



CHINA

Proxy Voting Guidelines Benchmark Policy Recommendations

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Overview

Companies must hold their AGMs within six months of the close of each fiscal year. The following resolutions are commonly seen at a shareholder meeting:

- Approval of financial statements and statutory reports;
- Dividend distribution;
- Election of directors;
- Election of supervisors;
- Auditor appointment;
- Capital raising requests;
- Debt issuance requests;
- Amendments to articles of associations;
- Provision of guarantees;
- Related-party transactions.

Other items that may be submitted for shareholder approval include:

- Remuneration;
- Mergers and acquisitions;
- Investments in financial products using idle funds.

Policies in this document are presented in the order that generally appears on the ballot.

Vote Requirements:

- Ordinary resolutions require the approval of a majority of attending shareholders to pass.
- Special resolutions require the approval of a super majority (2/3) of all attending shareholders to pass.

Under certain circumstances, resolutions that are normally ordinary become special resolution:

- Resolutions on provisions of loan become special resolutions if the cumulative amount of the guarantee provision has already exceeded or will exceed 30 percent of the company's last audited total asset value with the addition of the new guarantee being proposed.

1. Financial Statements/Dividends

Approval of Financial Statements and Statutory Reports

Resolution Type: Ordinary

General Recommendation: Generally vote for approval of financial statements, report of board of directors, supervisors, and independent directors and other statutory reports unless there are concerns about the accounts presented or audit procedures used.

Discussion

Pursuant to Article 6.2 of Shenzhen Stock Exchange (SZSE) Listing Rules and Article 6.1 of Shanghai Stock Exchange (SSE) Listing Rules, listed companies are required to prepare and release annual reports within four months of the end of each financial year; interim reports within two months of the end of the first half of each financial year; and quarterly reports within one month of the end of the first three months and the end of the first nine months of each financial year, respectively.

In addition to financial statements, Chinese companies often submit the report of board of directors, supervisors, and independent directors (collectively referred to as statutory reports) to shareholders for approval.

- The report of directors typically discusses the company's operations for the previous year, including a review of the company's performance, justification of dividend levels and profits or losses, special events such as acquisitions or disposals, and future plans for the company.
- The report of supervisors contains statements as to the company's performance, finances, related-party transactions, and other operating matters during the year. Supervisors review the company's various documents, management work reports, special reports, and major policy decision matters as presented in the company's shareholder meetings and board of directors meetings and determine whether these are in accordance with prevailing laws and regulations.

These reports are usually included in the company's annual report and are ordinarily non-contentious in nature.

Dividend Distribution

Resolution Type: Ordinary

General Recommendation: Generally vote for approval of the allocation of income, unless:

- The dividend payout ratio has been consistently low without adequate explanation; or
- The payout is excessive given the company's financial position.

2. Board of Directors

Article 108 of the Company Act requires a company to have five to 19 directors on the board, whilst a 2001 China Securities Regulatory Commission (CSRC) guidance document requires that independent directors should represent at least one-third of the board, of which at least one independent director must be an accounting professional. Independent directors are subject to a maximum term of six years.

Meeting attendance of independent directors is required to be disclosed. Independent directors who do not join in a board of directors meeting in person for three consecutive times are required to step down and be replaced.

Voting for Director Nominees in Uncontested Elections

Resolution Type: Ordinary

General Recommendation: Generally vote for the re/election of directors, except where:

Independence:

- The nominee has been a partner of the company's auditor within the last three years, and serves on the audit committee;
- Any non-independent director nominees where the board is less than one-third independent under ISS classification of directors.

Composition:

- The independent director nominee has attended less than 75 percent of board meetings over the most recent fiscal year¹, without a satisfactory explanation. Acceptable reasons for director absences are generally limited to the following:
 - Medical issues/illness;
 - Family emergencies;
 - The director has served on the board for less than a year; and
 - Missing only one meeting (when the total of all meetings is three or fewer).

Generally vote for the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value.

