



NEW ZEALAND

Proxy Voting Guidelines Benchmark Policy Recommendations

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Introduction

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

The principle underpinning all ISS' benchmark recommendations is that security holders are the owners of listed entities, and as such, they are entitled to assess every resolution that seeks their approval and to understand how it affects their interests as the owners of the company. An overarching ideal in corporate governance is that the laws, standards, and principles applied require accountability, transparency and fairness.

Disclosure

Shareholders in listed companies are entitled to clear and meaningful disclosure of company finances, the names, roles, and experience of directors and senior management, and the remuneration paid to directors, auditors, and executives, as well as any other transactions between the company and associates of its management.

In addition, shareholders as owners should receive information on the internal and external governance mechanisms of a company, including the details of membership of board committees, attendance at board and committee meetings by directors, and disclosure of committee charters and/or responsibilities. Adequate disclosure on governance mechanisms includes the disclosure of the number of votes cast 'For', 'Against', and 'Abstain' on particular resolutions at company meetings.

In the absence of such disclosures, shareholders will lack sufficient information to assess how their interests as owners are being safeguarded. In cases where disclosure is generally inadequate, ISS will consider on a case-by-case basis recommending against resolutions such as the election of directors, especially the chairperson, the acceptance of Shareholders have no decision-making ability in the management of the listed entity. Their main rights in this regard are to receive information about a company's performance and to vote on resolutions put before an annual or, where applicable, extraordinary general meeting.

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

- Consideration of the financial statements and reports (not normally a voting item);
- Election or re-election of directors;
- Changes in the Constitution of a company;
- Consideration of certain related party transactions;
- Consideration of an increase in the directors' total fee pool (directors are able to determine the quantum of fees each individual will receive from that pool); and
- Approval of auditors and permitting a board to agree auditor remuneration.

The goals of these guidelines are to recognize that:

- The objective of most shareholders is to hold and manage their investments with long term value creation in mind; and
- The principles of corporate governance have an ability to impact shareholder value and risk.

1. General

Constitutional Amendment

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

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

ISS will pay particular attention to the likely impact of any proposed amendment on the rights of shareholders and will generally recommend against any amendment that reduces shareholder rights without adequate justification.

Alteration of the Number of Directors/Board Size in Constitution

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

The New Zealand Stock Exchange Main Board Listing Rules (under Listing Rule 2.1.1(a)) requires a minimum of three directors for public companies, and nominees are elected if they receive 50% shareholder support. There is no maximum board size limit set out in the New Zealand Companies Act nor the NZX Listing Rule, although company constitutions may set a maximum limit.

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

Financial Statements

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

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

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

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

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

- There are serious concerns about the accounts presented or the audit procedures used; and,

- Non-audit related fees are substantial or are routinely in excess of standard annual audit fees.

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

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

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

This type of resolution is not required under New Zealand law, but it will be a ballot item for NZX-listed companies that are incorporated in the United Kingdom, Papua New Guinea, and other countries where annual reappointment of the auditor is a statutory requirement. Refer to Chapter 4. Board of Directors for considerations of voting sanctions in regard to members of an Audit Committee.

Appointment of a New Auditor

General Recommendation: Generally vote for the appointment of a new auditor, unless:

- There are serious concerns about the effectiveness of the auditors;
- The auditors are being changed without explanation; or
- The lead audit partner(s) has been linked with a significant auditing controversy.

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

Where the auditor has resigned, the resignation letter should be posted on the company's website or as an announcement to the market. If the company proposes a new auditor, or an auditor resigns and does not seek re-election, the company should offer an explanation to shareholders. If no explanation is provided, ISS may recommend a vote against the election of the new auditor.

Change Company Name

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

Decisions on the company name require a special resolution of shareholders (75-percent majority of votes cast) and are best left to management. Typically, name changes are proposed to align the company name more closely with its primary businesses and activities and/or to simplify the company name. Such changes are usually made without detracting from market recognition of the company's identity and activities.

Significant Change in Activities

General Recommendation: Vote for resolutions to change the nature or scale of business activities (NZX Listing Rule 5.1) provided the notice of meeting and explanatory statement provide a sound business case for the proposed change.

