Companies should provide sufficient and timely information that enables shareholders to understand key issues, make informed vote decisions, and effectively engage with companies on substantive matters that impact shareholders' long-term interests in the company.

These principles guide our work assisting institutional investors in meeting their responsibilities to clients with respect to voting and engagement services. The UK and Ireland policy has been designed to be in alignment with these principles, and the section on remuneration is also in accordance with the ISS Global Principles on Executive and Director Compensation<sup>4</sup> as well as other UK good practice recommendations.

## Coverage Universe

This policy forms the basis of the ISS benchmark vote recommendations for companies listed in the United Kingdom and Ireland. It will also be applied to companies incorporated in other territories such as the Isle of Man, Jersey and Guernsey, and which are either listed in the UK and Ireland or on the Channel Islands Securities Exchange.

The ISS European Policy applies to Member States of the European Union or the European Free Trade Association, with the exception of the United Kingdom and Ireland, and it was reviewed as part of the codification exercise to produce this policy. The format of the UK and Ireland policy has been modelled on the ISS European Policy, and certain content has been incorporated for resolutions where a common, cross-market approach is taken.

## How this policy will be applied

This document is intended to provide investors with an insight into how ISS analyses companies in the UK and Irish markets. 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 company's situation, and consider any explanation for non-standard practice, when determining voting recommendations.

Investors recognize that appropriate corporate governance practices for companies can differ according to the company type, location and nature of operations, and index. The principles of good corporate governance are generally applicable to companies whatever their size, but we recognize that investors and other market participants have differing expectations for certain market segments. Where our approach for a certain index or company type differs from the core policy, this will be indicated in the sections for smaller companies and investment companies.

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<sup>4</sup> Page 11 <http://www.issgovernance.com/file/files/ISS2011InternationalPolicyUpdates20101119.pdf>

For the UK, the core ISS policy applies to all companies in the FTSE All Share index, excluding investment trusts. Certain provisions of the UK Corporate Governance Code do not apply to companies outside the FTSE 350, or there are different requirements for these companies. The core ISS policy recognizes these exceptions.

## Smaller Companies

Our approach in the UK to companies outside of the FTSE All Share is based around the NAPF Corporate Governance Policy and Voting Guidelines<sup>5</sup> for smaller companies. The NAPF policy is primarily designed for companies listed on the Alternative Investment Market (AIM), although the NAPF states that their policy is appropriate for other smaller quoted companies, including standard listed and ISDX<sup>6</sup> listed companies. The QCA Guidelines<sup>7</sup> may also be a helpful guide to investors' expectations of good corporate governance practices for AIM-listed companies.

The 2014/15 NAPF Corporate Governance Policy and Voting Guidelines<sup>8</sup> advise that, when assessing the practice of a smaller company, investors should be mindful of the individual circumstances of the business, including its size and complexity. ISS applies its approach to smaller companies to companies which are members of the FTSE Fledgling index, those listed on AIM and other companies which are not widely-held. Further details can be found in Chapter 6 of this document.

## Investment Companies

The NAPF Corporate Governance Policy and Voting Guidelines for investment companies<sup>9</sup> are the basis for our benchmark recommendations for investment trusts and venture capital trusts; these guidelines also refer to the key principles of the AIC Code<sup>10</sup>. Further details can be found in Chapter 7 of this document.

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<sup>5</sup>[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0278\\_Corporate\\_governance\\_policy\\_and\\_voting\\_guidelines\\_for\\_smaller\\_companies\\_an\\_NAPF\\_document.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0278_Corporate_governance_policy_and_voting_guidelines_for_smaller_companies_an_NAPF_document.aspx)

<sup>6</sup> Companies listed on the ICAP Securities and Derivatives Exchange

<sup>7</sup> <http://www.theqca.com/shop/guides/86557/corporate-governance-code-for-small-and-midsize-quoted-companies-2013-downloadable-pdf.shtml>

<sup>8</sup> Page 4, <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>


<sup>9</sup>[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279\\_%20Corporate\\_governance\\_policy\\_and\\_voting\\_guidelines\\_for\\_investment\\_companies\\_an\\_NAPF\\_document.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279_%20Corporate_governance_policy_and_voting_guidelines_for_investment_companies_an_NAPF_document.aspx)

<sup>10</sup> <https://www.theaic.co.uk/aic-code-of-corporate-governance-0>

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## 1. OPERATIONAL ITEMS

### Accept Financial Statements and Statutory Reports

-  **General Recommendation:** Generally vote for approval of financial statements and statutory reports, unless:
- › There are concerns about the accounts presented or audit procedures used; or
  - › There has been an accounting fraud or material misstatement during the year.

The overall quality of disclosure will be considered, and the weakest examples, such as where the meeting documents are not released in time for investors to review these ahead of the meeting, are likely to attract a negative vote recommendation.

### Amendments to the Articles of Association


-  **General Recommendation:** Vote case-by-case on amendments to the articles of association.

Requests to amend a company's articles of association are usually motivated by changes in the company's legal and regulatory environment, although evolution of general business practice can also prompt amendments.

When reviewing proposals to revise the existing articles or to adopt a new set of articles, ISS analyses the changes proposed according to what is in the best interest of shareholders.

Changes to the company's Articles should not be 'bundled' into a single resolution when they cover non-routine matters.<sup>11</sup>

### Approve Final Dividend

-  **General Recommendation:** Generally vote for proposals to approve the final dividend, unless:
- › The payout is excessive given the company's financial position.

The annual report includes a review of the company's performance during the year and should contain a justification for the dividend level. Unless there are major concerns about the payout ratio, ISS usually recommends approval of this item.

### Appointment of External Auditors

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<sup>11</sup> M.3 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

- ▶ **General Recommendation:** Generally vote for proposals to ratify the appointment of the external auditors, unless:
- › There are serious concerns about the procedures used by the auditor; or
  - › The auditors are being changed without explanation;

It is best practice in the UK to present the resolutions to appoint the external auditors and to fix their remuneration as two separate items.

In line with the NAPF position,<sup>12</sup> where the tenure of the external auditor extends beyond ten years and there has not been a recent tender process and no plans to put the audit out to tender are reported, then the chairman of the audit committee may receive a negative voting recommendation when he or she is next standing for re-election.

Where the auditor has resigned, the resignation letter should be posted on the company's website.<sup>13</sup> If the company proposes a new auditor, or an auditor resigns and does not seek re-election, the company should offer an explanation to shareholders. If no explanation is provided, ISS recommends a vote against the election of the new auditor.

### Authorise Board to Fix Remuneration of Auditors

- ▶ **General Recommendation:** Generally vote for proposals authorizing the board to fix the fees payable to the external auditors, unless:
- › Fees for non-audit services routinely exceed standard audit-related fees.

