



# Americas

Includes U.S., Canada, and Brazil

## Proxy Voting Guidelines Updates

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2016 Benchmark Policy Recommendations

Effective for Meetings on or after Feb. 1, 2016

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## UNITED STATES

### BOARD OF DIRECTORS- VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

#### Unilateral Bylaw/Charter Amendments

**Current General Recommendation:** Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors, as applicable:

- › The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- › Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- › The level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter;
- › The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- › The company's ownership structure;
- › The company's existing governance provisions;
- › Whether the amendment was made prior to or in connection with the company's initial public offering;
- › The timing of the board's amendment to the bylaws/charter in connection with a significant business development;
- › Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders.

#### Key Changes:

- › Separate the methodology for evaluating adoptions of bylaw or charter provisions made prior to or in connection with a company's initial public offering from the methodology for evaluating unilateral board amendments to the bylaws or charter made following completion of a company's initial public offering, and
- › Explicitly state that ISS will consider both such actions in determining vote recommendations for director nominees until such time as the actions are reversed or submitted to a binding vote of public shareholders.

#### **New General Recommendation:**

1.17. Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors:

- › The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- › Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- › The level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter;
- › The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- › The company's ownership structure;
- › The company's existing governance provisions;
- › The timing of the board's amendment to the bylaws/charter in connection with a significant business development; and,
- › Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders.

Unless the adverse amendment is reversed or submitted to a binding shareholder vote, in subsequent years vote case-by-case on director nominees. Generally vote against (except new nominees, who should be considered case-by-case) if the directors:

- › Classified the board;
- › Adopted supermajority vote requirements to amend the bylaws or charter; or
- › Eliminated shareholders' ability to amend bylaws.

1.18. For newly public companies, generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopts bylaw or charter provisions adverse to shareholders' rights, considering the following factors:

- › The level of impairment of shareholders' rights caused by the provision;
- › The company's or the board's rationale for adopting the provision;
- › The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholder right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- › The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and,
- › A public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering.

Unless the adverse provision is reversed or submitted to a vote of public shareholders, vote case-by-case on director nominees in subsequent years.

#### Rationale for Update:

This update clarifies ISS policy and aligns ISS' approach to evaluating unilateral bylaw and charter amendments by pre-IPO companies and post-IPO company board members with feedback received from institutional investors. This update also establishes separate methodologies to evaluate adoptions of bylaw or charter provisions made prior to or in connection with a company's initial public offering and unilateral board amendments made to the bylaws or charter following completion of a company's initial public offering. This bifurcation reflects the differing expectations that investors may have for the governance structures of a newly-public company versus a company that has been public for some period of time.

At companies that are already public, investors have seen a marked increase in moves by boards to circumvent votes by unilaterally amending their companies' governing documents—usually the bylaws—to reduce shareholders' rights. While ISS tracked 10 such cases in 2013 (the historic norm in terms of volume), unilateral adoptions jumped to 64 in 2014, and there have been 62 thus far in 2015.

A majority of investor respondents to the ISS 2015–2016 policy survey favor adverse vote recommendations for director nominees when a board unilaterally adopts bylaw or charter amendments that "materially diminish" shareholders' rights until such time as the rights are restored. Both investor and non-investor respondents identify "classifying the board" and "establishing supermajority vote requirements for bylaw/charter amendments" as the unilateral actions for which continuing adverse vote recommendations would be most appropriate.

A significant percentage of recent IPOs have included provisions that limit board accountability to post-IPO investors and make it difficult for shareholders to amend the company's governing documents or take other corporate actions. While some pre-IPO boards argue that these governance structures will benefit investors over the long run, few of them provide opportunities for post-IPO shareholders to ratify these provisions. Notably, the lion's share of recent IPO firms have limited directors' accountability to shareholders by staggering board terms (via classified boards) and adopting supermajority vote provisions to amend the firms' governing documents. A law firm analysis of governance

practices at more than 400 “emerging growth companies” that completed their IPOs in the period from Jan. 1, 2013, through Dec. 31, 2014, for example, found that 69 percent of these firms went public with classified boards and nearly three-quarters had supermajority vote requirements in place.<sup>1</sup> A separate law firm analysis of large IPOs at 46 non-controlled companies for the Sept. 1, 2001, to Oct. 31, 2013, period, found that 70 percent of the boards had staggered terms and 70 percent of the firms required supermajority votes to amend their bylaws.<sup>2</sup>

## Overboarded Directors

▶ **Current General Recommendation:** Vote against or withhold from individual directors who:

- › Sit on more than six public company boards; or
- › Are CEOs of public companies who sit on the boards of more than two public companies besides their own— withhold only at their outside boards<sup>3</sup>.

### Key Changes:

- › In 2016, ISS will note in its analysis if a director is serving on more than five (5) public company boards.
- › Starting in February of 2017, ISS will recommend against directors who sit on more than five (5) public company boards.

▶ **New General Recommendation:** Vote against or withhold from individual directors who:

- › Sit on more than six public company boards; for meetings on or after Feb. 1, 2017<sup>4</sup>, sit on more than five public company boards; or
- › Are CEOs of public companies who sit on the boards of more than two public companies besides their own— withhold only at their outside boards<sup>3</sup>.

### Rationale for Update:

More than a decade ago, in response to rising investor concerns about over-boarding and academic research questioning the performance of “busy” directors, ISS set limits of six directorships for most board members and three total board memberships (service on the home company board and two outside directorships) for sitting CEOs.

Since these limits were adopted, the average time commitment for board service has exploded. According to the National Association of Corporate Directors’ (NACD) 2014-2015 Public Company Governance Survey, respondent directors of public companies now spend an average of 242 hours a year (or more than 30 eight-hour work days annually) on board service. This typical time commitment jumps up to 278 hours (or nearly five more eight-hour work days) when you add in the survey respondents’ estimates of additional time spent in informal meetings/conversations with management. In contrast, the average annual director time commitment reported by NACD’s survey respondents in 2005 was 190 hours (or fewer than 24 eight-hour work days).

<sup>1</sup> Morrison & Foerster, Getting the Measure of EGC Corporate Governance Practices: A survey and related resources, 2015.