2. Capital Structure

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

Multiple Voting Rights

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

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

Non-Voting Shares

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

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

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

Mergers and Acquisitions

General Recommendation: Vote case-by-case on mergers and acquisitions. Review and evaluate the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors including:

- *Valuation* - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction and strategic rationale.
- *Market reaction* - How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.
- *Strategic rationale* - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
- *Negotiations and process* - Were the terms of the transaction negotiated at arm's-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation "wins"

can also signify the deal makers' competency. The comprehensiveness of the sales process (e.g., ability for alternate bidders to participate) can also affect shareholder value.

- *Conflicts of interest* - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. Consider whether these interests may have influenced these directors and officers to support or recommend the merger.
- *Governance* - Will the combined company have a better or worse governance profile than the current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

It is incumbent on the board to explain the structure proposed for a combination.

3. Share Capital

Reduction of Share Capital: Cash Consideration Payable to Shareholders

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

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

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

Reduction of Share Capital: Absorption of Losses

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

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

Buybacks/Repurchases

General Recommendation: Generally vote for requests to buy back or repurchase shares, unless:

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

Consider the following conditions in buyback plans:

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

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

Issue of Shares (Placement): Advance Approval

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

NZX Listing Rule 4.5.1(a) allows the company to issue equity securities provided that the number to be issued, together all other equity securities of the same class issued under Listing Rule 4.5.1 over the shorter of the previous 12 months or the period since the company was listed, will not exceed the aggregate of 15% of the equity securities of that class on issue at the beginning of that period.

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

Vote case-by-case on all requests taking into consideration:

- Dilution to shareholders:
 - In some cases, companies may need the ability to raise funds for routine business contingencies without the expense of carrying out a rights issue. Such contingencies could include the servicing of option plans, small acquisitions, or payment for services. When companies make issuance requests without preemptive rights, shareholders not participating in the placement will suffer dilution.;
 - Ordinarily, 10 percent dilution is considered high and consideration of other factors listed below will be important in supporting such resolutions;
- Discount/premium in the issue price to investors;
- Use of proceeds;
- The fairness opinion presented in an independent expert's report;
- Any resultant change in control;
- Other financing or strategic alternatives explored by the company (including any entitlement offers made to shareholders);
- Arms-length negotiations; and,
- Conversion rates on convertible equity (if applicable).

Issue of Shares (Placement): Retrospective Approval

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

NZX Listing Rule 4.5.1(c) allows the company to renew its capacity to issue ordinary shares within the 15 percent Rule, when it has been used, by obtaining subsequent ratification of the issue from shareholders of the company. The effect of this resolution will be to allow the company to retain the flexibility to issue equity securities in the future up to the 15 percent annual placement capacity set out in Listing Rule 4.1.2 without the requirement to obtain prior shareholder approval.

ISS would generally support a ratification under Listing Rule 4.5.1(c) up to 15 percent. However, vote case-by-case on all requests taking into consideration:

- Dilution to shareholders (10 percent is considered high and consideration of other factors listed below will be important in supporting such resolutions);
- Discount/premium in the issue price to investors;
- Use of proceeds;
- The fairness opinion presented in an independent expert's report;

- Any resultant change in control;
- Other financing or strategic alternatives explored by the company (including any entitlement offers made to shareholders);
- Arms-length negotiations; and
- Conversion rates on convertible equity (if applicable).

4. Board of Directors

As a general principle, ISS supports boards having a majority of independent non-executive directors with an independent chairperson. However, ISS acknowledges there will be cases where it is in the best interests of the company for a board not to comprise a majority of independent directors and will assess all resolutions concerning the election of directors on a case-by-case basis.

In assessing resolutions concerning directors, ISS will consider the following:

- Directors are the stewards of the shareholders' company;
- As such, directors should act in the interests of the company;
- Directors are best placed to provide oversight of the management and operations of a company;
- Directors should be responsive to the wishes of the shareholders whose interests they serve.

Director Age Limits

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

There is no requirement in the NZ Companies Act for directors to retire at a certain age.