Accountability:

Climate Accountability

For companies that are significant greenhouse gas (GHG) emitters, through their operations or value chain², generally vote against the responsible incumbent director(s), or any other appropriate item(s) in cases where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy.

¹ Companies are required to disclose the attendance record of independent directors only, and committee memberships and attendance are generally not disclosed.

² Companies defined as "significant GHG emitters" will be those on the current Climate Action 100+ Focus Group list.

Minimum steps to understand and mitigate those risks are considered to be the following. Both minimum criteria will be required to be in alignment with the policy:

- Detailed disclosure of climate-related risks, such as according to the framework established by the Task Force on Climate-related Financial Disclosures (TCFD), including:
 - Board governance measures;
 - Corporate strategy;
 - Risk management analyses; and
 - Metrics and targets.
- Appropriate GHG emissions reduction targets.

At this time, “appropriate GHG emissions reductions targets” will be medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for a company’s operations (Scope 1) and electricity use (Scope 2). Targets should cover the vast majority of the company’s direct emissions.

Governance Failures

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

- Material failures of governance, stewardship, risk oversight (including, but not limited to, environmental, social, and climate change issues), 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.

Classification of Directors

Executive Director

- Employee or executive of the company or a wholly-owned subsidiary of the company;
- Any director who is classified as a non-executive, but receives salary, fees, bonus, and/or other benefits that are in line with the highest-paid executives of the company.

Non-Independent Non-Executive Director (NED)

- Any director who is attested by the board to be a non-independent NED;
- Any director specifically designated as a representative of a shareholder of the company;
- Any director who is also an employee or executive of a significant^[1] shareholder of the company;
- Any director who is also an employee or executive of a subsidiary, associate, joint venture, or company that is affiliated with a significant^[1] shareholder of the company;
- Any director who is nominated by a dissenting significant shareholder, unless there is a clear lack of material^[2] connection with the dissident, either currently or historically;
- Beneficial owner (direct or indirect) of at least 10 percent of the company's stock, either in economic terms or in voting rights (this may be aggregated if voting power is distributed among more than one member of a defined group, e.g., family members who beneficially own less than 10 percent individually, but collectively own more than 10 percent), unless market best practice dictates a lower ownership and/or disclosure threshold (and in other special market-specific circumstances);
- Government representative;
- Currently provides or has provided (or a relative^[3] provides) professional services^[4] to the company, to an affiliate of the company, or to an individual officer of the company or of one of its affiliates in the latest fiscal year in excess of USD 10,000 per year;
- Represents customer, supplier, creditor, banker, or other entity with which the company maintains transactional/commercial relationship (unless company discloses information to apply a materiality test^[5]);
- Any director who has a conflicting relationship with the company, including but not limited to cross-directorships with executive directors or the chairman of the company;
- Relative^[3] of a current employee or executive of the company or its affiliates;
- Relative^[3] of a former employee or executive of the company or its affiliates;
- A new appointee elected other than by a formal process through the General Meeting (such as a contractual appointment by a substantial shareholder);
- Founder/co-founder/member of founding family but not currently an employee or executive;
- Former employee or executive (five-year cooling off period);
- Years of service is generally not a determining factor unless it is recommended best practice in a market and/or in extreme circumstances, in which case it may be considered.^[6]
- Any additional relationship or principle considered to compromise independence under local corporate governance best practice guidance.

Independent NED

- No material^[2] connection, either directly or indirectly, to the company (other than a board seat) or the dissenting significant shareholder.

Employee Representative

- Represents employees or employee shareholders of the company (classified as "employee representative" but considered a non-independent NED).

Footnotes:

[1] At least 10 percent of the company's stock, unless market best practice dictates a lower ownership and/or disclosure threshold.

[2] For purposes of ISS' director independence classification, "material" will be defined as a standard of relationship financial, personal, or otherwise that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

[3] "Relative" follows the definition of "immediate family members" which covers spouses, parents, children, stepparents, step-

children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.