<sup>2</sup> Davis Polk & Wardwell, Corporate Governance Practices in U.S. Initial Public Offerings (Excluding Controlled Companies, Jan, 2014).

<sup>3</sup> Although all of a CEO’s subsidiary boards will be counted as separate boards, ISS will not recommend a withhold vote from the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships.


<sup>4</sup> This policy change includes a 1-year transition period to allow time for affected directors to address necessary changes if they wish.

Recent academic research generally shows a negative association between board “busyness” and firm performance and director attendance at board meetings<sup>5</sup>. Notably, the authors of most of these studies define a “busy” director’s workload as three or more boards.

Many boards have responded to concerns about overboarding by placing limits on the number of public company directorships that their members may hold. Some boards appear to address time commitment concerns via their nominating panels. Spurred by these policies and common sense, most board members limit their board seats to four or fewer directorships.

ISS has periodically updated its overboarding policy since it was implemented in 2004, to incorporate the evolving market realities. The new policy aligns with feedback and research received from institutional investors as well as the issuer community (via our 2015-2016 policy survey and roundtable discussions) regarding the ability of a director to devote sufficient time to each board commitment. Based on that feedback as well as draft policy comments, ISS will continue evaluating the optimal level of directorships for individuals who are CEOs of public companies.

### Proxy Contests/Proxy Access — Voting for Director Nominees in Contested Elections


 **Current General Recommendation:** Vote case-by-case on the election of directors in contested elections, considering the following factors:

- › Long-term financial performance of the target company relative to its industry;
- › Management’s track record;
- › Background to the proxy contest;
- › Nominee qualifications and any compensatory arrangements;
- › Strategic plan of dissident slate and quality of critique against management;
- › Likelihood that the proposed goals and objectives can be achieved (both slates);
- › Stock ownership positions.

When the addition of shareholder nominees to the management card (“proxy access nominees”) results in a number of nominees on the management card which exceeds the number of seats available for election, vote case-by-case considering the same factors listed above.

#### Key Changes:

- › Clarifying a policy analysis framework to evaluate candidates nominated pursuant to proxy access as well as nominees in a proxy contest.
- › While several factors may be similar in each evaluation, there may be factors that are unique to analyzing proxy access nominations.

 **New General Recommendation:** Vote case-by-case on the election of directors in contested elections, considering the following factors:

<sup>5</sup> Cashman, George D. and Gillan, Stuart and Jun, Chulhee, Going Overboard? On Busy Directors and Firm Value (March 1, 2012). Available at SSRN: <http://ssrn.com/abstract=2044798> or <http://dx.doi.org/10.2139/ssrn.2044798>; Falato, Antonio and Kadyrzhanova, Dalida and Le, Ugur, Distracted Directors: Does Board Busyness Hurt Shareholder Value? (December 10, 2013). Available at SSRN: <http://ssrn.com/abstract=2272478> or <http://dx.doi.org/10.2139/ssrn.2272478>; Jiraporn, Pornsit and Davidson, Wallace N. and Ning, Yixi and DaDalt, Peter J., Too Busy to Show Up? An Analysis of Directors’ Absences (January 21, 2008). Available at SSRN: <http://ssrn.com/abstract=1254642> or <http://dx.doi.org/10.2139/ssrn.1254642>

- › Long-term financial performance of the target company relative to its industry;
- › Management's track record;
- › Background to the contested election;
- › Nominee qualifications and any compensatory arrangements;
- › Strategic plan of dissident slate and quality of critique against management;
- › Likelihood that the proposed goals and objectives can be achieved (both slates); and
- › Stock ownership positions.

In the case of candidates nominated pursuant to proxy access, vote case-by-case considering any applicable factors listed above or additional factors which may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether or not there are more candidates than board seats).

#### **Rationale for Update:**

This policy revision provides an analytical framework for evaluating candidates nominated pursuant to proxy access. ISS has a policy for evaluating director nominees in contested elections, which currently applies to proxy contests as well as proxy access nominations. However, the circumstances and motivations of a proxy contest and a proxy access nomination may differ significantly. Therefore, it is necessary to create adequate analytical latitude for evaluating candidates nominated through proxy access.

Proxy access rights have grown into a high-visibility corporate governance issue for US-listed companies. In 2014, ISS evaluated 18 shareholder proposals seeking proxy access rights. That number rose to more than 90 in 2015. Further, while five of the proposals received majority support in 2014, 52 have received majority support so far in 2015. Moreover, following the 2015 US proxy season, numerous companies have unilaterally adopted proxy access rights, even in the absence of majority-supported shareholder proposals.

While it is unlikely that many (or perhaps any) proxy access nominees will materialize in 2016, ISS believes it is prudent to update its framework for evaluating candidates nominated via proxy access right. In some cases, the nominating shareholder's views on the current leadership or company strategy may be opposed to the existing board's views. Alternatively, a shareholder nominator may generally agree with the company's strategy or have no specific critiques of incumbent directors, but may propose an alternative candidate to address a specific concern, such as board diversity or boardroom skills gaps.

## COMPENSATION

### **Advisory Votes on Executive Compensation— Problematic Pay Practices**

#### **Insufficient Executive Compensation Disclosure by Externally Managed Issuers**

 **Current General Recommendation:** None.

Currently, insufficient disclosure regarding compensation arrangements for executives at an externally-managed issuer (EMI) is not considered a problematic pay practice under ISS policy. Absent any other significant concerns identified, ISS has generally not issued adverse say-on-pay recommendations on this basis. ISS does raise concerns, however, regarding the lack of transparency resulting when an EMI provides a say-on-pay proposal without information that enables investors to make an informed voting decision on the proposal.



**Key Changes:** Update the Problematic Pay Practice policy, add "Insufficient Executive Compensation Disclosure by Externally Managed Issuers (EMIs)" to the list of practices that may result in an adverse recommendation on the advisory vote on executive compensation. This refers to an EMI's failure to provide sufficient disclosure to enable shareholders to make a reasonable assessment of compensation arrangements for the EMI's named executive officers.

**New General Recommendation:** For externally-managed issuers (EMIs), generally vote against the say-on-pay proposal when insufficient compensation disclosure precludes a reasonable assessment of pay programs and practices applicable to the EMI's executives.

