

2017/2018

PROXY PAPER™

GUIDELINES

AN OVERVIEW OF THE CGI GLASS LEWIS
APPROACH TO PROXY ADVICE

NEW ZEALAND



GLASS LEWIS

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The New Zealand Governance Landscape

INVESTOR PROTECTION IN NEW ZEALAND

Entities listed on the New Zealand Stock Exchange ("NZX") must comply with the requirements of the NZX Listing Rules and the New Zealand Companies Act 1993 (the "Act"). Further, NZX-listed entities are regulated by the Financial Markets Authority (New Zealand) ("FMA").

The NZX has adopted a Corporate Governance Best Practice Code ("[the Code](#)") covering eight principles that reflect internationally accepted corporate governance practices intended to protect the interests of and provide long term value to shareholders while also seeking to reduce the cost of capital for issuers. Although compliance with the Code is not mandatory, a listed issuer should disclose in its annual report the extent to which its corporate governance processes materially differ from the principles set out in the Code.¹

The FMA released its revised "Corporate Governance in New Zealand - Principles and Guidelines" handbook ("[FMA Guidelines](#)") in December 2014. The FMA Guidelines set out nine principles for application within a broad range of entities, including the following:

- Detailed recommendations on board composition, specifically around diversity requirements which include considerations of gender, ethnicity, cultural background, age and specific relevant skills;
- Greater emphasis on the role of board committees, particularly the audit and risk committees; and
- The need to increase board's focus on ensuring transparent remuneration arrangements, specifically with regards to providing more disclosure on incentive payments.

Compliance with the FMA Guidelines is not mandatory, however, the FMA expects company boards to report on how they observe (or why they do not observe) these standards to their investors and other stakeholders.

In 2015, a group of New Zealand institutional investors, which collectively manage New Zealand equities totaling more than 15% of the total New Zealand equity market established a forum to improve corporate governance at New Zealand companies, the Corporate Governance Forum ("[CGF](#)"). The CGF released a set of best practice guidelines for New Zealand listed companies ("[CGF Guidelines](#)"), which include the following aspects:

- Best practice is for boards of listed companies to be comprised of a majority of independent non-executive directors ("NEDs").
- Directors serving longer than nine years should be subject to annual re-election in order to improve independence, succession planning and board renewal.
- Companies should communicate their processes for ensuring an appropriate mix of skills and diversity on the board.

¹ NZX Listing Rule 10.5.5(i).

- Whilst shareholders want boards to have the flexibility to raise capital efficiently, companies should not be able to materially dilute shareholders without their approval and the current level in NZ is too high.
- Institutional investors want better disclosure across a range of issues which are material to the long-term success of a company. These include strategy, risks, key performance indicators, remuneration policy and environmental and social issues.
- The current use of a 'show of hands' at NZ company AGMs undermines the principle of one share – one vote in the NZ market.

The CGF Guidelines are intended to be used by both companies and institutional investors. They are designed as a contemporary governance reference for shareholders, chairs, directors and senior executives of listed companies.

CGI Glass Lewis is strongly supportive of the key tenets of the CGF Guidelines, many of which are consistent with long-standing guidelines we have had in place for the market.

THE NEW CODE

In 2015, NZX commenced a comprehensive review of the Code, the first substantive update since 2003. The new NZX Corporate Governance Code (“the new Code”) will replace the existing Best Practice Code on October 1, 2017.²

The new NZX Code closely follows a three-tiered approach:

1. The top tier sets out eight principles, which are closely based on those contained in the FMA Guidelines;
2. The second tier sets out recommendations which will apply on a ‘comply or explain’ basis. [Additional requirements](#) will apply if the issuer has not followed a recommendation for any part of the reporting period, including a provision of reasons for not following the recommendation and what, if any, alternative governance practice the issuer adopted in lieu of the recommendation during that period. This differs from NZX’s current approach, which requires an explanation of how an issuer’s corporate governance practices materially differ from the NZX Code but not necessarily an explanation why.
3. The final tier contains commentary which explains how issuers can meet each recommendation and outlines additional optional guidance for issuers in areas where NZX thinks the suggested approaches reflect good practice.