While the use of auditors for non-audit work can on occasion be justified on grounds of cost and relevant expertise, the NAPF<sup>14</sup> has proposed a non-audit fee cap of 100 percent of audit fees, absent an explanation of any exceptional circumstances which may apply such as an initial public offering.

Companies are encouraged to make a full public disclosure of the amount and nature of any payments for non-audit services, to enable investors to appropriately assess these when considering the ratio of audit to non-audit services. Where payments to the auditor for non-audit services appear under the category of "Other Fees" in the annual report, ISS expects that the company will disclose the nature of these services.

Where the ratio of non-audit fees to audit fees has been over 100 per cent for more than one year, and the company appears unwilling to address the issue, ISS may recommend a vote against the remuneration of the external auditors. In addition, the chairman of the audit committee is likely to receive a negative voting recommendation when he or she is next standing for re-election.

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<sup>12</sup> F.5 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>13</sup> F.6 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>14</sup> F.9 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>



## 2. BOARD OF DIRECTORS

### Director Elections



**General Recommendation:** Generally vote for the election or re-election of directors, unless:

- › Adequate disclosure has not been provided in a timely manner;
- › The board fails to meet minimum corporate governance standards – please see the following sections on independence classification and Board and Committee composition for further details of how this is interpreted in practice; or
- › There are specific concerns about the individual, such as their ability to commit sufficient time to the role.

An appropriate level of biographical detail should include a statement of a director's other directorships and responsibilities (including any relevant previous positions held), the experience and skills that they bring and the contribution that the director can make to the board. If the board provides no biographical details for a director who is standing for election for the first time, this is likely to result in a negative vote recommendation. A negative vote recommendation may also be considered in the absence of a supporting statement from the board where a director is standing for re-election.

There is no hard-and-fast threshold on the maximum number of directorships that are considered acceptable, but the NAPF<sup>15</sup> advises that the issue of time commitment is especially pertinent to the role of Chair, particularly where a company is both complex and global in scale and furthermore if it operates within a highly regulated sector such as financial services. The director's board and committee attendance will be considered when an individual holding multiple board positions stands for election or re-election. Under extraordinary circumstances, ISS will consider recommending a vote against individual directors for material failures of governance, stewardship, or risk oversight.

In addition to these general factors, ISS may recommend against due to concerns related to at least one of the following specific factors, which are presented below as separate subsections:

- Representatives of a controlling shareholders where no relationship agreement is in place
- Board independence classification
- Tenure
- Other resolutions

### Controlling shareholders

Following recent changes to the UK Listing Rules which apply to companies with a controlling shareholder,<sup>16</sup> the election or re-election of an independent director must now be approved by a normal ordinary resolution and separately approved by the minority shareholders. Both new applicants and existing listed companies must also have a written and legally binding relationship agreement with any controlling shareholder(s). Details of the relationship with the controlling shareholder should be disclosed to investors.<sup>17</sup>

### Board independence classification

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<sup>15</sup> A.11 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>


<sup>16</sup> <http://fshandbook.info/FS/html/handbook/LR/6/1>

<sup>17</sup> E.16 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

ISS classifies directors as either an executive director or as a non-executive director. Non-executive directors may be considered either independent or non-independent; an executive director is always considered to be non-independent.

The Chairman may be either a non-executive or an executive, although the designation of an executive chairman could be interpreted negatively by investors as evidence of one individual combining leading the board with bearing some executive responsibility for the company's operations.

The independence of the non-executive directors is assessed on an ongoing basis, while the independence of the chairman is assessed on appointment.

 **General Recommendation:** Directors are assessed on a case-by-case basis, although a non-executive director is likely to be considered as non-independent if one (or more) of the issues listed below apply.

In line with the UK Corporate Governance Code<sup>18</sup>:

- › Has been an employee of the company or group during the last FIVE years;
- › Has, or a connected person has had, within the last THREE years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- › Has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or performance-related pay schemes, or is a member of the company's pension scheme;
- › Has close family ties with any of the company's advisers, directors or senior employees;
- › Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; or
- › Represents a significant shareholder.

In addition:

- › Is attested by the board to be a non-independent non-executive director;
- › Is a former board chairman;
- › Has a substantial personal shareholding of  $\geq 1$  per cent ; or
- › Tenure (see next section).

## Tenure

On **tenure**, one of the conditions the Code includes to determine independence is whether a director has served on the board for more than nine years from the date of his or her first election. ISS follows the NAPF position<sup>19</sup> that if a non-executive director has served concurrently with an executive director for over nine years, that director should no longer be deemed to be independent. If a non-executive director has served for fifteen years on the board, ISS considers their independence has been impaired.

## Other resolutions

Where there is evidence of long-standing poor practice and the Company seems unwilling to address shareholder concerns, then the analyst may choose to escalate the issue. Typically, this is achieved through a negative vote

<sup>18</sup> B.1.1 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.asp>

<sup>19</sup> E.13 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

recommendation applied to the election or re-election of the Board or a committee chairman. Resolutions which take this approach are listed below:

- Appointment of external auditors
- Authorise board to fix remuneration of auditors
- Board and committee composition

In addition, applying the guidelines for a combined Chairman and CEO and the election of a former CEO as Chairman will result in a vote recommendation on a director's election.

## Board and committee composition



**General Recommendation:** Generally vote against any non-independent non-executive director whose presence on the board, audit or remuneration committee renders the board or committee insufficiently independent, unless:

- › The company discloses details of how the issue of concern will be resolved by the next AGM.

Non-independent non-executive directors serving on the nomination committee are assessed on a case-by-case basis.

### Discussion

ISS will support the election of non-independent directors to the board, so long as the overall board and committee composition is in line with the Code's requirements. A negative vote recommendation against a non-independent non-executive director would normally be warranted only where the composition of the key committees or the balance of the board was compromised.

**For companies in the FTSE350**, at least half the **board** excluding the chairman should comprise non-executive directors determined by the board to be independent.<sup>20</sup> The **audit** committee should comprise at least three independent non-executive directors.<sup>21</sup> The **remuneration** committee should<sup>22</sup> comprise at least three independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. A majority of the **nomination** committee should be independent non-executive directors.<sup>23</sup>

**Companies in the FTSE All Share below the FTSE350** should have at least two independent non-executive directors on the **board**. The board should establish **audit** and **remuneration** committees with at least two independent non-executive directors on each committee. The company chairman may be a member of, but not chair, either committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman.

If there is evidence of long-running, systemic issues around board and committee composition which the company seems unable or unwilling to address, the **chairman** may receive a negative vote recommendation on their reappointment, given he or she retains overall responsibility for the board's corporate governance arrangements.