#### **Rationale for Update:**

##### *Lack of Disclosure Precludes a Reasonable Assessment of Executive Compensation Arrangements*

Like most U.S. public companies, EMIs are subject to periodic, advisory say-on-pay vote requirements. However, an EMI typically does not directly compensate its executives. Instead, executives are compensated by the external manager, which is reimbursed by the EMI through a management fee.

EMIs typically do not disclose any details about their compensation arrangements or payments made to executives by external managers. Many EMIs do not provide even basic disclosure regarding executive compensation arrangements and payments between the external manager and the EMI's executives. When "executive compensation information" is disclosed, it is usually limited to the aggregate management fee paid by the EMI to its manager. Without adequate information, shareholders are unable to conduct a reasonable assessment of executive compensation arrangements in order to identify potentially problematic aspects of those arrangements and to make an informed decision when voting on the EMI's say-on-pay proposal.

Some EMIs provide disclosure about the value and nature of NEOs' compensation arrangements in sufficient detail to enable shareholders to reasonably assess the arrangements and cast an informed vote on the EMI's say-on-pay proposal. Some EMIs, for example, disclose the aggregate portion of such fees that is allocable to executive compensation expenses. A small number of EMIs disclose detailed information on behalf of their external managers. This enhanced transparency demonstrates that such information can be made available within the constraints of company agreements with external managers.

As such, ISS will consider insufficient disclosure regarding compensation arrangements between executives and the external manager to be a problematic practice that warrants an AGAINST recommendation on the say-on-pay proposal.

##### *2015-2016 Policy Survey*

Based on 2015-2016 ISS Policy Survey results, 71% of investor respondents indicated that, in the event an EMI does not provide disclosure on the compensation paid to management by the external manager, ISS should recommend an AGAINST vote on the say-on-pay proposal, given that the level of disclosure does not meet shareholders' informational needs. Even a sizable minority (24%) of non-investor respondents (companies and advisors) responded that an AGAINST recommendation would be warranted.

##### *U.S. Compensation Roundtables*

At the 2015 ISS U.S. Compensation Roundtable held on Sept. 22, 2015, nearly all participants expressed their support for a policy update in which ISS would recommend AGAINST the say-on-pay proposals for EMIs that do not provide sufficient executive compensation disclosure. No participant expressed a preference for continuation of ISS' current approach of supporting the say-on-pay proposals in such cases. At the 2014 ISS U.S. Compensation Roundtable held on Sept. 16, 2014, participants similarly indicated that they considered an EMI's lack of compensation disclosure to inhibit shareholders' ability to fully assess the merits of the company's pay program and practices.



## Hold Equity Past Retirement or for a Significant Period of Time



**Current General Recommendation:** Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain all or a significant portion of the shares acquired through compensation plans, either:

- › while employed and/or for two years following the termination of their employment ; or
- › for a substantial period following the lapse of all other vesting requirements for the award (“lock-up period”), with ratable release of a portion of the shares annually during the lock-up period.

The following factors will be taken into account:

- › Whether the company has any holding period, retention ratio, or officer ownership requirements in place. These should consist of:
  - › Rigorous stock ownership guidelines;
  - › A holding period requirement coupled with a significant long-term ownership requirement; or
  - › A meaningful retention ratio;
- › Actual officer stock ownership and the degree to which it meets or exceeds the proponent’s suggested holding period/retention ratio or the company’s own stock ownership or retention requirements;
- › Post-termination holding requirement policies or any policies aimed at mitigating risk taking by senior executives;
- › Problematic pay practices, current and past, which may promote a short-term versus a long-term focus.

A rigorous stock ownership guideline should be at least 10x base salary for the CEO, with the multiple declining for other executives. A meaningful retention ratio should constitute at least 50 percent of the stock received from equity awards (on a net proceeds basis) held on a long-term basis, such as the executive’s tenure with the company or even a few years past the executive’s termination with the company.

Vote case-by-case on shareholder proposals asking companies to adopt policies requiring Named Executive Officers to retain 75% of the shares acquired through compensation plans while employed and/or for two years following the termination of their employment, and to report to shareholders regarding this policy. The following factors will be taken into account:


- › Whether the company has any holding period, retention ratio, or officer ownership requirements in place. These should consist of:
  - › Rigorous stock ownership guidelines, or
  - › A holding period requirement coupled with a significant long-term ownership requirement, or
  - › A meaningful retention ratio,
- › Actual officer stock ownership and the degree to which it meets or exceeds the proponent’s suggested holding period/retention ratio or the company’s own stock ownership or retention requirements.
- › Problematic pay practices, current and past, which may promote a short-term versus a long-term focus.

A rigorous stock ownership guideline should be at least 10x base salary for the CEO, with the multiple declining for other executives. A meaningful retention ratio should constitute at least 50 percent of the stock received from equity awards (on a net proceeds basis) held on a long-term basis, such as the executive’s tenure with the company or even a few years past the executive’s termination with the company.

Generally vote against shareholder proposals that mandate a minimum amount of stock that directors must own in order to qualify as a director or to remain on the board. While ISS favors stock ownership on the part of directors, the company should determine the appropriate ownership requirement.

**Key Changes:**

- › Broaden policy to encompass executive equity retention proposals more generally, eliminating the need for a separate policy covering proposals seeking retention of 75% of net shares.
- › Clarify that the proposed retention ratio and the required duration of retention are some of the several factors that will be considered in ISS' case-by-case analysis.

 **New General Recommendation:** Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain a portion of net shares acquired through compensation plans. The following factors will be taken into account:

- › The percentage/ratio of net shares required to be retained;
- › The time period required to retain the shares;
- › Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
- › Whether the company has any other policies aimed at mitigating risk taking by executives;
- › Executives' actual stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's existing requirements; and
- › Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.


**Rationale for Update:**

This policy update clarifies the factors considered in ISS' case-by-case analysis. It also broadens the policy to encompass equity retention proposals more generally, thereby eliminating the need for a separate policy tied to a specified retention ratio.

Specifically, the revised policy clarifies that the proponent's suggested retention percentage/ratio and the required retention duration are two of the several factors to be assessed under ISS' case-by-case approach. This change eliminates the need for separate policies tied to specified retention ratios (i.e. a separate policy for proposals requesting 75% net share retention), since the retention ratio is a factor to be considered for every proposal. In more clearly identifying the factors and eliminating repetitive language, the new policy is more streamlined and easier to understand.