[4] Professional services can be characterized as advisory in nature and generally include the following: investment banking/financial advisory services; commercial banking (beyond deposit services); investment services; insurance services; accounting/audit services; consulting services; marketing services; and legal services. The case of participation in a banking syndicate by a non-lead bank should be considered a transaction (and hence subject to the associated materiality test) rather than a professional relationship.

[5] A business relationship may be material if the transaction value (of all outstanding transactions) entered into between the company and the company or organization with which the director is associated is equivalent to either 1 percent of the company's turnover or 1 percent of the turnover of the company or organization with which the director is associated. OR, A business relationship may be material if the transaction value (of all outstanding financing operations) entered into between the company and the company or organization with which the director is associated is more than 10 percent of the company's shareholder equity or the transaction value, (of all outstanding financing operations), compared to the company's total assets, is more than 5 percent.

[6] For example, in Hong Kong and Singapore, directors with a tenure exceeding nine years will be considered non-independent, unless the company provides sufficient and clear justification that the director is independent despite his long tenure.

Voting for Director Nominees in Contested Elections

Resolution Type: Ordinary

General Recommendation: Vote case-by-case on the election of directors in contested elections, including election of shareholder nominees or the dismissal of incumbent directors. For shareholder nominees, ISS places the persuasive burden on the nominee or the proposing shareholder to prove that they are better suited to serve on the board than management's nominees. Serious consideration of shareholder nominees will be given only if there are clear and compelling reasons for the nominee to join the board. These nominees must also demonstrate a clear ability to contribute positively to board deliberations; some nominees may have hidden or narrow agendas and may unnecessarily contribute to divisiveness among directors.

The major decision factors are:

- 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
- Whether a takeover offer has been rebuffed.

When analyzing proxy contests/ shareholder nominees, ISS focuses on two central questions: (1) Have the dissidents proved that board change is warranted? and (2) if so, are the dissident board nominees likely to effect positive change (i.e., maximize long-term shareholder value)?

It is not, however, uncommon in China for a major shareholder to propose shareholder nominees. While these candidates are technically shareholder nominees, they are usually presented with consent of and often at the request of management. ISS treats the election of these shareholder nominees as uncontested director election unless there is an indication of director contest.

3. Board of Supervisors

The Company Act requires that companies establish a supervisory board, and that this board consists of at least three members, with no less than one-third representing mass employees. These employee representatives are elected by employees and are not subject to shareholder approval in general meetings. Directors and senior executives are prohibited from serving as supervisors.

These supervisory boards are charged with overseeing company finances and supervising the conduct of directors and senior executives, with supervisors typically nominated by major shareholders of the company.

Election of Supervisors

Resolution Type: Ordinary

General Recommendation: Generally vote for such candidates unless:

- He or she is a senior executive or director of the company;
- He or she has been a partner of the company's auditor within the last three years; or
- There are concerns about the performance or conduct of an individual candidate.

4. Remuneration

Director Remuneration

Resolution Type: Ordinary

General Recommendation: Generally vote for resolutions regarding directors' and supervisors' fees unless they are excessive relative to fees paid by other companies of similar size.

Discussion

According to Article 37 of the Company Act, director and supervisor remuneration requires shareholder approval. In most cases, however, it is disclosed as an aggregate amount. One exception is the finance industry, where state-owned entities are subject to higher disclosure requirements.

Equity-based Compensation

A-share Stock Option Schemes and Performance Share Schemes

Resolution Type: Special

General Recommendation: Vote against a stock option and/or performance share scheme if:

- Pricing Basis - The plan permits the exercise price of the stock options and/or grant price of the performance shares³ to be set at an unreasonable price⁴ compared to the market price without sufficient justification;
- Dilution - The maximum dilution level for the scheme exceeds 10 percent of issued capital; or 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;
- Performance benchmark - The scheme is proposed in the second half of the year and the measurement of the company's financial performance starts from the same year. The rationale is that the company's financial performance has been largely determined for that particular year and thus by linking the vesting conditions of part of the options and/or performance shares to that year's financial performance, the company is providing incentives for the period of the second half only, which can either be too aggressive (if the target is far out of reach) or too insufficient (i.e., the target has already been reached); or
- Incentive plan administration - Directors eligible to receive options and/or performance shares under the scheme are involved in the administration of the scheme.