The new Code has focused on four areas which have gained increased importance for investors in recent years:

- Diversity;³
- Director and executive remuneration reporting requirements;⁴
- Environmental, social and governance (ESG) reporting;⁵ and
- Health and safety risk management.⁶

² Must be reported against for reporting periods ending December 31, 2017 and beyond.

³ Recommendation 2.5 of the new Code: 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.

⁴ Principle 5 of the new Code.

⁵ Recommendation 4.3 of the new Code: Financial reporting should be balanced, clear and objective. An issuer should provide non-financial disclosure at least annually, including considering material exposure to environmental, economic and social sustainability risks and other key risks. It should explain how it plans to manage those risks and how operational or non-financial targets are measured.

⁶ Recommendation 6.2 of the new Code: An issuer should disclose how it manages its health and safety risks and should report on their health and safety risks, performance and management.

SUPERMAJORITY VOTE REQUIREMENTS

The Act provides for shareholders to make voting decisions by ordinary resolution (a simple majority of votes cast on the resolution)⁷ or by special resolution (a 75% majority of votes cast on the resolution).⁸

Most shareholder decisions are made by ordinary resolution and the Act specifies which type of decision has to be made by special resolution. A common type of special resolution is an amendment of the company's constitution.

CGI Glass Lewis believes supermajority vote requirements can act as impediments to shareholder action on ballot items which are critical to shareholder interests.

RIGHT OF SHAREHOLDERS TO CALL A SPECIAL MEETING/SUBMIT A SHAREHOLDER PROPOSAL

Under the Act, one or more shareholders holding 5% or more of voting capital can call a special shareholder meeting or (as is now the practice in the very few cases where these rights have been exercised) add an agenda item to a pending shareholder meeting to be voted on by shareholders at the meeting.⁹

CGI Glass Lewis evaluates shareholder proposals on a case-by-case basis. We generally favour proposals that are likely to increase shareholder value and/or promote and protect shareholder rights. We typically prefer to leave decisions regarding day-to-day management of the business and policy decisions related to environmental, social or political issues to management and the board, except when we see a clear and direct link between the proposal and some economic or financial issue for the company.

We believe shareholders should not attempt to micromanage the business or its board and executives through the initiative process. Rather, shareholders should use their influence to push for governance structures which protect shareholders, and then put in place a board they can trust to make informed and careful decisions which are in the best interests of the business and its owners. We believe shareholders should hold directors accountable for management and policy decisions through the election of directors and we will recommend shareholders vote against the re-election of one or more members of the board if we find that they have not handled key issues effectively.

BINDING NATURE OF SHAREHOLDER VOTES

In general, decisions made by shareholders of NZX-listed companies by resolution in a duly convened general meeting are binding on the company.

APPLICATION OF THESE GUIDELINES

These Guidelines form the basis of the CGI Glass Lewis approach to proxy advice for the 2017-2018 proxy season. We may refer to best practice, however, CGI Glass Lewis agrees with the analytical framework set out by the CGF Guidelines asking boards to explain how they comply with each principle, rather than 'comply or explain why not' principle.

CGI Glass Lewis' New Zealand policy guidelines take into account not only the recommendations of the Act, the Code and the FMA Guidelines, but also what we view as overall general policies for corporate governance best practices.

We will review these guidelines annually to ensure they remain appropriate with market practice and the ever-evolving standards of corporate governance.

⁷ Companies Act, Part 7 s 105.

⁸ Companies Act, Part 7 s 106.

⁹ Companies Act, Part 7 s 121(b).

Transparency and Integrity in Financial Reporting

ACCOUNTS AND REPORTS

Where annual accounts are submitted to a shareholder vote, we will recommend voting for the proposal except in the case where there are concerns about the integrity or quality of the accounts.

Where accounts are not submitted to a shareholder vote, we will raise any concerns about the integrity or quality of the accounts in the election of director proposal.