## ENVIRONMENTAL AND SOCIAL ISSUES

**Animal Welfare**

 **Current General Recommendation:** Generally vote for proposals seeking a report on a company's animal welfare standards, unless:

- › The company has already published a set of animal welfare standards and monitors compliance;
- › The company's standards are comparable to industry peers; and
- › There are no recent, significant fines or litigation related to the company's treatment of animals.

**Key Changes:**

- › Add "or animal welfare-related risks" to introductory sentence;
- › Add "controversies" to last bullet point; and
- › Add "and/or its suppliers'" to the last bullet point.

**New General Recommendation:** Generally vote for proposals seeking a report on a company's animal welfare standards, or animal welfare-related risks, unless:

- › The company has already published a set of animal welfare standards and monitors compliance;
- › The company's standards are comparable to industry peers; and
- › There are no recent significant fines, litigation, or controversies related to the company's and/or its suppliers' treatment of animals.

#### Rationale for Update:

In 2014, some proponents began submitting shareholder proposals requesting reports on the risks associated with the use of certain methods of animal housing (e.g. gestation crates and battery cages) and other animal welfare practices deemed inhumane in a company's supply chain. The updated policy clarifies that proposals requesting a report on animal welfare-related risks, including the aforementioned resolutions on supply chain risks, are analyzed under this policy. The inclusion of controversies, along with fines and litigation, provides for consistent language across the Environmental and Social Issues policies, and ensures consistent evaluation and incorporation of relevant information.

### Pharmaceutical Pricing, Access to Medicines, and Prescription Drug Reimportation

**Current General Recommendation:** Vote case-by-case on proposals requesting that a company report on its product pricing or access to medicine policies, considering:

- › The nature of the company's business and the potential for reputational and market risk exposure;
- › Existing disclosure of relevant policies;
- › Deviation from established industry norms;
- › Relevant company initiatives to provide research and/or products to disadvantaged consumers;
- › Whether the proposal focuses on specific products or geographic regions; and
- › The potential burden and scope of the requested report.

#### Key Changes:

- › Add "regulatory" to the risk exposure bullet point; and  
Add a bullet point for "recent significant controversies, litigation, or fines at the company."

**New General Recommendation:** Vote case-by-case on proposals requesting that a company report on its product pricing or access to medicine policies, considering:

- › The potential for reputational, market, and regulatory risk exposure;
- › Existing disclosure of relevant policies;
- › Deviation from established industry norms;
- › Relevant company initiatives to provide research and/or products to disadvantaged consumers;
- › Whether the proposal focuses on specific products or geographic regions;
- › The potential burden and scope of the requested report;
- › Recent significant controversies, litigation, or fines at the company.

**Rationale for Update:**

This update codifies ISS' current practice. When evaluating resolutions that request a report on a company's policies related to product pricing and access to medicine, ISS considers the potential for regulatory risks and the company's exposure to controversies, litigation, or fines.

The addition of the controversies bullet point reflects the increased criticism regarding the pricing of pharmaceutical products, in particular specialty drugs. This criticism has not only resulted in media coverage, but also Senate and U.S. Department of Justice investigations at some companies. Additionally, a growing number of states have either passed or have presented legislation aiming to cap pricing for certain products or to require drug manufacturers to provide increased disclosure on the cost of drug research and production, resulting in additional regulatory risks for the pharmaceutical industry.

**Climate Change/Greenhouse Gas (GHG) Emissions**

**Current General Recommendation:** Generally vote for resolutions requesting that a company disclose information on the impact of climate change on its operations and investments, considering:

- › Whether the company already provides current, publicly-available information on the impacts that climate change may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
- › The company's level of disclosure is at least comparable to that of industry peers; and
- › There are no significant controversies, fines, penalties, or litigation associated with the company's environmental performance.

**Key Changes:**

Add "such as financial, physical, or regulatory risks" to the introductory sentence.

**New General Recommendation:** Generally vote for resolutions requesting that a company disclose information on the risks related to climate change on its operations and investments, such as financial, physical, or regulatory risks, considering:

- › Whether the company already provides current, publicly-available information on the impact that climate change may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
- › The company's level of disclosure is at least comparable to that of industry peers; and
- › There are no significant controversies, fines, penalties, or litigation associated with the company's environmental performance.

**Rationale for Update:**

During the 2015 proxy season, proponents filed new shareholder proposals addressing companies' capital expenditure strategies as they relate to investments in fossil fuel and stranded carbon asset risk (investment in high-cost, high-carbon assets could be stranded, as global demand for fossil fuels slows in the coming years and/or potential climate change regulations make them unburnable). These resolutions asked companies to either report on the consistency of their capital expenditure strategies with policymakers' goals to limit greenhouse gas emissions, or a company's strategy

to address the risk of stranded assets presented by global climate change and associated demand reductions for oil and gas.

The revisions to the current policy clarify the types of risks related to climate change that can impact a company's operations and investments. It also clarifies that the capital expenditure strategy and stranded carbon asset resolutions are evaluated pursuant to this policy.

## CANADA

## BOARD OF DIRECTORS- VOTING ON DIRECTOR NOMINEES IN UNCONTESTED ELECTIONS

**Overboarded Directors –TSX**

▶ **Current General Recommendation:** Generally vote withhold for individual director nominees if:

- › Irrespective of whether the company has adopted a majority voting policy, the director is overboarded<sup>6</sup> AND the individual director has attended less than 75 percent of his/her respective board and committee meetings held within the past year without a valid reason for these absences.

Cautionary language will be included in ISS reports where directors are overboarded regardless of attendance.

**Key Changes:**

- › Change the definition of "overboarded" from more than 2 outside public company boards to more than 1 in the case of CEOs, and from more than 6 total public company boards to more than 4 in the case of non-CEOs.
- › Commencing as of February 2017 meeting dates, the new policy definition will be implemented under the ISS Canada TSX Overboarded Directors policy.