Employee Stock Purchase Plans

Resolution Type: Ordinary

General Recommendation: Generally vote for employee stock purchase plans (ESPPs) unless any of the following applies:

- The total stock allocated to the ESPP exceeds 10 percent of the company's total shares outstanding at any given time;
- The share purchase price is less than 90 percent of the market price⁵ when the share purchase is conducted solely through private placement;
- The company's significant shareholders (i.e. individuals with 5 percent or more of beneficial ownership of the company) are involved as plan participants;
- The ESPP is proposed in connection with an equity financing scheme which does not warrant shareholder support; or
- The ESPP contains any other terms that are deemed disadvantageous to shareholders.

³ Performance share, termed as “restricted stock” literally in Chinese by companies incorporated in China, is a type of stock award that is commonly granted as a performance-based incentive in the market. The shares issued under such performance share plans are immediately locked after issuance and will only be vested upon completion of certain performance conditions.

⁴ The Administrative Measures on the Equity-based Incentive Schemes of Listed Companies recommends the following pricing basis:

- Performance share grant price - the higher of 50 percent of the two: 1) the average trading price one day before the announcement day; 2) the average trading price 20, 60, or 120 days before the announcement day.
- Stock option exercise price - the higher of the two: 1) the average trading price one day before the announcement day; 2) the average trading price 20, 60, or 120 days before the announcement day.

⁵ Market price is taken as the average trading price 20 trading days prior to the pricing reference date, pursuant to the CSRC's guidelines on private placements, or the unaffected price prior to the announcement of the private placement.

5. Auditor (Re)Appointment

Resolution Type: Ordinary

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

- There are serious concerns about the accounts presented or the audit procedures used;
- The auditor is being changed without explanation.; or
- Non-audit related fees are substantial or are routinely in excess of standard annual audit fees.

Whilst ISS will consider the nature and scope of non-audit fees when assessing their magnitude, where non-audit fees have constituted more than 50 percent of total auditor compensation during three out of the five most recent financial years, ISS will ordinarily not recommend support for the reelection of the audit firm.

6. Capital Raising

Share Issuance Requests

Resolution Type: Special

General Recommendation: Vote case-by-case on share issuance request, with reference to the identity of the placees, the use of proceeds, and the company's past share issuance requests.

Discussion

Share issuance requests allow companies to issue shares to raise funds for general financing purposes. In the Measures for the Administration of the Issuance of Securities by Listed Companies, the China Securities Regulatory Commission (CSRC) stipulates the following regarding public rights offerings:

- The number of new shares issued via a public rights offering shall not exceed 30 percent of the number of shares already issued;
- A successful rights offering shall have subscription rate of no less than 70 percent. The controlling shareholder is required to make a public commitment to indicate the number of rights to which it will subscribe.

In the Chinese market, the rights issued are non-renounceable rights, which are not transferable and cannot be traded in the open market. The trading of rights issued in the A-share market was terminated by the CSRC in June 1996. Investors therefore could not sell their entitlements for a cash value to, in turn, compensate for the losses in their percentage of ownership should they decide not to exercise the rights entitlements.

Further, given the high level of retail investors' participation in the market, a portion of the rights issued are often left unexercised due to the lack of awareness of these investors, resulting in increased control by the controlling shareholder at a steep discount via the public rights offering.