APPOINTMENT OF AUDITOR AND AUTHORITY TO SET FEES

Under New Zealand corporate law, a company's external auditor is automatically re-appointed at the company's AGM.¹⁰ Further, it is the responsibility of the audit committee to ensure the external auditor or lead audit partner is changed at least every five years.¹¹

An external auditor may resign at any time by giving written notice to the board, and the company must, as soon as practicable, notify its shareholders of the auditor's resignation.¹² A company must not appoint a new auditor in the place of an incumbent auditor unless written notice has been given to the incumbent auditor and the incumbent auditor has been given reasonable opportunity to make representations to the shareholders on the appointment of another auditor.¹³

We believe the role of the auditor is crucial in protecting shareholder value. Shareholders should demand the services of objective and well-qualified auditors at every company in which they hold an interest. Like directors, auditors should be free from conflicts of interest and should assiduously avoid situations that require them to make choices between their own interests and the interests of the public they serve.

Voting Recommendations in the Case of Appointment of Auditors and Authority to Set Fees:

We will generally support management's recommendation regarding the selection of an auditor and granting the board the authority to fix auditor fees except in cases where we believe the independence of a returning auditor or the integrity of the audit has been compromised.

Some of the reasons why we may not recommend ratification of the auditor and/or authorising the board to set auditor fees include:

- When audit fees added to audit-related fees total less than the tax fees and/or other non-audit fees. We are also mindful of one-time corporate finance transactions and due diligence work for mergers, acquisitions or disposals.
- When the company has demonstrated aggressive accounting policies.

¹⁰ Companies Act, Part 11 s 207T(1).

¹¹ NZX Listing Rule 3.6.3(f).

¹² Companies Act, Part 11 s 207V(1).

¹³ Companies Act, Part 11 s 207U(1)(b).

- When the company fails to disclose the fees paid to the auditor.
- When the company has poor disclosure or lack of transparency in its financial statements.
- Where the auditor limited its liability through its contract with the company.
- When there have been recent material restatements or late filings by the company where the auditor bears some responsibility for the restatement or late filing (e.g. a restatement due to a reporting error).
- When there are other relationships or issues of concern with the auditor that might suggest a conflict between the interest of the auditor and the interests of shareholders.
- When the auditor performs prohibited services such as tax-shelter work, tax services for top executives, or contingent-fee work, such as a fee based on the percentage of economic benefit to the company.

A Board of Directors that Serves the Interests of Shareholders

ELECTION AND REMOVAL OF DIRECTORS

Shareholders of NZX-listed companies get to vote on their board representatives, individually, at least every three years. Under NZX Listing Rules, at least one-third of the directors or, if their number is not a multiple of three, then the number nearest to one-third, shall retire from office at each annual general meeting (“AGM”), but may seek re-election by shareholders at that meeting. Those to retire shall be those who have been longest in office since they were last elected or deemed elected.¹⁴ Any director appointed by the board subsequent to the last AGM must stand for election by shareholders at the next AGM.¹⁵

One executive director and/or special office holder (as approved by the NZX) may be exempted from retirement by rotation as above, provided they retire after no more than a five year appointment and then stand for re-election.¹⁶ However, no term of appointment of any executive director must exceed five years, but this does not preclude reappointment of an executive director or affect the terms of engagement of an executive director as an employee.¹⁷

The Act provides an additional mechanism that enables shareholders to nominate director candidates and remove existing directors from the board of a New Zealand-incorporated listed company. That mechanism entitles one or more shareholders representing 5% or more of the voting equity¹⁸ to convene a special meeting of shareholders or to add an agenda item to a forthcoming meeting of shareholders, including for the appointment of a new director to, or the removal of an existing director from, the board.

The election or appointment of a director to, and/or the removal of a director from, the board is by ordinary resolution (simple majority of votes cast).

There are no restrictions on the persons who may be nominated as directors (other than the holding of qualification shares, if the Constitution so requires), nor is there any precondition to the nomination of a director other than compliance with certain time limits. The closing date for nominations must be no more than two months before the date of the meeting at which the election is to take place. The company will make an announcement to the market of the closing date for director nominations and contact details for making nominations no less than 10 business days prior to the closing date for director nominations. The company will specify in a notice every nomination received before the closing date and the board’s view on whether or not the nominee would qualify as an independent director.¹⁹

BOARDS

The purpose of CGI Glass Lewis’ proxy research and advice is to facilitate shareholder voting in favour of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. CGI Glass Lewis looks for talented boards with a proven record of protecting shareholders and

¹⁴ NZX Listing Rule 3.3.11.