▶ **New General Recommendation:** Generally vote withhold for individual director nominees if:

- › Irrespective of whether the company has adopted a majority voting policy, the director is overboarded<sup>6,7</sup> AND the individual director has attended less than 75 percent of his/her respective board and committee meetings held within the past year without a valid reason for these absences.

Cautionary language will be included in ISS reports where directors are overboarded regardless of attendance.

**Rationale for Update:**

Directors need sufficient time and energy in order to be effective representatives of shareholders' interests. Directors' responsibilities are increasingly complex as board and key committee memberships demand greater time commitments.

In a [2014 study](#), 120 board chairs, directors and CEOs across Canada were surveyed regarding their annual time commitment per board on which they served. The survey found that the average annual time commitment per board for a Canadian director was 304 hours. This number was higher for directors of companies with assets of more than CA\$5 billion (388 hours) and also higher for those with assets between CA\$1 billion and CA\$5 billion (335 hours). There

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<sup>6</sup> "Overboarded" is defined as: a CEO of a public company who sits on more than 2 outside public company boards in addition to the company of which he/she is CEO (withholds would only apply on outside boards these directors sit on), OR the director is not a CEO of a public company and sits on more than 6 public company boards in total.

<sup>7</sup> Starting February 1, 2017, "overboarded" will be defined as: a CEO of a public company who sits on more than 1 outside public company board in addition to the company of which he/she is CEO (withholds would only apply on outside boards these directors sit on), OR the director is not a CEO of a public company and sits on more than 4 public company boards in total.

was also a correlation between the role of a director and average annual time commitment. As expected, being a board chair is the most time consuming role; however, being a committee chair can be almost as time consuming.

While it appears that no comparable studies were conducted for previous years in Canada, according to a 2014-2015 US survey conducted by the National Association of Corporate Directors (NACD), directors of US public companies spent an annual average of 278 hours on board-related matters.

Based on the results of the 2015-16 ISS Global Policy Survey, a plurality of investor responses indicated that four total board seats is an appropriate limit for directors who are not active CEOs, and that a total of two board seats (a CEO's "home board" plus one outside board) is an appropriate limit for directors who are active CEOs.

ISS also obtained feedback in one-on-one discussions with institutional investors, the results of which indicate that a majority of those canvassed support maximum limits of four and two total board seats for non-CEO directors and CEO directors, respectively. These limits are reasonable in light of the "double-trigger" approach of jointly evaluating both number of board seats and attendance under Canadian policy.

## Externally-Managed Issuers (EMIs) –TSX and TSXV

▶ **Current General Recommendation:** None.

### Key Changes:

Provide a framework for reviewing board accountability at EMIs, in cases where disclosure is limited or insufficient with respect to the management services agreement and how senior management is compensated.

▶ **New General Recommendation:** Vote case-by-case on say-on-pay resolutions where provided, or on individual directors, committee members, or the entire board as appropriate, when an issuer is externally-managed and has provided minimal or no disclosure about their management services agreements and how senior management is compensated. Factors taken into consideration may include but are not limited to:

- › The size and scope of the management services agreement;
- › Executive compensation in comparison to issuer peers and/or similarly structured issuers;
- › Overall performance;
- › Related party transactions;
- › Board and committee independence;
- › Conflicts of interest and process for managing conflicts effectively;
- › Disclosure and independence of the decision-making process involved in the selection of the management services provider;
- › Risk mitigating factors included within the management services agreement such as fee recoupment mechanisms;
- › Historical compensation concerns;
- › Executives' responsibilities; and
- › Other factors that may reasonably be deemed appropriate to assess an externally-managed issuer's governance framework.

### Rationale for Update:

Externally-managed issuers (EMIs) typically pay fees to outside firms in exchange for management services. In most cases, some or all of the EMI's executives are directly employed and compensated by the external management firm.




EMIs typically do not disclose details of the management agreement in their proxy statements and only provide disclosure on the aggregate amount of fees paid to the manager, with minimal or incomplete compensation information.

Say-on-pay resolutions are voluntarily adopted in Canada, and none of the currently identified Canadian EMIs had a say-on-pay resolution on ballot this past year. Additionally, all non-controlled TSX-listed issuers are required to adopt majority voting director resignation policies which could result in a director being required to resign from a board if he or she receives more 'withhold' than 'for' votes at the shareholders' meeting. Some investor respondents to ISS' 2015-16 ISS Global Policy Survey indicated that in cases where an externally managed company does not have a say-on-pay proposal (i.e., 'withhold' votes may be recommended for individual directors), factors other than disclosure should be considered, such as performance, compensation and expenses paid in relation to peers, board and committee independence, conflicts of interest, and pay-related issues. Policy outreach sessions conducted with Canadian institutional investors resulted in identical feedback.

## COMPENSATION

### Equity Compensation Plans–TSX

 **Current General Recommendation:** Vote case-by-case on equity-based compensation plans. Vote against the plan if any of the following factors applies:

- › **Cost of Equity Plans:** The total cost of the company's equity plans is unreasonable;
- › **Dilution and Burn Rate:** Dilution and burn rate are unreasonable, where the cost of the plan cannot be calculated due to lack of relevant historical data.
- › **Plan Amendment Provisions:** The provisions do not meet ISS guidelines regarding those amendments that should require shareholder approval..
- › **Non-Employee Director Participation:** Participation of directors is discretionary or unreasonable.
- › **Pay for performance:** There is a disconnect between CEO pay and the company's performance.
- › **Repricing Stock Options:** The plan expressly permits the repricing of stock options without shareholder approval and the company has repriced options within the past three years.
- › **Problematic Pay Practices:** The plan is a vehicle for problematic pay practices.

#### Key Changes:

Similar to the model introduced in the United States for the 2015 proxy season, ISS is adopting a "scorecard" model (Equity Plan Scorecard – "EPSC") for Canadian TSX equity plans that considers a range of positive and negative factors to evaluate equity incentive plan proposals. In concert with ISS' longstanding Canadian policies for TSX equity plans (relating to non-employee director participation, amendment provisions, and repricing without shareholder approval), the total EPSC score will determine whether ISS recommends for or against the proposal.

EPSC factors will fall under three categories ("EPSC pillars"): Plan Cost, Plan Features, and Grant Practices.