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<sup>20</sup> B.1.2 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>21</sup> C.3.1 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>22</sup> D.2.1 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>23</sup> B.2.1 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

## Combined Chairman and CEO

- ▶ **General Recommendation:** Generally vote against a director who combines the CEO and Chairman roles, unless:
- › The company can provide a strong justification as to why this non-standard governance arrangement is appropriate for their specific situation for a limited period of time.

Separation of these roles is a cornerstone of governance in the UK, and thus one person holding the roles of both Chairman and CEO is a serious breach of good practice. However, the temporary combination of the roles may be justified, for example when a chairman “bridges the gap” between the departure of a CEO and the appointment of his or her successor.<sup>24</sup> ISS would not usually recommend support for the election of a director to serve as a combined chairman and CEO, but when the company provides an explanation which states that the company has adopted this arrangement in exceptional circumstances, this will be considered.

## Election of a Former CEO as Chairman

- ▶ **General Recommendation:** Generally vote against the election of a former CEO as chairman, unless:
- › The company can provide a strong justification as to why this non-standard governance arrangement is appropriate for their specific situation and for a limited period of time.

The succession of the CEO to chairman is a significant issue, acceptable only on rare occasions. Investors would expect confirmation that external search consultants had been engaged and that external candidates of at least equivalent stature had been considered.<sup>25</sup> The complexity of the business is an insufficiently persuasive argument to justify this type of succession. Given the issues posed by a former CEO assuming the Chair of the board, it is important for shareholder approval to be sought at the AGM coinciding with or following the appointment.<sup>26</sup>

## Contested Director 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.

<sup>24</sup> D.2 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>25</sup> D.8 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>26</sup> D.9 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

When analysing 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.

### 3. REMUNERATION

The ISS approach is aligned with the five remuneration principles for building and reinforcing long-term business success developed by the NAPF<sup>27</sup> in conjunction with a number of leading UK institutional investors. The principles state that:

- › Remuneration committees should expect executive management to make a material long-term investment in shares of the businesses they manage;
- › Pay should be aligned to the long-term strategy and the desired corporate culture throughout the organisation;
- › Pay schemes should be clear, understandable for both investors and executives, and ensure that executive rewards reflect returns to long-term shareholders;
- › Remuneration committees should use the discretion afforded them by shareholders to ensure that rewards properly reflect business performance; and
- › Companies and investors should have appropriately regular discussions on strategy and long-term performance.

While ISS' approach to remuneration is informed by the NAPF Corporate Governance Policy and Voting Guidelines 2014/15 which contain the above principles,<sup>28</sup> the IMA Principles of Remuneration,<sup>29</sup> and The Directors' Remuneration Reporting Guidance<sup>30</sup> produced by the GC100 and Investor Group, also influence the recommendations ISS makes, as does the remuneration section of the UK Corporate Governance Code.<sup>31</sup> In addition, for a number of years, ISS has supplemented the NAPF policy and these other sources with its own remuneration guidelines.

#### 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. 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 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) and then only as one part of an assessment of the

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<sup>27</sup>[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0351\\_remuneration\\_principles\\_for\\_building\\_and\\_reinforcing%20longterm\\_business\\_success\\_nov2013.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0351_remuneration_principles_for_building_and_reinforcing%20longterm_business_success_nov2013.aspx)

<sup>28</sup> <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>29</sup> <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>30</sup> <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>31</sup> Section D <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

remuneration policy. One-off pay awards to address concerns over the retention of an executive director 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 share award schemes on top of existing plans is likely to be viewed sceptically. Remuneration arrangements should be clearly disclosed, and sufficient detail provided about the performance conditions adopted in order to allow shareholders to make their own assessment of whether they are appropriate. However, bringing a remuneration policy into line with accepted good market practice should not be used as justification for an increase in the size of the overall package.


Investors expect that a company will work within its remuneration policy, and only seek approval to go outside the policy in genuinely exceptional circumstances. Seeking approval for awards outside the policy is likely to be viewed sceptically by investors. 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. ISS will consider this principle when evaluating Joint Share Ownership Plans.

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 in the banking sector

The amendments to the Capital Requirements Directive limit the ratio between variable and fixed remuneration for certain key bank staff to 1:1, unless shareholders approve a higher ratio (up to a maximum of 2:1). ISS will consider banks' remuneration policies in the context of its overall approach to assessing executive pay on a case-by-case basis.

## Remuneration Policy

 **General Recommendation:** Vote the resolution to approve the remuneration policy on a case-by-case approach, paying particular attention as to whether:

- › The company's approach to fixed remuneration is appropriate;
- › The award levels for the different components of variable pay are capped, and the quantum is reasonable when compared to peers;
- › Increases to the maximum award levels for the LTIP and bonus have been adequately explained;
- › Performance conditions for all elements of variable pay are clearly aligned with the company's strategic objectives, and vesting levels are in line with UK good practice;
- › Change of control, good leaver and malus/clawback provisions are in line with standard practice in the UK market;
- › The shareholding requirement for executive directors is a minimum of 200% of base salary;
- › Service contracts contain notice periods of no more than twelve months' duration and potential termination payments are linked to fixed pay with no contractual entitlements to unearned bonus on termination;
- › Non-executive directors do not receive any performance-related remuneration beyond their standard fees;
- › The treatment of new joiners is appropriate, with particular attention paid to the use of buy-out awards, and that the potential for any additional awards is capped;
- › The remuneration committee seeks to reserve a degree of discretion in line with standard UK practice; and
- › There are any issues in the policy which would be of concern to shareholders.

Where a policy 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 "For", whereas a single, serious deviation may be sufficient to justify an "Against" vote recommendation.

The binding vote on the remuneration policy is forward-looking and in most cases will apply for three years. Therefore, many shareholders will want to ensure that the policy takes into account good market practice in a number of key areas.