¹⁵ NZX Listing Rule 3.3.6.

¹⁶ NZX Listing Rule 3.3.15.

¹⁷ NZX Listing Rule 3.3.9.

¹⁸ Companies Act, Part 7 s 121(b).

¹⁹ NZX Listing Rule 3.3.5.

delivering value over the medium and long-term. Boards working to protect and enhance the best interests of shareholders typically possess the following three characteristics:

- Independence;
- Breadth and depth of experience and diversity; and
- A record of performance.

BOARD SIZE

NZX-listed companies are required to have a minimum of three directors.

Voting Recommendations on the Basis of Board Size:

CGI Glass Lewis does not recommend against the election or re-election of a director for any reason if it means the board size will be reduced to less than three directors.

We believe boards of NZX-listed companies whose size exceeds 14 may have difficulty reaching consensus and making timely decisions. With boards consisting of more than 14 directors, and without an adequate explanation, we may consider recommending shareholders vote against the election or re-election of the nomination committee chair or its equivalent.

INDEPENDENCE

An issuer's board should be comprised of a majority of non-executive directors. A director's independence should also be considered, particularly in light of Listing Rule 3.3.1 (namely 'that the minimum number of independent directors shall be two or if there are eight or more directors, three or one-third of the number of directors, whichever is greater').

We look at each individual on the board and examine his or her relationships with the company,²⁰ the company's executives, and with other board members. This inquiry is to determine whether pre-existing personal, familial,²¹ business or financial relationships might impact the decisions of that board member. The existence of personal, familial, business or financial relationships can make it difficult for a director to put the interests of all shareholders above the director's own interests or those of the related party.

We classify directors in three categories based on the type of relationships they have with the company:

1. **Independent Director** — An independent director has no current material familial, financial or business relationship with the company, its executives or other board members, except for board service and standard fees paid for that service.
2. **Affiliated Director** — An affiliated director has (or within the past three years, had) a material familial, financial or business relationship with the company, its executives or other board members, but is not an employee of the company. Scenarios that would cause us to consider a director to be affiliated include, but are not limited to:
 - **Former employee** — The director has been an employee of the company within the last three years. Further, a NED who has been employed by the company as a senior executive is not considered to be independent unless there has been a break of at least three years between leaving that employment and becoming a NED of the company.

²⁰ "Company" includes any parent or subsidiary in a consolidated group with the company or any company that merged with, was acquired by, or acquired the company.

²¹ "Familial" includes a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces and nephews, including in-laws, and anyone (other than domestic employees) who shares such person's home.

- **Material business relationship** — The director has or had within the past three years a material²² business relationship with the company.
- **Familial relationship** — The director has a familial relationship with any of the company’s key personnel.
- **Significant beneficial ownership** — The director controls 5% or more of the company’s voting shares or is a senior executive or other representative of a company that owns or controls 5% or more of the company’s voting shares. Where a NED is a representative of such a substantial shareholder and remains on the board after that substantial shareholder ceases ownership, and in the absence of any other relationship between the company and the NED or the former substantial shareholder, we will reclassify the NED as independent. Similarly, where a NED resigned from his/her role with a substantial shareholder, and in the absence of any other relationship between the company and the NED or the substantial shareholder, we will reclassify the NED as independent.
- **Company classification** — If the company classifies the director as non-independent but the reason for the director’s non-independent status cannot be discerned from the company’s documents, we will classify the director as affiliated and footnote the director in the board table as “Not considered independent by the Company”. In all other cases, we will footnote the reasons or circumstances for the director’s affiliated or insider status.
- **Board interlock** — The director holds cross-directorships or has significant links with other directors through involvement in other companies or bodies.
- **Board tenure** — The director has served on the board for a period, which, in the view of CGI Glass Lewis, might impair the NED’s independence (see “Director Term Limits and Mandatory Retirement Provisions” below).

3. **Inside Director** — An inside director is an employee of the company.

SEPARATION OF THE ROLES OF CHAIR AND CEO

The usual practice for NZX-listed companies, supported by the Code and the FMA Guidelines, is for the roles of the chair and CEO to be separated.²³

CGI Glass Lewis believes that separating the roles of corporate officers and the board chair is typically a better governance structure than a combined executive/chair position. We do not, however, normally recommend shareholders vote against CEOs who chair the board, but we do typically encourage our clients to support a separation between the roles of chair and CEO, whenever that question is posed in a proxy, as we believe that in the long-term this is in the best interests of the company and its shareholders.