The Detailed Rules for Private Placement by Listed Companies and the relevant Q&A from the CSRC stipulate the following regarding share private placements:

- Share issuances via a private placement shall be issued to not more than 35 specific parties;

- The share issue price for a private placement shall not be lower than 80 percent of the average trading price of the company's A shares 20 trading days prior to the pricing reference date;
- In cases when all the placees have been determined in advance and belong to any of the following categories: (i) the ultimate controller, controlling shareholder and/or related parties controlled by them; (ii) investors who will obtain control over the company after the private placement; and (iii) strategic investors, the pricing reference date can be either the corresponding board meeting announcement date, the shareholder meeting resolution announcement date, or the first day of the share issuance period;
- In the aforementioned cases, the share lock-up period should be 18 months. In other cases, the issue price and placees will be determined via bidding process and the share lock-up period will be six months;
- In general, a cooling-off period of at least 18 months from the last share issuance should be in place. For companies that have used up their previous raised funds or have invested their raised funds as planned may not be subject to the above restriction, however, a cooling-off period of at least six months shall still be in place;
- The resulting dilution from a private share placement should be capped at 30 percent of the company's total shares prior to the share issuance.

Chinese companies do not ask for general mandates to issue shares to third parties, rather they seek shareholder approval for a specific issuance.

Adjustments of Conversion Price of Outstanding Convertible Bonds

Resolution Type: Special

General Recommendation: Generally vote against the downward adjustment of the conversion price of A-share convertible bonds unless the proposed adjusted conversion price is deemed reasonable given the company's justification; and the company is under extraordinary circumstances, such as liquidation or debt restructuring process due to financial distress.

Debt Issuance Requests

Resolution Type: Ordinary

The issuance of debt instruments is a commonly seen financing channel used by companies to finance its projects and fund operations in China. In evaluating such proposals, the following factors will be considered:

- Rationale/use of proceeds - Why does the company need additional capital? How will that capital be used?
- Terms of the debts - Are the debt instruments convertible into equity? What are the interest rate and maturity? Any call or put options? Often these terms will not be determined until the time of issuance of debt instruments (or when the actual loan agreement is signed). The terms of the debts would generally be determined by the market conditions, and lack of disclosure concerning these terms should not be a cause for significant concern so long as the debt is not convertible into equity.
- Size - At a minimum, the size of the debt issuance/potential borrowing should be disclosed.
- The company's financial position - What is the company's current leverage and how does that compare to its peers?
- The risk of non-approval - What might happen if the proposal is not approved? Any alternative source of funding? Could the company continue to fund its operations? Would it hinder the company's ability to realize opportunities?

General Recommendation: Vote case-by-case on non-convertible debt issuance requests. Generally vote for such requests if:

- The size of the debt being requested is disclosed;
- A credible reason for the need for additional funding is provided;
- Details regarding the assets to be pledged are disclosed (for specific asset pledge proposals); and
- There are no significant causes for shareholder concerns regarding the terms and conditions of the debt.

A vote against will be warranted only in extremely egregious cases or where the company fails to provide sufficient information to enable a meaningful shareholder review.

For the issuance of convertible debt instruments, as long as the maximum number of common shares that could be issued upon conversion meets ISS' guidelines on equity issuance requests, a vote for will be warranted. ISS will also recommend voting for proposals to restructure existing debt arrangements unless the terms of the restructuring would adversely affect the rights of shareholders.

Moreover, where a general authority to issue debt or pledge assets is requested, in addition to the above criteria, we will oppose such a proposal if it could result in a potentially excessive increase in debt. A potential increase in debt may be considered excessive when:

- The proposed maximum amount is more than twice the company's total debt;
- It could result in the company's debt-to-equity ratio exceeding 300 percent (for non-financial companies); and
- The maximum hypothetical debt-to-equity ratio is more than three times the industry and/or market norm.

If data on the normal level of debt in that particular industry or market is not available, only the company-specific information will be considered.

Provision of Guarantees

Resolution Type: Ordinary, [unless the cumulative amount exceeds threshold.](#)

General Recommendation: Vote case-by-case on proposals to provide loan guarantees for subsidiaries, affiliates, and related parties. Generally vote against the provision of a guarantee where:

- The identity of the entity receiving the guarantee is not disclosed;
- The guarantee is being provided to a director, executive, parent company or affiliated entities where the company has no direct or indirect equity ownership; or
- The guarantee is provided to an entity in which the company's ownership stake is less than 75 percent; and such guarantee is not proportionate to the company's equity stake or other parties have not provided a counter guarantee.