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

Independence of Directors

ISS classifies directors as executive, non-independent non-executive, or independent non-executive. ISS' definition of an independent director uses the Financial Services Council (FSC, formerly the Investment and Financial Services Association or IFSA) definition as its core. The FSC definition closely reflects the definition used by the ASX Corporate Governance Council. The ASX Corporate Governance Council definition is used because many NZ companies are listed on the ASX and in turn a substantial part of the NZX 50 consists of ASX-listed companies. The ASX definition is similar to the definition adopted by the NZX Listing Rules of an independent director but is more specific and in some cases more stringent. It defines an independent director as a non-executive director who:

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

ISS' definition of independence is as follows:

ISS Classification of Directors – New Zealand

Executive Director

- Employee or executive of the company.

Non-Independent Non-Executive Director (NED)

A non-executive director who is:

- Classified as non-independent in the company's annual report;
- A former executive of the company or of another group member if there was less than a three-year period between the cessation of employment and board service;
- A major shareholder, partner, or employee of a material¹ adviser/supplier/customer;
- A substantial shareholder of the company²;
- A founder of the company, even if no longer a substantial shareholder;
- A relative (or a person with close family ties) of a substantial shareholder or of a current or former executive;
- A designated representative of a substantial shareholder, or a director of a substantial shareholder which is not a public portfolio investor;
- A director who has served for 12 or more years on the board;
- A director with any material³ relationship to the company, other than a board seat; and
- A director holds cross-directorships or has significant links with other directors through involvement in other companies or board.

Independent Non-Executive Director

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

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

Footnotes:

¹ The materiality threshold for transactions is NZ\$25,000 per annum. These thresholds are assessed by looking at transactions during the three most recent financial years.

² A substantial product holder is a shareholder controlling 5 percent or more of the quoted voting rights in the company. This is in accordance with Financial Markets Conduct Act 2013 (FMCA). At the point a person is no longer a substantial shareholder (or representative of a substantial shareholder), they may be reclassified as independent by the company. However, for the purposes of ISS' director independence classification, this threshold looks back to the three most recent financial years.

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

Voting on Director Nominees

Overview

When voting on director nominees, take into consideration:

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

In doing so, ISS will bear in mind prevailing NZ board structures although, as a general principle, ISS supports audit, remuneration, and nomination committees that have a majority of independent non-executive directors.

ISS will also consider the history of a particular director when deciding whether to recommend in favor of his or her (re)election. Examples of circumstances where ISS will consider recommending against a director's election, regardless of board composition, is when a director has had a significant involvement with a failed company or where a director has in the past acted against the interests of all shareholders.

Voting on Director Nominees in Uncontested Elections

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

Attendance:

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

Generally, vote against the chairman or deputy chairman if no disclosure of board and/or committee attendance is provided.

Overboarding (unless exceptional circumstances exist):

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

When applying this policy, ISS will consider the nature and scope of the various appointments and the companies concerned, and if any exceptional circumstances exist. Exceptional circumstances include entities outside the NZX 50 index and are:

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

For the avoidance of doubt, exceptions do not apply to entities included in the NZX 50 index.

Independence Considerations:

- Is an executive and board chair, and no "lead director" has been appointed from among the independent directors or other control mechanisms are in place. Exception may be made for company founders who are integral to the company or if other exceptional circumstances apply;
- Where an executive is a member of the audit or remuneration committee, vote against the executive and the chairman of the board and/or chairman of the relevant committee;
- A former partner or employee of the company's auditor who serves on the audit committee; and
- A director who is a former partner of the company's audit firm and receives post-employment benefits.

Board Independence:

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

- Executive directors (except for the CEO and founders integral to the company);
- Non-independent NEDs whose presence causes the board not to be majority independent without sufficient justification. Exceptional factors may include:
 - Whether a non-independent director represents a substantial shareholder owning at least 15 percent of the company's shares and whose percentage board representation is proportionate to its ownership interest in the company; and
 - The level of board independence (i.e. generally, a recommendation against non-independent directors if the board composition is wholly non-independent, whereas a case-by-case analysis may be undertaken where a board is at or near 50% independent and the reasons for non-independence of certain directors may include excessive board tenure greater than 12 years).