Policy component	Good market practice
The start and end date of the policy	Both the GC100 and Investor Group guidance <sup>32</sup> and the IMA Principles <sup>33</sup> state that investors are generally in favour of the remuneration policy coming in to effect immediately following approval at the general meeting. They also note that investors generally expect to see companies put forward their policy for approval every three years. ISS will consider the start date of each policy and its duration based upon the explanation provided by the company.
Base salaries	The remuneration committee should explain their policy for setting and reviewing salary levels.
Benefits and pensions	<p>Companies must describe the benefits provided to directors, which are expected to be not excessive and in line with standard UK practice. The maximum participation should be stated, and not be uncapped.</p> <p>Companies must<sup>34</sup> give a clear explanation of pension-related benefits, including the approach taken to making payments in lieu of retirement benefits or defined benefit arrangements. The IMA Principles<sup>35</sup> note the pension provision for executives should, where possible, be in line with the general approach to the employees as a whole. No element of variable pay should be pensionable.</p>
Annual bonus	<p>Annual bonuses exist to reward contribution to the business during the year above the level expected for being in receipt of a salary<sup>36</sup>. They should be clearly linked to business targets, ideally through the key performance indicators (KPIs) reported in the Strategic Report. Companies should explain the performance measures chosen.</p> <p>The GC100 and Investor Group<sup>37</sup> states that the maximum amount of the short-term incentive that might be earned must be disclosed as well as the amounts that could be paid for reaching certain thresholds or targets. In cases where a remuneration committee increases the maximum bonus opportunity, the performance targets should be made sufficiently more challenging to justify the additional reward that can be earned. Any increase in this limit from one policy period to another should be fully explained. ISS does not typically support uncapped bonus schemes.</p> <p>Deferring a portion of the bonus into shares can create a greater alignment with shareholders, particularly where there is no long term incentive, although the introduction of deferral should not of itself result in an increase to the overall quantum of the bonus. Dividends may be credited on deferred bonus shares held during the deferral</p>

<sup>32</sup> 4.2 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>33</sup> Appendix 1 <https://www.avis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>34</sup> 4.3.3 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>35</sup> Section B.2 and C (introduction) <https://www.avis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>36</sup> Section C1 <https://www.avis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>37</sup> 4.3.4 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>



Policy component	Good market practice
	<p>period, but no further dividends should be paid on undelivered shares or options after the end of the designated deferral period.</p> <p>Provisions to pay a guaranteed annual bonus will attract a negative vote recommendation.</p>
Long-term Incentive Plans (LTIP)	<p>Scheme and individual participation limits must be fully disclosed, and any change to the maximum award should be explained and justified.<sup>38</sup> Any matching shares will be considered as part of the overall quantum. Performance periods longer than three years and compulsory post-vesting holding periods are encouraged. Firms should avoid operating multiple long-term schemes.<sup>39</sup></p> <p>ISS does not typically support uncapped LTIPs in line with the Code<sup>40</sup> recommendation that upper limits should be set and disclosed. The fact that the remuneration committee will not be able to grant share awards higher than the limits set out in the remuneration policy is not a sufficient reason for removing individual limits from the rules of the relevant incentive scheme.</p> <p>Performance conditions, including non-financial metrics where appropriate, should be relevant, stretching and designed to promote the long-term success of the company.<sup>41</sup> The IMA Principles<sup>42</sup> state that comparator groups used for performance purposes should be both relevant and representative. Remuneration committees should satisfy themselves that the comparative performance will not result in arbitrary outcomes.</p> <p>ISS prefers to see vesting levels at no more than 25% for threshold performance. Vesting should not occur for below median performance.</p> <p>Dividends relating to the duration of the performance period may be paid retrospectively on shares that the executive retains after the performance targets have been measured, but no dividends should be paid on any part of the award that lapsed. The practice of crediting dividend payments on undelivered shares or options after the end of the performance period or beyond a compulsory post-vesting holding period is opposed.</p>
Malus and/or clawback	<p>Malus and clawback are sometimes confused, so it is worth clarifying that 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 LTIP or annual bonus schemes. When designing schemes of performance-related remuneration for executive directors, the 2014 revision of the Code<sup>43</sup> states that schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any</p>

<sup>38</sup> Section C2i <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>39</sup> B.23i <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>40</sup> Schedule A <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>41</sup> Schedule A <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>42</sup> Principle C.2ii <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>43</sup> D.1.1 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

Policy component	Good market practice
	sum, and specify the circumstances in which the committee considers it would be appropriate to do so. The NAPF advise that such provisions should not be restricted solely to material misstatements of the financial statements. <sup>44</sup>
Good leavers	<p>Where individuals choose to terminate their employment before the end of the service period, or in the event that employment is terminated for cause, the IMA Principles<sup>45</sup> suggest that any unvested options or conditional share-based awards should normally lapse.</p> <p>In other circumstances of cessation of employment, some portion of the award may vest, but always 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. However, where in the opinion of the Remuneration Committee, 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	The IMA <sup>46</sup> suggests that scheme rules should state 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.
Shareholding requirement	The Code <sup>47</sup> advises that the remuneration committee should consider requiring directors to hold a minimum number of shares. The NAPF policy <sup>48</sup> argues for minimum shareholding guidelines of 200% of basic salary. Unvested holdings in share incentive plans do not count towards fulfillment of the requirement.
Executive directors' service contracts, including exit payments	<p>Executive Directors should have service contracts in place with notice periods set at one year or less.<sup>49</sup> If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period. All termination payments should be subject to phased payment and mitigation.</p> <p>Exit payments should be linked to the fixed pay due for the notice period, with no guaranteed entitlement to any unearned variable pay. The vesting of outstanding long-term awards should be pro-rated for time and performance. The NAPF jointly with the ABI has published guidance on termination payments which states that severance</p>

<sup>44</sup> B.3 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>45</sup> Principle C.2viii <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>46</sup> Principle C.2vi <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>47</sup> Schedule A <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>48</sup> B.3 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>49</sup> D.1.5 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

Policy component	Good market practice
	payments arising from poor corporate performance should not extend beyond fixed pay and benefits. <sup>50</sup>
Arrangements for new joiners	<p>The GC100 and Investor Group<sup>51</sup> suggests that companies may wish to consider a statement that new directors will participate in short-term and long-term incentive plans on the same basis as existing directors. If companies wish to have the ability to make sign-on payments or awards, they must ensure the remuneration policy covers such arrangements. When describing their sign-on policies, companies must disclose the type of awards that could be made, the potential use of performance criteria and holding periods, and any application of recovery or withholding policies. The potential to offer sign-on payments or awards should not be open-ended. Remuneration of this nature should be subject to specific caps.</p> <p>Where remuneration committees offer buy-out awards to compensate executives for awards foregone at their previous employer, the cost is expected to be kept to a minimum and not exceed the realistic value of rewards forfeited by changing employer. Remuneration policies will be opposed if the door is left open to potential "golden hellos" or other non-performance related awards which do not clearly align with shareholders' interests.</p>
Discretion	Recognising that payments cannot be made outside of the framework voted on by shareholders, there is a balance to be found between a committee having scope to make appropriate changes within the policy, and a committee having broad flexibility to go outside the standard policy in certain circumstances. The GC100 and Investor Group guidance <sup>52</sup> advises against including a general statement that the remuneration policy may be amended at the complete discretion of the remuneration committee. ISS will recommend a vote against any policy which gives the remuneration committee the ability to make open-ended changes to the policy.
Non-Executive Director pay	The NAPF <sup>53</sup> suggests that additional remuneration, other than fees, including participation in a share option scheme, pension scheme 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.
All-Employee Schemes	ISS generally supports all-employee schemes, such as Save As You Earn (SAYE) schemes and Share Incentive Plans (SIPs) as a way of promoting employee ownership. ISS follows the IMA <sup>54</sup> position that if newly issued shares are utilised, the overall dilution limits for share schemes should be complied with.