As part of the new approach, the updated policy will:

- › Utilize two index groups to determine certain thresholds and factor weightings:<sup>8</sup>
  - › S&P/TSX Composite Index; and
  - › Non-Composite TSX-listed Issuers.
- › Utilize individual scorecards for both index groups, as well as Special Cases versions of these scorecards where certain historic data are unavailable;
- › Measure plan cost (Shareholder Value Transfer or SVT) through both of the following:
  - › The company's total new and previously reserved equity plan shares plus outstanding grants and awards ("A+B+C shares"); and
  - › Only the new request plus previously reserved but ungranted shares ("A+B shares");
- › Incorporate a wide range of new factors for consideration, both positive and negative, in determining how to recommend for a given equity plan.



**New General Recommendation:** Vote case-by-case on equity-based compensation plans using an "equity plan scorecard" (EPSC) approach. Under this approach, certain features and practices related to the plan<sup>9</sup> are assessed in combination, with positively-assessed factors potentially counterbalancing negatively-assessed factors and vice-versa. Factors are grouped into three pillars:

- › **Plan Cost:** The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
  - › SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
  - › SVT based only on new shares requested plus shares remaining for future grants.
- › **Plan Features:**
  - › Absence of problematic change-in-control (CIC) provisions, including:
    - › Single-trigger acceleration of award vesting in connection with a CIC; and
    - › Settlement of performance-based equity at target or above in the event of a CIC-related acceleration of vesting regardless of performance.
  - › No financial assistance to plan participants for the exercise or settlement of awards;
  - › Public disclosure of the full text of the plan document; and
  - › Reasonable share dilution from equity plans relative to market best practices.
- › **Grant Practices:**
  - › Reasonable three-year average burn rate relative to market best practices;
  - › Meaningful time vesting requirements for the CEO's most recent equity grants (three-year lookback);
  - › The issuance of performance-based equity to the CEO;
  - › A clawback provision applicable to equity awards; and
  - › Post-exercise or post-settlement share-holding requirements (S&P/TSX Composite Index only).

Generally vote against the plan proposal if the combination of above factors, as determined by an overall score, indicates that the plan is not in shareholders' interests. In addition, vote against the plan if any of the following unacceptable factors have been identified:

- › Discretionary or insufficiently limited non-employee director participation;

<sup>8</sup> Additional Special Cases versions of both models will also be developed for companies that have recently IPO'd or emerged from bankruptcy and where the burn-rate factor would therefore not apply.

<sup>9</sup> In cases where certain historic grant data are unavailable (e.g. following an IPO or emergence from bankruptcy), Special Cases models will be applied which omit factors requiring these data.

- › An amendment provision which fails to adequately restrict the company's ability to amend the plan without shareholder approval;
- › A history of repricing stock options without shareholder approval (three-year look-back);
- › The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances; or
- › Any other plan features that are determined to have a significant negative impact on shareholder interests.

#### **Rationale for Update:**

As issues around cost transparency and best practices in equity-based compensation have evolved in recent years, ISS has determined to update its Canadian Equity Plans policy in order to provide for a more nuanced consideration of equity plan proposals.

Currently, the Canadian policy for equity plans comprises a series of pass/fail tests relating to plan cost and to three key concerns of Canadian investors:

- › Non-employee director participation;
- › Plan amendment provisions; and
- › Repricing without shareholder approval.

While the three policy cornerstones above will continue to be overriding negative factors under the new policy, the pass/fail test for plan cost will be replaced with a scorecard approach designed to provide a robust overview of an equity plan's strengths and weaknesses.

Feedback obtained through ongoing consultation with institutional investors since the 2013-2014 ISS policy cycle indicates strong support for the new approach, which incorporates the following key goals:

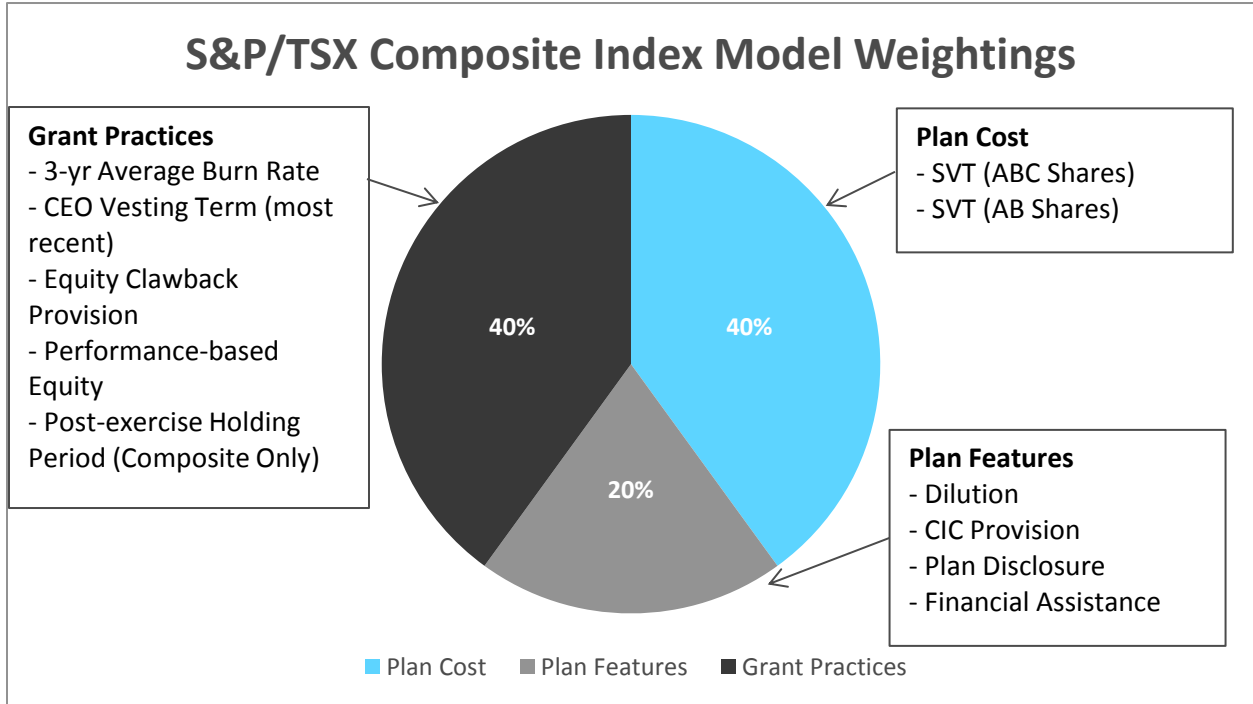
1. Consider a range of factors, both positive and negative, in determining vote recommendations;
2. Select factors based on institutional investors' concerns and preferences and on best practices within the Canadian market established through regulation, disclosure requirements, and best practice principles;
3. Establish factor thresholds and weightings which are cognizant of the Canadian governance landscape (separate scorecards for the S&P/TSX Composite Index and the broader TSX);
4. Ensure that key concerns addressed by policy continue to hold paramount importance (institution of overriding negative factors).