When the proposed guarantee does not fall into the above criteria, vote for such request provided that there are no significant concerns regarding the entity receiving the guarantee, the relationship between the listed company and the entity receiving the guarantee, the purpose of the guarantee, or the terms of the guarantee agreement. Examples of such concerns include a previous default by the entity receiving the guarantee or a sub-investment grade credit rating.

Discussion

Chinese companies often provide loan guarantees for subsidiaries, affiliates, and sometimes even unrelated parties.

According to Article 9.11 in the Listing Rules of both Shanghai and Shenzhen stock exchanges, shareholder approval shall be sought in the following situations:

- the amount of the guarantee is more than 10 percent of the last audited net asset value; or
- the cumulative amount of the guarantee provision over the most recent 12-month period has already exceeded or will exceed 50 percent of the last audited net asset value with the addition of the new guarantee being proposed
- the guarantee-receiving party has a debt-to-asset ratio over 70 percent;
- the cumulative amount of the guarantee provision over the most recent 12-month period has already exceeded or will exceed 30 percent of the company's last audited total asset value with the addition of the new guarantee being proposed; or
- the cumulative amount of the guarantee provision over the most recent 12-month period has already exceeded or will exceed 50 percent of the last audited net asset value with the addition of the new guarantee being proposed and the absolute amount of the proposed guarantee exceeds CNY 50 million.

7. Amendments to Articles of Association/Company Bylaws

Communist Party Committee

Resolution Type: Special for article amendments

General Recommendation: Generally vote against proposals for article and/or bylaw amendments regarding Party Committees where the proposed amendments lack transparency or are not considered to adequately provide for accountability and transparency to shareholders.

Discussion

Driven by the corporate reforms initiated by the China Communist Party, the regulatory enforcements to legitimize the existence of a Communist Party Committee or to establish one in state-owned enterprises (SOEs) have prompted listed SOEs to amend their articles, while non-SOEs have begun to follow suit. Such committees' members are not necessarily directors elected by shareholders, nor are they carrying out their duties as transparently as any board members or held accountable to shareholders. However, whilst no regulations explicitly grant the Party Committee the authority to override a company's board of directors, many proposals have included provisions that will modify the board representation and allow the Party Committee to assert disproportionate influence over the board. These issues raise governance concerns. Given that most companies neither delineate the responsibilities of the Party Committee from those of the board of directors or its key committees, nor specify clearly the actual interaction between the two when making material decisions, a more stringent approach is requested by institutional investors and market participants, including issuers, in general.

Other Articles of Association/Bylaw Amendments

Resolution Type: Special for article amendments; Ordinary for bylaw amendments

General Recommendation: Vote case-by-case on Articles of Association/bylaw amendments.

Generally vote for bylaw amendments if:

- They are driven by regulatory changes and are technical in nature; or
- They are meant to update company-specific information in the bylaws such as registered capital, address, and business scope, etc.

Generally vote against the amendments if:

- The company has failed to provide either a comparison table or a summary of the proposed amendments; or
- The amendments include the increase in the decision authority which is considered excessive and the company fails to provide a compelling justification.

Vote case-by-case on the adoption of new constitutional document with no previous reference.

Discussion

Proposals to amend company's Articles of Association and other bylaws are commonly seen at shareholder meetings. Companies usually disclose what being amended, or the amended bylaws, or both in their meeting circulars. Amendments are nearly always bundled together as a single voting resolution, and ISS' general approach is to review these amendments on a case-by-case basis and to oppose article amendments as a whole when they include changes ISS opposes.

Other company bylaws include but are not limited to:

- Rules and Procedures Regarding Shareholder's Meeting;
- Rules and Procedures Regarding Board of Directors' Meeting;
- Rules and Procedures Regarding Supervisors' Meeting;
- Rules and Procedures for Election of Directors and Supervisors;
- Working System for Board of Directors/Supervisors
- Management System of Raised Funds/ Related-Party Transactions;
- Management System of External Investment/ External Guarantee Provision.