## Remuneration Report

<sup>50</sup>3.8

[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~/\\_media/Policy/Documents/0059\\_Executive\\_contracts\\_and\\_severance\\_ABI\\_NAPF\\_Statement\\_0208.ashx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~/_media/Policy/Documents/0059_Executive_contracts_and_severance_ABI_NAPF_Statement_0208.ashx)

<sup>51</sup> 4.6 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>52</sup> 1.3 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>53</sup>Page 8

[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0278\\_Corporate\\_governance\\_policy\\_and\\_voting\\_guidelines\\_for\\_smaller\\_companies\\_an\\_NAPF\\_document.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0278_Corporate_governance_policy_and_voting_guidelines_for_smaller_companies_an_NAPF_document.aspx)

<sup>54</sup> Principle C.2xiii <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

► **General Recommendation:** Vote the resolution to approve the remuneration report on a case-by-case approach, paying particular attention as to whether during the year under review:

- › Any increases, either to fixed or variable remuneration, for the year under review or the upcoming year were well-explained and not excessive;
- › The bonus received and/or the proportion of the LTIP which vested was a fair reflection of the performance achieved;
- › Performance targets are measured over an appropriate period and are sufficiently stretching;
- › Targets for the bonus or the LTIP are disclosed in an appropriate level of detail;
- › Any exit payments to departing directors or special arrangements for new joiners were reasonable;
- › The remuneration committee exercised discretion appropriately; and
- › There are no issues in the report which would be of concern to shareholders.

Where the 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 recommendation of a “For”, whereas a single, serious deviation may be sufficient to justify an ‘Against’ vote recommendation.

Following the introduction of the separate binding vote on the remuneration policy, the remuneration report now serves as a way for shareholders to make their views known on the company’s pay practices during the year under review, and the extent to which these were compliant with the remuneration policy. The elements of the report which ISS considers are described in more detail in the following section.

Report component	Good market practice
Base salaries, benefits and pensions	<p>Remuneration committees are required to justify salary levels and increases in basic salary with reference to their remuneration policy.</p> <p>Annual increases in salary 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, increases in responsibilities and new recruits to the board. Changes in pay levels should take into account the pay and conditions across the company. The IMA Principles<sup>55</sup> advise that where remuneration committees seek to increase base pay, salary increases should not be approved purely on the basis of benchmarking against peer companies.</p> <p>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>
Annual Bonus	<p>The annual bonus earned for the year under review should be explained in a fashion which allows shareholders to clearly link performance with pay. The IMA Principles<sup>56</sup> advise that remuneration committees should provide informative disclosure on the extent to which performance targets have been met. 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>

<sup>55</sup> Section B.1 <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>56</sup> Section C.1 <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

Report component	Good market practice
	<p>There is an increasing expectation among investors that bonus targets will be disclosed retrospectively. If a remuneration committee believes that bonus target disclosure – even on a retrospective basis – is difficult for reasons of commercial sensitivity, it should explain when such considerations will fall away and provide a commitment to disclosure at that time. 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>The payment of a ‘one-off’ special bonus is likely to attract a negative vote recommendation. ISS will not typically support transaction-related bonuses.</p>
Long Term Incentive Plan (LTIP)	<p>Under the resolution to approve the remuneration report, ISS considers both the LTIP awards granted and those vested or lapsed during the year under review.</p> <p>When assessing the awards which <b>vested</b>, the IMA Principles<sup>57</sup> advise that remuneration committees should ensure that the result does not produce outcomes that are out of line with the overall performance of the company, its future prospects or the experience of its shareholders over the performance period. The definition of any performance measurement should be clearly disclosed.</p> <p>For awards <b>granted</b> in the year under review, the IMA Principles<sup>58</sup> note that companies should disclose the potential value of awards due to individual scheme participants on full vesting, expressed by reference to the face value of shares or shares under option at point of grant, and expressed as a multiple of base salary. 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<sup>59</sup>. ISS supports the limits recommended as good practice by the IMA.</p> <p>The rules of a scheme must provide that commitments to issue new shares or to re-issue treasury shares, when aggregated with awards under all of the company's other schemes, must not exceed 10% of the issued ordinary share capital, adjusted for share issuance and cancellation, in any rolling 10 year period.</p> <p>Commitments to issue new shares or re-issue treasury shares under executive (discretionary) schemes should not exceed 5% of the issued ordinary share capital of the company, adjusted for share issuance and cancellation, in any rolling 10 year period.</p>

<sup>57</sup> Section C.2ii <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>58</sup> Section C.2v <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

<sup>59</sup> Section C.2i <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

Report component	Good market practice
Any exit payments to departing directors or special arrangement for new joiners	<p>Exit payments to departing directors should not go beyond those to which the director is entitled under the terms of his or her service contract or the rules of the relevant incentive schemes. Ex gratia or special payments on termination are not supported.</p> <p>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 do not support special awards for new joiners except in exceptional situations.</p>
The pay of the NEDs	Any increases to NED pay during the year under review will be considered alongside pay increases to executive directors and the broader workforce.
The company's disclosure as to the use of remuneration consultants	The annual remuneration report must name any person who provided material advice or services to a relevant committee in the reported year, and set out additional details in respect of some of them. The GC100 and Investor Group <sup>60</sup> suggest these persons may include principal internal providers of material advice and services, remuneration consultants or external lawyers who provided any material advice other than advice on compliance with the relevant legislation.
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 rare that a remuneration committee chooses to amend the targets used for either the annual bonus or the LTIP subsequent to 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>

### Approval of a new or amended LTIP



**General Recommendation:** Vote the resolution to approve a new or amended LTIP on a case-by-case approach, paying particular attention as to whether:

- › The LTIP is aligned with the company's strategy and fosters an appropriately long-term mindset;
- › The proposed award levels are appropriate, and, in the case of an amended plan, any increases to the previous award levels are well-explained;
- › The maximum payout is capped;
- › The vesting levels for threshold and on target performance are in line with market norms, with threshold vesting no higher than 25%;
- › The LTIP is in line with the current remuneration policy;
- › Change of control, good leaver and malus/clawback provisions are present and the terms are in line with standard practice in the UK market;
- › The remuneration committee seeks to reserve a degree of discretion in line with standard UK practice;

<sup>60</sup> 3.11 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

- › The company is operating within the dilution limits of the company's share-based incentive schemes; and
- › There are no issues with the plan which would be of concern to shareholders.