The EPSC policy for equity plan proposals significantly iterates ISS' current Canadian policy by providing a full-spectrum overview of plan cost, plan features, and historic grant practices. This allows shareholders greater insight into rising governance concerns, such as the implementation of risk-mitigating mechanisms, the strength of vesting provisions, and the use of performance-based equity, while also providing added assessments of longstanding concerns relating to equity plans such as burn rate and dilution.

By assessing these factors in combination, the EPSC is designed to facilitate a more holistic approach to vote recommendations. For example, a plan where cost is nominally higher than a company's allowable cap may receive a favourable recommendation if sufficient positive factors are present. Conversely, a plan where cost is nominally lower than the allowable cap may ultimately receive a negative recommendation if a preponderance of scorecard factors demonstrates adverse qualities. Plans will, however, continue to be subject to the scrutiny of overriding negative factors reflecting ISS' current policies regarding problematic non-employee director participation, insufficient plan amendment provisions, repricing without shareholder approval, and other egregious practices. Plans permitting these unacceptable practices will continue to receive an "against" recommendation.

A scorecard approach will enable the evaluation of equity plan proposals in consideration of a range of best practices. Weightings for the three scorecard pillars applicable to S&P/TSX Composite Index constituents and non-Composite TSX-

listed issuers are shown below, along with the factors within each pillar. More information about the policy and weightings will be included in ISS' EPSC FAQ to be published in December.



## BRAZIL

## BOARD OF DIRECTORS - DIRECTOR ELECTIONS

**Election of board and fiscal council nominees presented by minority ordinary and preferred holders under separate election items**

- ▶ **Current General Recommendation:** Vote against the election of directors nominated by non-controlling shareholders presented as a separate voting item if the nominee names are not disclosed in a timely manner prior to the meeting.

The policy is silent regarding the election of fiscal council members (statutory auditors) nominated by non-controlling shareholders, presented as separate voting items, as allowed by the Brazilian Corporate Law.

**Key Changes:**

- › Recommend an abstain vote in the absence of timely disclosure regarding the names of the minority shareholders' director nominees (both ordinary minority nominee and/or preferred minority nominee, as applicable), when presented under a separate election; and
- › Add the provision of an abstain vote recommendation in the absence of timely disclosure regarding the names of minority shareholders' fiscal council nominees and alternates (both ordinary and preferred minority nominees, as applicable), when presented under a separate election.

- ▶ **New General Recommendation:** Vote abstain on the election of directors and fiscal council members nominated by non-controlling shareholders presented as a separate voting item if the nominee names are not disclosed in a timely manner prior to the meeting.

**Rationale for Update:**

The current recommendation to vote against the election of directors nominated by non-controlling shareholders presented as a separate voting item if the nominee names are not disclosed in a timely manner prior to the meeting is part of the Brazilian policy carved out from the Americas Regional policy mid-2013, effective as of Feb. 1, 2014, but was not fully implemented by the Latin America Research team due to the evolving processes in the voting operations chain regarding minority elections presented under separate items in the Brazilian market.

Minority nominees are generally considered independent and, as they can legally be presented up to the time of the meeting, a vote against would disenfranchise minority shareholders who could benefit from greater independent representation. Nonetheless, a vote for minority nominees in the absence of the disclosure of such names is inconsistent with ISS transparency principles and the overall policy framework for the Latin America region.

As such, an abstain vote is the most effective (and neutral) way to address minority shareholder election items when adequate disclosure is not provided in a timely manner. The policy update maintains the current practice of recommending a for vote if the names of the minority nominees are disclosed, and, in the absence of timely disclosure, to recommend an abstain vote for all minority election items, including directors and fiscal council nominees (ordinary and preferred shareholder meeting).

## Combined Chairman/CEO

▶ **Current General Recommendation:** None specific to the combination of Chair/CEO.

### Key Changes:

Introduce policies for voting on directors at companies listed under the differentiated corporate governance segments in Brazil that maintain a combined Chair/CEO structure

▶ **New General Recommendation:** Vote against the bundled election of directors of companies listed under the differentiated corporate governance segments of the Sao Paulo Stock Exchange (BM&FBovespa)--Novo Mercado, Nivel 2, and Nivel 1-- if the company maintains or proposes a combined chairman/CEO structure, after three (3) years from the date the company's shares began trading on the respective differentiated corporate governance segment.

Vote against the election of the company's chairman, if the nominee is also the company's CEO, when it is presented as a separate election at companies listed under the differentiated corporate governance segments of the Sao Paulo Stock Exchange (BM&FBovespa)--Novo Mercado, Nivel 2, and Nivel 1-- after three (3) years from the date the company's shares began trading on the respective differentiated corporate governance segment.

### Rationale for Update:

The policy update is consistent with the current regulatory requirements of the Brazilian differentiated corporate governance listing segments (Novo Mercado, Nivel 2, and Nivel 1) adopted by the BM&FBovespa in 2010, which established the following:

No Accumulation of Positions. The offices of chairman of the board of directors and the chief executive officer or major executive officer of the Company shall not be accumulated in a single person, except in case of vacancy, in which event the circumstance will be disclosed to the market and action will be taken within the subsequent one hundred and eighty (180) days to fill in the positions.

However, accumulation of positions of chairman of the board of director and chief executive officer or major executive officer of the Company will be permitted on an exceptional and transitional basis for a maximum period of three (3) years starting from the date the Company shares begin to trade on the Novo Mercado, the Nivel 2 and Nivel 1.