Combined Chair/CEO

The NZX Corporate Governance Code ("CGC") calls for the separation of the roles of stewardship and management. Recommendation 2.9 of the NZX CGC states that "An issuer should have an independent chair on the board. If the chair is not independent, the chair and the CEO should be different people".

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

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

Gender Diversity

Recommendation 2.5 of the NZX Corporate Governance Code states that an issuer should have a written diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving diversity (which, at a minimum, should address gender diversity) and to assess annually both the objectives and the entity's progress in achieving them. The issuer should disclose the policy or a summary of it.

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

Mitigating factors include:

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

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

Problematic Risk and Audit-Related Practices:

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

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

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

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

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

Shareholder Nominees:

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

Governance Failures:

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

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

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

- Material failures of governance, stewardship, risk oversight², or fiduciary responsibilities at the company (objectively coming to light in legal proceedings, regulatory investigation or enforcement, or other manner which takes place in relation to the company, directors, or management);
- Failure to replace management as appropriate;
- Significant involvement with a failed company, or egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company; or
- Service on other boards where any of the above matters and facts have subsequently emerged.

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

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

Voting on Director Nominees in Contested Elections

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

- Company performance relative to its peers;
- Strategy of the incumbents versus the dissidents;
- Independence of directors/nominees;
- Experience and skills of board candidates;
- Governance profile of the company;
- Evidence of management entrenchment;
- Responsiveness to shareholders; and,
- Whether minority or majority representation is being sought.

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

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

² Examples of failure of risk oversight include but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; significant adverse legal judgments or settlements; hedging of company stock; or significant pledging of company stock.

5. Remuneration

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

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

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

General Recommendation: Vote case-by-case on resolution that seeks shareholder approval for an increase in the maximum aggregate level of fees payable to the company's non-executive directors.

It is a requirement of the NZX Listing Rules for companies to obtain shareholder approval for any increase in the fee cap or alternatively, the individual remuneration paid to non-executive directors. Changes to the Listing Rules in April 2009 also allow the resolution authorizing the directors' remuneration to enable the directors to receive some or all of their fees in shares issued at the market price.

In assessing director remuneration, ISS' overriding consideration is how remuneration relates to shareholders' interests, specifically:

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

Generally vote for a fee cap resolution that also seeks to allow directors to receive part or all of their fees in shares. The NZX Corporate Governance Code and investor governance guidelines support such schemes as increasing the alignment of interests between directors and shareholders.

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

Remuneration of Non-Executive Directors: Issue of Options

General Recommendation: Generally vote against the issue of options to non-executive directors.

This type of resolution seeks shareholder approval for the issue of options, or similar performance-linked securities, to non-executive directors. The NZX Code encourages such schemes.

However, ISS will generally recommend against the issue of options to non-executive directors because issuing performance-linked equity incentives to directors may impair their ability to exercise independent judgment on behalf of investors. Investor governance standards such as the U.K. Combined Code and various Australian codes oppose the issue of options to non-executive directors. As noted elsewhere, outside of certain circumstances (such as very large equity issues), the NZX Listing Rules no longer require shareholder approval for the issue of options to directors.

Remuneration of Non-Executive Directors: Approval of share plan

General Recommendation: Generally vote against the issue of options to non-executive directors.

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

Transparency of CEO Incentives

General Recommendation: Vote against the re-election of members of the remuneration committee if:

- The remuneration of the CEO is not appropriately disclosed to allow shareholder scrutiny; or
- There is evidence that the CEO has been granted a substantial quantity of equity incentives; and,
- The remuneration of the CEO is excessive compared with peers.

It is common in NZX-listed companies for the CEO not to be a member of the board of directors. On May 9, 2017, the New Zealand Stock Exchange released its updated Corporate Governance Code following feedback from the market. One of the changes sought disclosure of the CEO's remuneration arrangements in the annual report, including base salary, short-term incentives, and long-term incentives, as well as performance criteria used to determine performance-based awards. This is a major advance in disclosure and governance standards which is typically seen by investors in other developed markets around the world. It is reasonable for shareholders to be

able to assess the remuneration of the most senior member of management, and to be able to vote on any equity incentives that they may be offered.