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 flagged 'For', whereas a single, serious deviation may be sufficient to justify an "Against" vote recommendation.

The IMA Principles<sup>61</sup> emphasise that all new incentives or any substantive changes to existing schemes should be subject to prior approval by shareholders by means of a separate and binding resolution. When a new or amended LTIP is presented to shareholders for approval, ISS considers the points listed above, plus others which are relevant to the specific plan. Relevant issues are discussed in more detail in the earlier sections on the remuneration policy and report.

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<sup>61</sup> C.2i <https://www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf>

## 4. CAPITAL STRUCTURE

### Authorise Issue of Equity with and without Pre-emptive Rights

▶ **General Recommendation:** Generally vote for a resolution to authorise the issuance of equity, unless:

- › The general issuance authority exceeds one-third (33%) of the issued share capital. Assuming it is no more than one-third, a further one-third of the issued share capital may also be applied to a fully pre-emptive rights issue taking the acceptable aggregate authority to two-thirds (66%); or
- › The routine authority to disapply preemption rights exceeds 5% of the issued share capital.

ISS will generally support resolutions seeking authorities in line with the IMA's Share Capital Management Guidelines<sup>62</sup> and the Pre-Emption Group Statement of Principles.<sup>63</sup>

ISS will support an authority to allot up to two-thirds of the existing issued share capital, providing that any amount in excess of one-third of existing issued shares would be applied to fully pre-emptive rights issues only.

Under the Principles, the routine authority to disapply preemption rights should not exceed more than 5 percent of ordinary share capital in any one year, with an overall limit of 7.5 percent in any rolling three-year period.

In line with the NAPF<sup>64</sup>, the authorities should not be bundled together, or with any other voting issue. It is good practice, in terms of duration, for the authorities to require renewal at the following year's AGM.

### Authorise Market Purchase of Ordinary Shares

▶ **General Recommendation:** Generally vote for the resolution to authorise the market purchase of ordinary shares, unless:

- › The authority requested exceeds the levels permitted under the Listing Rules; or
- › The company seeks an authority covering a period longer than 18 months.

AGM agendas routinely include a resolution allowing companies to make market purchases of their shares. ISS will usually support this resolution if it is in line with the Listing Rules LR 12.4.1<sup>65</sup> which allows companies to buy back up to 15 percent of their shares in any given year, provided that the maximum price paid is not more than 5 percent above the average trading price.

Under the Companies Act 2006, the share buyback authority cannot be for a period longer than five years. ISS recommends that the renewal of such authorities be requested annually, and that the duration be no longer than 18 months or until the next AGM, if sooner. However, ISS will support a five-year authority if, in practice, the company has a history of reverting to shareholders annually.

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<sup>62</sup> <https://www.ivis.co.uk/media/9777/Share-Capital-Management-Guidelines-30-July-2014-.pdf>

<sup>63</sup> <https://www.ivis.co.uk/media/6059/Statement-of-Principles-July-2008.pdf>

<sup>64</sup> J.4 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>65</sup> <http://fshandbook.info/FS/html/handbook/LR/12/4>



## 5. OTHER ITEMS

### Mergers and Acquisitions

- ▶ **General Recommendation:** Vote mergers and acquisitions on a case-by-case basis, 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, where one is provided, may provide an initial starting point for assessing the appropriateness of the valuation, ISS places particular emphasis on the offer premium, market reaction and strategic rationale in the analysis.
Market reaction	How has the market responded to the proposed deal? A negative market reaction will be viewed with caution.
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 favourable track record of successful integration of historical acquisitions.
Conflicts of interest	Are insiders benefiting from the transaction disproportionately and inappropriately as compared to outside shareholders? ISS will consider whether any special interests may have influenced these directors 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.

### 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.

In the UK, under the Listing Rules<sup>66</sup> the listed company 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.

The NAPF<sup>67</sup> notes that concerns may arise if the transaction does not seem to be subject to proper oversight, is not undertaken on fully commercial terms in the normal course of business, or the company has not clearly explained how the transaction is in the interests of the company and all shareholders.

## Mandatory Takeover Bid Waivers

► **General Recommendation:** Generally vote against mandatory takeover bid waivers.

The mandatory bid requirement, as contained in Rule 9 of the Takeover Code, seeks to prevent "creeping acquisitions" and to ensure that shareholders, other than the controlling shareholder, receive a control premium when control of the company shifts further to the large shareholder.

When the issue of new securities as consideration for an acquisition or a cash subscription would otherwise result in the controlling shareholder being obliged to make a general offer, the Takeover Panel will normally waive the obligation if there is an independent vote at a shareholders' meeting. Waivers are usually sought where a company proposes to institute a share buyback programme in which a large investor or concert party intends not to participate.

In line with the NAPF<sup>68</sup>, ISS will usually recommend a vote against Rule 9 waivers.

## Reincorporation Proposals

► **General Recommendation:** Vote reincorporation proposals on a case-by-case basis.

When examining a reincorporation proposal, ISS first examines the reasons for the move. Sometimes a reincorporation proposal is part of a restructuring effort or merger agreement that contributes significantly to a company's growth, financial health and competitive position more than the anticipated negative consequences of incorporating in another country. However, reincorporation in a country with less stringent disclosure requirements or corporate governance provisions may be perceived as an attempt by management to lessen accountability to shareholders. In such cases, ISS may recommend voting against the proposal.

## Authorise the Company to Call a General Meeting with Two Weeks' Notice

► **General Recommendation:** Generally vote for the resolution to authorise the company to call a general meeting with 14 days' notice if the company has provided assurance that the authority will only be used when merited.

<sup>66</sup> <http://fshandbook.info/FS/html/handbook/LR/11/1>

<sup>67</sup> H.3 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>68</sup> K.1 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

Before the implementation of the EU Shareholder Rights Directive, companies were able to hold general meetings on 14 days' notice in line with the Companies Act 2006; however, since the Directive increased the minimum notice period to 21 days, shareholder authority must first be granted to opt out of the requirement.

Companies are expected to give as much notice as is practicable when calling a general meeting, with the additional flexibility afforded by this authority only being used in limited and time-sensitive circumstances where it would clearly be to the advantage of shareholders as a whole. ISS will generally support these resolutions, if the company has provided assurance that the shorter notice period would only be used when merited. However, companies which have used this authority inappropriately can expect future requests to be viewed sceptically when they attempt to renew this authority in future years.