8. Related-Party Transactions

ISS assesses related-party transactions on a case-by-case basis. However, all analyses are conducted from the point of view of long-term shareholder value for the company's existing shareholders.

As with many Asian markets, two types of related-party transactions are commonly seen in China – the non-recurring transaction and the recurring service provision agreement. Commonly seen related-party transactions include (but are not limited to):

- Transactions involving the sale or purchase of goods;
- Transactions involving the sale or purchase of property and/or assets;
- Transactions involving the lease of property and/or assets;
- Transactions involving the provision or receipt of services or leases;
- Transactions involving the transfer of intangible items (e.g., research and development, trademarks, license agreements);
- Transactions involving the provision, receipt, or guarantee of financial services (including loans and deposit services);
- Transactions involving the assumption of financial/operating obligations;

- Transactions that include the subscription for debt/equity issuances; and
- Transactions that involve the establishment of joint-venture entities.

Discussion

According to Article 5.1 of Guidelines for Introducing Independent Directors to the Board of Listed Companies by CSRC, 2001, independent directors must ratify any related-party transaction amounting to more than 5 percent of net assets or CNY 3 million, whilst at board meetings held to discuss such transactions interested directors must abstain from voting (Article 124 of the Company Act).

Related-party transactions are regulated by Chapter 9 and 10 in the Listing Rules of Shanghai and Shenzhen stock exchanges, with definitions of related parties and associated transactions given in articles 10.1.1, 10.1.3, and 10.1.5. These rules require that related parties abstain from voting on defined related-party transactions at shareholder meetings.

Articles 74 to 77 of the Code of Corporate Governance also include principles regarding the disclosure, pricing, and other issues involved in a typical related-party transaction.

Loan Financing Requests

Resolution Type: Ordinary

General Recommendation: Vote case-by-case on loans and financing proposals.

In assessing requests for loan financing provided by a related party:

- ISS will examine stated uses of proceeds, the size or specific amount of the loan requested, and the interest rate to be charged. ISS also gives importance to, and seeks disclosure on, the specific relation of the party providing the loan to the company.

In assessing requests to provide loan financing to a related party:

- ISS will examine stated uses of proceeds, the size or specific amount of the loan requested, and interest rates to be charged. ISS also gives importance to, and seeks disclosure on, the specific relation of the party to be granted the loan by the company.
- ISS will generally recommend that shareholders vote against the provision of loans to clients, controlling shareholders, and actual controlling persons of the company.
- ISS will generally recommend that shareholders vote against the provision of loans to an entity in which the company's ownership stake is less than 75 percent and the financing provision is not proportionate to the company's equity stake.

Discussion

Chinese companies often seek loan financing from banks, financial institutions, or controlling shareholders. Occasionally, companies also undertake to provide funding for its subsidiaries, affiliates, or related parties. Generally, the funds obtained from the loan application are used by companies, its subsidiaries, affiliates, and related parties to supplement working capital, fund ongoing projects, and take advantage of investment plans.

Article 10.2.3 of the Listing Rules of both Shanghai and Shenzhen stock exchanges prohibits the making of loans to directors, supervisors, or senior management either directly or through its subsidiaries.

Group Finance Companies

Resolution Type: Ordinary

General Recommendation: Vote against requests to deposit monies with a group finance company.

Discussion

It is not uncommon for large companies in China to establish group finance companies (GFC) as an internal agent to accept deposits from, and make loans to, group companies. Shareholder approval is typically required when the company makes deposits to, obtains loans from, and/or receives other forms of financial services from a GFC.

9. Mergers & Acquisitions

Resolution Type: Special

General Recommendation: Vote case-by-case on mergers and acquisitions, taking into consideration of following factors:

- Valuation - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? If a fairness opinion has been prepared, it provides an initial starting point for assessing valuation reasonableness, but ISS also places emphasis on the offer premium, market reaction, and strategic rationale.
- Market reaction - How has the market responded to the proposed deal? A negative market reaction will cause ISS to scrutinize a deal more closely.
- Strategic rationale - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
- Negotiations and process - Were the terms of the transaction negotiated at arms-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders.
- Conflicts of interest - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. ISS will consider whether these interests may have influenced these directors and officers to support or recommend the merger.
- Governance - Will the combined company have a better or worse governance profile than the respective 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.