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

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

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

Under the NZX Listing Rules, companies are able to issue securities to employees without shareholder approval so long as such issues do not exceed 3 percent of issued capital per annum. Since changes to the Listing Rules in April 2009, approval is not required for the issue of securities to directors so long as the issue occurs under the general employee share plan limit and their participation is determined on the same basis as that of other employees. Certain NZ companies will continue to require shareholder approval of equity incentives for directors given they are also listed on the Australian Securities Exchange, where Listing Rule 10.14 requires prior approval for the issue of equity securities to a director under an employee incentive scheme.

Evaluate long-term incentive plans (and proposed grants of equity awards to particular directors) according to the following criteria:

Exercise Price

- Option exercise prices should not be at a discount to market price at the grant date (in the absence of demanding performance hurdles).
- Plans should not allow the repricing of underwater options.
- The allocation of ZEPs should not be based on a discounted price of a company's securities (or "fair value"), which has the effect of increasing the number of equity awards which are granted, and could exponentially increase the value of the incentive or share-based payment received by the executive upon any vesting.

Vesting Period

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

Performance Hurdles

- Generally, a hurdle that relates to total shareholder return (TSR) is preferable to a hurdle that specifies an absolute share price target or an accounting measure of performance (such as earnings per share (EPS)).
- Where a relative hurdle is used (comparing the company's performance against a group of peers or against an index), no vesting should occur for sub-median performance. ISS will consider the availability of an appropriate peer group for NZ based companies as a material factor in assessing relative benchmarks.

- The use of ‘indexed options’ – where the exercise price of an option is increased by the movement in a suitable index of peer companies (such as the NZX50) – is generally considered a sufficiently demanding hurdle.
- A sliding-scale hurdle – under which the percentage of rights that vest increases according to a sliding scale of performance (whether absolute or relative) – is generally preferable to a hurdle under which 100 percent of the award vests once a single target is achieved (i.e. no "cliff vesting").
- In the absence of relative performance hurdles, absolute share price hurdles may be appropriate so long as they are sufficiently stretching. Where an absolute share-price target is used, executives can be rewarded by a rising market even if their company does relatively poorly. In addition, even if a share price hurdle is set at a significantly higher level than the prevailing share price, if the option has a long life then the hurdle may not be particularly stretching.
- In determining whether an absolute share price target is sufficiently stretching, take into consideration the company’s explanation of how the target share price has been calculated. ISS will be more likely to consider an absolute share price target as sufficiently stretching when the target price is reflected in the option exercise price.
- The issue of options with no performance conditions other than continued service and the exercise price (set as being equal to the share price on date of issue) is not generally considered to be a sufficiently demanding hurdle.
- ISS will support incentive schemes with accounting-based hurdles if they are sufficiently demanding. An accounting-based hurdle does not necessarily require that shareholder value be improved before the incentive vests as it is possible for incentives to vest – and executives to be rewarded – without any medium- to long-term improvement in returns to shareholders. Growth in EPS may, but does not always, translate into a material increase in share price and dividends over the medium to long-term.
- Hurdles which relate option vesting to share price performance against a company’s cost of capital may be considered acceptable if the exercise price is adjusted to reflect the cost of capital over the vesting period. Shareholders must also be given sufficient information to determine if the cost of capital will be calculated or reviewed independently of management.
- Two different types of options should be distinguished: (1) grants of market-exercise-price options (traditional options), and (2) zero exercise price options (also called conditional awards, performance shares, and performance rights). Traditional options have an in-built share price appreciation hurdle, because the share price must increase above its level at grant date for the executive to have an incentive to exercise. Performance rights have no exercise price; the executive pays nothing to the company on exercising the rights. An EPS hurdle can lead to executive reward without any increase in shareholder return if the instruments are performance rights, but not if they are traditional options. Therefore, an EPS hurdle can more readily be supported if traditional options, rather than performance rights, are being granted.
- For an EPS target to be sufficiently stretching, where a single target is used (with 100 percent of options/rights vesting on the target being achieved), the target should generally specify a challenging target that is at least in line with analyst and management earnings forecasts. For targets which see rewards vest based on a sliding scale, vesting should start at a level below consensus forecasts only if a substantial portion of the award vests for performance above consensus forecasts.