### Authorise EU Political Donations and Expenditure



**General Recommendation:** Generally vote for the resolution to authorise EU political donations and expenditure, unless:

- › The company made explicit donations to political parties or election candidates during the year under review;
- › The duration of the authority sought exceeds one year and the company has not clarified that separate authorisation will be sought at the following AGM should the authority be used; or
- › No cap is set on the level of donations.


Companies which have no intention of making donations to political parties or incurring obvious political expenditure may, consider it prudent to seek shareholder approval for certain types of donation or expenditure which might be considered to fall within the broader definition of 'political' under the Companies Act 2006.<sup>69</sup>

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<sup>69</sup> <http://www.legislation.gov.uk/ukpga/2006/46/section/366>

## Shareholder Proposals (ESG)

ISS applies a common approach globally to evaluating social and environmental proposals, which cover a wide range of topics including consumer and product safety, environment and energy, labour standards and human rights, workplace and board diversity, and corporate political issues.

 **General Recommendation:** Vote on all environmental, social and governance proposals on a case-by-case basis, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder value, and whether:

- › The issues presented in the proposal are more appropriately or effectively dealt with through legislation or government regulation;
- › The company has already responded in an appropriate and sufficient manner to the issue(s) raised in the proposal;
- › The proposal's request is unduly burdensome, in terms of scope, timeframe or cost, or overly prescriptive, and how it compares with any industry standard practices for addressing the issue(s) raised by the proposal;
- › Sufficient information is currently available to shareholders from the company or from other publicly available sources, if the proposal requests increased disclosure or greater transparency; and
- › Implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

While a variety of factors are incorporated into each analysis, the overall principle guiding all vote recommendations is to focus on how the proposal may enhance or protect the position of shareholders in both the short term and long term.

## 6. SMALLER COMPANIES

ISS applies its smaller companies approach to companies which are members of the FTSE Fledgling index, those listed on AIM and other companies which are not widely-held. Further information can be found on Page 6 of this document. The approach is largely in line with the core policy, with the exceptions identified below.

### Accept Financial Statements and Statutory Reports

▶ **General Recommendation:** Generally vote for approval of financial statements and statutory reports, unless:

- › There are concerns about the accounts presented or audit procedures used; or
- › There has been an accounting fraud or material misstatement during the year.

In addition to the rationale stated under this resolution in the core policy (see above), where no appropriate resolution to target an investor's specific concern is on the ballot, perhaps because the company does not have annual elections for directors, ISS may suggest a negative vote recommendation against this resolution.

### Director Elections

▶ **General Recommendation:** Generally vote for the election or re-election of directors, unless:

- › Adequate disclosure has not been provided in a timely manner;
- › The board fails to meet minimum corporate governance standards – please see the following sections on independence classification and Board and Committee composition for details of how this is interpreted in practice; or
- › There are specific concerns about the individual, such as their ability to commit sufficient time to the role.

### Board independence classification

In addition to the conditions stated in the main policy, a non-executive director of a smaller company is likely to be considered as non-independent if he or she has a substantial personal shareholding of **greater than 3 per cent**.

### Discussion

The requirements for Fledgling companies are the same as for FTSE SmallCap companies, as set out in the core policy. A non-executive director of an AIM or ISDX company, who formerly served as board chairman, may still be considered independent.

The award of share options, the receipt of additional remuneration from the company apart from a director's fee, or participation in performance-related pay schemes, can result in the independence of NEDs being impaired. Options will not impact upon a NED's independence if the quantum is not considered to be material and if the company has a policy of no longer granting options to non-executives.

## Board and Committee Composition

The requirements for Fledgling companies are the same as for FTSE SmallCap companies, as set out in the core policy.

The chairman may sit on all committees provided that he or she continues to be considered independent.

For AIM companies only, which are not subject to the Code, the **audit** and **remuneration** committees should comprise a majority of independent non-executive directors, and half the members of the **nomination** committee need to be independent.

## Authorise Issue of Equity without Pre-emptive Rights



**General Recommendation:** Generally vote for a resolution to authorise the issuance of equity, unless:

- › The general issuance authority exceeds one-third (33%) of the issued share capital. Assuming it is no more than one-third, a further one-third of the issued share capital may also be applied to a fully pre-emptive rights issue taking the acceptable aggregate authority to two-thirds (66%); or
- › The routine authority to disapply preemption rights exceeds 10% of the issued share capital in any one year.

## Remuneration



**General Recommendation:** When assessing the remuneration resolutions for both FTSE Fledgling and AIM companies, a negative vote recommendation would be considered if any of the following had occurred:

- › Executive directors are not employed under formal service contracts or their service contracts, in the event of termination, provide for more than 12 months' notice;
- › NEDs have received performance-related pay, during the year under review;
- › Options have been re-priced during the period under review;
- › Vesting of incentive awards is not conditional on the achievement of performance hurdles;
- › Re-testing is allowed throughout the performance period; or
- › Awards granted to executive directors during the year under review feature a vesting period of less than three years.


The award of options to NEDs is not in line with best practice as it can cause a potential conflict of interest that may affect a NED's independent judgment. Therefore, the NAPF Smaller Companies Policy expects companies to remunerate NEDs with basic fees only, in the form of cash or shares.

## 7. INVESTMENT COMPANIES

The NAPF Corporate Governance Policy and Voting Guidelines for investment companies<sup>70</sup> are the basis for our benchmark recommendations for investment trusts and venture capital trusts; these guidelines also refer to the key principles of the AIC Code<sup>71</sup>.

Investment companies differ significantly in terms of structure from the majority of companies covered by the UK and Ireland policy because they generally have: (i) a board comprising of Non-executive Directors (NEDs) who are responsible for safeguarding shareholder interests; and (ii) an investment manager (either a person or an organization) who is responsible for the company's portfolio. The majority of trusts are externally-managed, but some investment trusts are internally-managed or self-managed. This means that they do not have third party investment managers, and instead have a managing director (normally a board member) who is responsible for the management of client portfolios.

### Director Elections

 **General Recommendation:** Generally vote for the election or re-election of directors, unless:

- › Adequate disclosure has not been provided in a timely manner;
- › The board fails to meet minimum corporate governance standards – please see the following sections on independence classification and Board and Committee composition for details of how this is interpreted in practice; or
- › There are specific concerns about the individual, such as their ability to commit sufficient time to the role.

### Board independence classification

In addition to the conditions stated in the main policy, the non-executive director of an investment company is likely to be considered as non-independent if he or she has a substantial shareholding of **greater than 1 per cent** providing the investment trust is listed in the FTSE All-Share index.