10. Proposals to Invest in Financial Products Using Idle Funds

Resolution Type: Ordinary

General Recommendation: Vote on proposals to invest in financial products using idle funds on a case-by-case basis. Key factors for evaluating such requests include:

- Any known concerns with previous investments;
- The amount of the proposed investment relative to the company's assets;
- Disclosure of the nature of the products in which the company proposes to invest; and
- Disclosure of associated risks of the proposed investments and related risk management efforts by the company.

Generally vote for such proposals unless the company fails to provide sufficient information to enable a meaningful shareholder vote or there are significant concerns with the company's previous similar investments.

Discussion

According to Article 9.3.2 of the listing rules, the company's external investments, including investment in financial products, with a cumulative amount more than 50 percent of its last audited net asset value and exceeding CNY 50 million in the previous 12 months requires shareholder approval. In addition, CSRC issued a new regulation in late 2012 to allow listed companies to invest part of their idle raised funds in financial products with approval of shareholders.

11. Social and Environmental Issues

General Approach

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, labor standards and human rights, workplace and board diversity, and corporate political issues. While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short or long term.

General Recommendation: Generally vote case-by-case, examining primarily whether implementation of the proposal is likely to enhance or protect shareholder value. The following factors will be considered:

- If the issues presented in the proposal are being appropriately or effectively dealt with through legislation or government regulation;
- If the company has already responded in an appropriate and sufficient manner to the issue(s) raised in the proposal;
- Whether the proposal's request is unduly burdensome (scope or timeframe) or overly prescriptive;
- The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
- Whether there are significant controversies, fines, penalties, or litigation associated with the company's practices related to the issue(s) raised in the proposal;
- If the proposal requests increased disclosure or greater transparency, whether reasonable and sufficient information is currently available to shareholders from the company or from other publicly available sources; and
- If the proposal requests increased disclosure or greater transparency, whether implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

Say on Climate (SoC) Management Proposals

General Recommendation: Vote case-by-case on management proposals that request shareholders to approve the company's climate transition action plan⁶, taking into account the completeness and rigor of the plan. Information that will be considered where available includes the following:

- The extent to which the company's climate related disclosures are in line with TCFD recommendations and meet other market standards;
- Disclosure of its operational and supply chain GHG emissions (Scopes 1, 2, and 3);
- The completeness and rigor of company's short-, medium-, and long-term targets for reducing operational and supply chain GHG emissions (Scopes 1, 2, and 3 if relevant);
- Whether the company has sought and approved third-party approval that its targets are science-based;
- Whether the company has made a commitment to be "net zero" for operational and supply chain emissions (Scopes 1, 2, and 3) by 2050;
- Whether the company discloses a commitment to report on the implementation of its plan in subsequent years;
- Whether the company's climate data has received third-party assurance;
- Disclosure of how the company's lobbying activities and its capital expenditures align with company strategy;
- Whether there are specific industry decarbonization challenges; and
- The company's related commitment, disclosure, and performance compared to its industry peers.

Say on Climate (SoC) Shareholder Proposals

General Recommendation: Vote case-by-case on shareholder proposals that request the company to disclose a report providing its GHG emissions levels and reduction targets and/or its upcoming/approved climate transition action plan and provide shareholders the opportunity to express approval or disapproval of its GHG emissions reduction plan, taking into account information such as the following:

- The completeness and rigor of the company's climate-related disclosure;
- The company's actual GHG emissions performance;
- Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to its GHG emissions; and
- Whether the proposal's request is unduly burdensome (scope or timeframe) or overly prescriptive.

⁶ Variations of this request also include climate transition related ambitions, or commitment to reporting on the implementation of a climate plan.

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