## Conflicts of Interest (Policy change applies to Americas Regional policy as well)

▶ **Current General Recommendation:** Under extraordinary circumstances, vote against individual directors, 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 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.

**Key Changes:**

Include the provision to recommend against an individual nominee, committee members, or the entire board in light of a conflict of interest that raises significant risk, which has not yet materialized (forward looking), in the absence of mitigating measures.

▶ **New General Recommendation:** Under extraordinary circumstances, vote against individual directors, member(s) 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 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.

Vote against individual directors, members of a committee, or the entire board due to a conflict of interest that raises significant potential risk, in the absence of mitigating measures and/or procedures.

**Rationale for Update:**

The current policy framework refers to conflicts of interest that raise concern in specific transactions. The update addresses a conflict of interest that raises potential significant risk in terms of future possible actions or transactions that could be adverse to shareholders' interests, when the company does not disclose policies and procedures that would mitigate such risk.

## COMPENSATION

**Management Compensation**

▶ **Current General Recommendation:** Generally vote for management compensation proposals that are presented in a timely manner and include all disclosure elements required by the Brazilian Securities Regulator (CVM).

Vote against management compensation proposals when:

- › The company fails to present a detailed remuneration proposal or the proposal lacks clarity; or
- › The company does not disclose the total remuneration of its highest-paid executive; or
- › The figure provided by the company for the total compensation of its highest-paid administrator is not inclusive of all elements of the executive's pay.

**Key Changes:**

Include a provision that a significant increase in the proposed remuneration cap on a year-over-year basis will trigger further scrutiny of the company's remuneration proposal, providing a framework for a more qualitative remuneration analysis.

▶ **New General Recommendation:** Generally vote for management compensation proposals that are presented in a timely manner and include all disclosure elements required by the Brazilian Securities Regulator (CVM).

Vote against management compensation proposals when:



- › The company fails to present a detailed remuneration proposal or the proposal lacks clarity; or
- › The company does not disclose the total remuneration of its highest-paid executive; or
- › The figure provided by the company for the total compensation of its highest-paid administrator is not inclusive of all elements of the executive's pay.

Vote case-by-case on global remuneration cap (or company's total remuneration estimate, as applicable) proposals that represent a significant increase of the amount approved at the previous AGM (year-over-year increase). When further scrutinizing year-over-year significant remuneration increases, jointly consider some or all of the following factors, as relevant:

- › Whether there is a clearly stated and compelling rationale for the proposed increase;
- › Whether the remuneration increase is aligned with the company's long-term performance and/or operational performance targets disclosed by the company;
- › Whether the company has had positive TSR for the most recent one- and/or three-year periods;
- › Whether the relation between fixed and variable executive pay adequately aligns compensation with the company's future performance.

#### Rationale for Update:

In Brazil, shareholders are asked to approve the aggregate remuneration of directors and executive officers annually through a binding resolution presented at a shareholder meeting. Regulatory changes implemented late 2009, effective as of January 2010 (Instructions 480 and 481), provided the framework of full disclosure of the proposed remuneration, including detailed information of executive remuneration (not individualized), which has now been in place for several years. While current policy has based recommendations solely on companies' compliance with the disclosure requirements, this update provides for a more qualitative analysis when a significant year-over-year increase signals that further scrutiny of remuneration practices is warranted.

### Compensation Plans



**Current General Recommendation:** ISS will generally support reasonable equity pay plans that encourage long-term commitment and ownership by its recipients without posing significant risks to shareholder value.


Practically all of the plans presented since the implementation of the 2009 CVM guidelines have included reasonable dilution limits and adequate vesting conditions. Performance criteria, meanwhile, are rarely disclosed. ISS' assessments of these plans have generally hinged on the presence of discounted exercise prices (which are common in Brazil), particularly in the absence of specific performance criteria.

Vote against a stock option plan, or an amendment to the plan, if:

- › The plan lacks a minimum vesting cycle of three years; and/or
- › The plan permits options to be issued with an exercise price at a discount to the current market price, in the absence of explicitly stated, challenging performance hurdles related to the company's historical financial performance or the industry benchmarks; and/or
- › The maximum dilution exceeds ISS guidelines of 5 percent of issued capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features such as challenging performance criteria and meaningful vesting periods, as these features partially offset dilution concerns by reducing the likelihood that options will become exercisable unless there is a clear improvement in shareholder value; and/or
- › Directors eligible to receive options under the scheme are involved in the administration of the plan.


**Key Changes:**

Reference restricted share plans to clarify that ISS will recommend against such plans based on the proposal of full-value shares (which essentially represent a 100-percent discount to market price) in the absence of publicly disclosed performance targets and hurdles.

-  **New General Recommendation:** ISS will generally support reasonable equity pay plans that encourage long-term commitment and ownership by its recipients without posing significant risks to shareholder value.

Practically all of the plans presented since the implementation of the 2009 CVM guidelines have included reasonable dilution limits and adequate vesting conditions. Performance criteria, meanwhile, are rarely disclosed. ISS' assessments of these plans have generally hinged on the presence of discounted exercise prices (which are common in Brazil), particularly in the absence of specific performance criteria.

Vote against a stock option plan and/or restricted share plan, or an amendment to the plan, if:

- › The plan lacks a minimum vesting cycle of three years; and/or
- › The plan permits options to be issued with an exercise price at a discount to the current market price, or permits restricted shares to be awarded (essentially shares with a 100 percent discount to market price), in the absence of explicitly stated, challenging performance hurdles related to the company's historical financial performance or the industry benchmarks; and/or
- › The maximum dilution exceeds ISS guidelines of 5 percent of issued capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features such as challenging performance criteria and meaningful vesting periods, as these features partially offset dilution concerns by reducing the likelihood that options will become exercisable unless there is a clear improvement in shareholder value; and/or
- › Directors eligible to receive options under the scheme are involved in the administration of the plan. 

**Rationale for Update:**

Currently, ISS Brazil policy does not address restricted share plans, only stock option plans, although the latter have been seen more frequently in the last couple of years. As such, this policy update includes specific reference to restricted share plans under the current policy framework already adopted for stock options plans.

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