Retesting

- A re-test is where the performance hurdle has not been achieved during the initial vesting period, and the plan permits further testing of the performance hurdle on a later date or dates. Many investors, in markets like the U.K., do not support re-testing of performance criteria on share options or other share-based incentive awards, on the basis that retesting undermines the incentive value of such awards. Such provisions have not been uncommon in the Australian market. However, as companies have moved toward annual grants of awards that mitigate the concerns over “cliff-vesting,” and the increasingly held view among institutional investors that re-testing does not constitute best practice, companies have now moved to a minimal number of re-tests, or they have eliminated re-testing altogether.
- In cases where re-testing exists, ISS will evaluate the type of re-testing, either fixed-base or rolling, and the frequency of the re-testing. (Fixed-base testing means performance is always tested over an ever-increasing period, starting from grant date. This is less concerning than re-testing from a rolling start date.) Where a

company has a particularly generous re-testing regime and has not committed to significantly reduce the number of re-tests, vote against a resolution to approve the plan in question, or a grant of rights under the plan. This may also warrant a vote against the remuneration report, depending on other aspects of executive and non-executive remuneration practices. In the case of new plans, as a best practice, companies should not include re-testing provisions, but evaluate on a case-by-case approach basis.

Transparency

- The methodology for determining exercise price of options should be disclosed.
- Shareholders should be presented with sufficient information to determine whether an incentive scheme will reward superior future performance.
- The proposed volume of securities which may be issued under an incentive scheme should be disclosed to enable shareholders to assess dilution.
- Time restrictions before options can be exercised should be disclosed, as should the expiry date of the options. Any restrictions on disposing of shares received on the exercise of options should be disclosed.
- If a value has been assigned to the options, the method used to calculate cost of options should be disclosed.
- The method of purchase or issue of shares on exercise of options should be disclosed.

Dilution of Existing Shareholders' Equity

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

Level of Reward

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

Eligibility for Participation in the Scheme

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

Other

- Incentive plans should include reasonable change-in-control provisions (i.e. pro-rata vesting based on the proportion of the vesting period expired and performance against the hurdles taking into account the size of awards).
- Incentive plans should include 'good' leaver/'bad' leaver provisions to minimize excessive and unearned payouts.

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

Remuneration: Shareholder Resolutions

General Recommendation: Generally vote for appropriately-structured shareholder resolutions calling for increased disclosure of executive remuneration and/or the introduction of a non-binding shareholder vote on a company's remuneration policy.

The NZ Companies Act and the NZSX Listing Rules do not presently require the disclosure of senior executives' remuneration – beyond disclosure of the number of executives earning above NZ\$100,000 per annum in bands of NZ\$10,000 – or what part of executives' remuneration is linked to performance.

Executives are employees of shareholders, and it is therefore appropriate for shareholders to be informed as to the level of executive remuneration, and how it is determined. It is also appropriate for shareholders to be given a non-binding vote on a company's general approach to executive remuneration, and a number of jurisdictions, including the U.S., U.K., Australia, Sweden, and the Netherlands, have adopted such non-binding votes. These votes can be a valuable and relatively inexpensive way for shareholders to communicate concerns over remuneration to a company.

6. Environmental and Social Issues

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

Issues covered under the policy include a wide range of topics, including consumer and product safety, environment and energy, labor covered standards and human rights, workplace and board diversity, and corporate political issues. While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short term or long term.

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

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

When evaluating ESG shareholder proposals, ISS will consider the nature and extent of engagement with the shareholder proponent and any undertakings given by the board in addressing the matters raised in the shareholder proposal.

Board Diversity

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

Proxy research reports on each company will include whether:

- There is a disclosed diversity policy;
- There are disclosed and measurable objectives in promoting gender diversity, amongst others;
- The company reports on progress against those measurable objectives;
- The company reports on the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the company has defined "senior executive" and various management positions, for these purposes); and
- The company uses Recommendation 2.5 of the NZX Corporate Governance Code 2020 to create the company's diversity policy.

Economic, Environmental, and Sustainability Risks

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

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 plan³, 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.

³ 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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