Also, the non-executive director of either a venture capital trust or an investment trust is likely to be considered as non-independent if he or she holds a directorship in one or more investment companies or venture capital trusts managed by the same manager, or they have a relationship with the investment manager.

### Board and committee composition

Whether executive directors are present or not, at least half of the board should comprise independent NEDs.

The **audit** committee should include independent NEDs only. The **remuneration** committee should comprise a majority of independent NEDs when no executive directors are present and independent NEDs only when executive directors are present. At least half of the members of a **nomination** committee should be independent.

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<sup>70</sup>[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279\\_%20Corporate\\_governance\\_policy\\_and\\_voting\\_guidelines\\_for\\_investment\\_companies\\_an\\_NAPF\\_document.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279_%20Corporate_governance_policy_and_voting_guidelines_for_investment_companies_an_NAPF_document.aspx)

<sup>71</sup><https://www.theaic.co.uk/aic-code-of-corporate-governance-0>

The chairman may sit on all committees provided that he or she continues to be considered independent. If more than half the board has served in excess of 9 years, a negative vote recommendation would over time be applied to the Chairman's re-election.

## Authorise Issue of Equity without Pre-emptive Rights



**General Recommendation:** Generally vote for a resolution to authorise the issuance of equity, unless:

- › The general issuance authority exceeds one-third (33%) of the issued share capital. Assuming it is no more than one-third, a further one-third of the issued share capital may also be applied to a fully pre-emptive rights issue taking the acceptable aggregate authority to two-thirds (66%); or
- › The routine authority to disapply preemption rights exceeds 5% of the issued share capital in any one year, or 10% if there is a commitment that any issuance will be at or above net asset value.

## Manager Evaluation

The NAPF<sup>72</sup> policy references the AIC Principles dealing with the relationship between a board and the manager which state that the board should regularly review the performance of, and contractual arrangements with, the manager (or executives of a self-managed company).

The AIC Code<sup>73</sup> recommends that management engagement committees should be established, consisting solely of directors independent of the manager or executives of self-managed companies, which should review the manager's performance and contractual arrangements annually and for any resulting decisions to be disclosed in the annual report.

The 2014/15 NAPF Corporate Governance Policy and Voting Guidelines<sup>74</sup> advise that of particular importance to shareholders is that the board of an investment company is, and acts, fully independently of the firm providing fund management services.

## Continuation of Investment Trust



**General Recommendation:** Generally vote the continuation resolution as described below:

- › ISS will vote for when the Board has tabled the resolution to comply with the requirement in the Trust's Articles of Association that this vote be put to shareholders at regular intervals, and there are no issues of concern;
- › If the Board has called a special meeting, due to the shares trading at a discount to Net Asset Value over a prolonged period, ISS will consider the issues on a case-by-case basis.

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<sup>72</sup>[http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279\\_%20Corporate\\_governance\\_policy\\_and\\_voting\\_guidelines\\_for\\_investment\\_companies\\_an\\_NAPF\\_document.aspx](http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0279_%20Corporate_governance_policy_and_voting_guidelines_for_investment_companies_an_NAPF_document.aspx)

<sup>73</sup> <https://www.theaic.co.uk/aic-code-of-corporate-governance-0>

<sup>74</sup> Page 4, <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>



## 8. OTHER POINTS TO NOTE

### Voting disclosure and the response to significant shareholder dissent

Investors expect that information regarding the voting outcomes on the resolutions presented at the 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 shares in respect of which the vote was directed to be withheld, and the overall percentages for each group.

The 2014 Code<sup>75</sup> states that when, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result. The FRC does not include a threshold for significant dissent, and ISS notes that market practice is bound to evolve in this area given this is a new provision in the Code. However, many investors will use the 20 percent figure, initially suggested by the GC100 and Investor Group<sup>76</sup> as a guideline for remuneration concerns, as a threshold for identifying significant issues more generally, although there may be reasons why, for some companies and/or types of resolution, a higher or lower level might be more appropriate.

In the accompanying feedback statement<sup>77</sup>, the FRC clarified that it was not the intention that votes withheld should be included, although other market participants such as the NAPF<sup>78</sup> are of the view that dissent should be taken to mean both active abstentions and votes against. The GC100 and Investor Group<sup>79</sup> advises that, although “votes withheld” (abstentions) are not votes in law, companies may wish to consider viewing votes withheld (or in combination with votes against) exceeding 20 percent as indicating a low level of support from investors that they would wish to address, although this will depend on the company concerned. Across other markets globally, ISS sees a consensus emerging with a figure somewhere in the range 20% to 30% consistently seen as a threshold for significant dissent.

### Board Diversity

ISS research includes commentary on the company's approach to diversity. The NAPF<sup>80</sup> expects companies to include a description of the board's policy on diversity, including professional, international and gender diversity, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

### Board Director acts as Company Secretary

The Code<sup>81</sup> states that the company secretary should be responsible for advising the board through the chairman on all governance matters, and investors typically expect this role to be filled by a non-board member.

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<sup>75</sup> E.2.2 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

<sup>76</sup> 3.1.2 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>77</sup> <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Feedback-Statement-Revisions-to-the-UK-Corporate-G.pdf>

<sup>78</sup> Page 13, Section E <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>79</sup> 3.1.2 <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

<sup>80</sup> A.9 <http://www.napf.co.uk/PolicyandResearch/Corporate-Governance/NAPF-Corporate-Governance-Policy-and-Voting-Guidelines.aspx>

<sup>81</sup> B.5 <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

## 9. APPENDIX

### **Good practice guidance referenced in this policy**

The following documents are referred to in this document, and are listed here in alphabetical order with the year of publication included where relevant:

The AIC Corporate Governance Guide for Investment Companies (2013)

Changes to the UK Listing Rules following CP 13/15 (2014)

The GC100 and Investor Group Directors' Remuneration Reporting Guidance (2013)

The GC100 and Investor Group Directors' Remuneration Reporting Guidance: 2014 Statement (2014)

The IMA Principles of Remuneration (2014)

The IMA Share Capital Management Guidelines (2014)

The ISS Global Principles on Executive and Director Compensation

The ISS Global Voting Principles

The NAPF Corporate Governance Policy and Voting Guidelines (2014)

The NAPF Corporate Governance Policy and Voting Guidelines for Investment Companies (2012)

The NAPF Corporate Governance Policy and Voting Guidelines for Smaller Companies (2012)

The Pre-emption Group – Disapplying Pre-emption Rights – A Statement of Principles (2008)

The QCA Corporate Governance Code for Small and Mid-Size Quoted Companies (2013)

Remuneration Principles for Building and Reinforcing Long-Term Business Success (2013)

The UK Corporate Governance Code (2014)

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