In companies which have a combined CEO/chair, CGI Glass Lewis strongly supports the existence of a presiding or lead independent director with authority to set the agenda for the meetings and to lead sessions outside the presence of the insider chair.

DIRECTOR TERM LIMITS AND MANDATORY RETIREMENT PROVISIONS

While CGI Glass Lewis believes periodic director rotation is appropriate, we also accept accumulated experience in a company over a substantial period or business cycles may be a valuable resource to a board and investors in the company. Nor do we believe the number of years served on a board is necessarily an accurate indicator of independence.

²² “Material” typically means a relationship where the dollar value exceeds: (i) NZ\$60,000 for NZX50 companies (NZ\$30,000 for ex NZX50 companies) (or where no amount is disclosed) for NEDs who personally receive remuneration for a service they have agreed to perform for the company, outside of their service as a NED, including professional or other services; (ii) NZ\$200,000 for NZX50 companies (NZ\$100,000 for ex NZX50 companies) (or where no amount is disclosed) for those NEDs employed by a professional services firm such as an accounting firm, consulting firm, law firm or investment bank where the firm is paid for services but not the individual directly.

²³ Code Principle 2.1, Recommendation 2.8 of the new Code and FMA Guidelines Principle 2. The FMA Guidelines allow for only exceptional circumstances should the chief executive go on to become the chair.

However, the longer the period of service, the more likely it is that the independence, and possibly also the contribution, of a NED will be blunted. Further, in today's fast-changing business environment, there is a risk that a long-serving NED's particular skill set and experience could diminish in value to the board.

CGI Glass Lewis, therefore, applies the principle that, after 15 years of service, we will review the classification of the NED and, unless we are satisfied from our review that the NED remains demonstrably independent, we will cease to classify the NED as independent.

Voting Recommendations on the Basis of Independence:

In general, at least a majority of the board should consist of appropriately qualified independent directors. If 50% or more of the members are affiliated or inside directors, we will consider recommending shareholders vote against the election or re-election of one or more of the affiliated and/or inside directors in order to satisfy the independent majority; however, we will continue to consider such issues as the size of the board, director skills, the shareholding mix and other factors as appropriate in making voting recommendations.

CONFLICT OF INTEREST

Voting Recommendations on the Basis of Conflict of Interest:

Regardless of the overall presence of independent directors on the board, we believe that a board should be free of people with an identifiable conflict of interest. Accordingly, we typically recommend shareholders vote against the election or re-election of directors in the following cases:

- **Overcommitted NEDs** — NEDs who presently sit on an excessive number of boards. NEDs who serve on more than six major boards²⁴ will usually receive an "against" voting recommendation from CGI Glass Lewis. Depending on our assessment of the particular NED's workload, including on other boards, and capacity, we may also recommend voting against a NED who serves on more than five major boards. For this purpose, we believe service as non-executive board chair is equivalent to two ordinary non-executive directorships, given the amount of time needed to fulfil the duties of chair. This is reflected in the increased fees paid to non-executive company chairs (typically between two and three times the ordinary NED's fee).
- **Additional executive role** — NEDs who serve as an executive of any public company (or large unlisted company) while serving on more than one other public company (or large unlisted company), unless the director is in a publicly disclosed transition from an executive to a non-executive career.²⁵ We make an exception when the NED is an executive of a substantial shareholder of the company and is serving on the board of the company as a representative of the substantial shareholder. We may also make an exception when the executive is a NED of a listed company in conformity with a disclosed policy of the executive's employer permitting the executive to be a NED of another listed company.
- **Professional services relationship** — NEDs who provided material professional services at any time during the past three years (or if their immediate family members or professional services firms of which they are a current or recent member provided such services). Such directors may unnecessarily have to make complicated decisions that may pit their interests against those of the shareholders they serve. Given the pool of director talent and the limited number of directors on any board, we think shareholders are best served by finding individuals who are not conflicted to represent their interests on the board.
- **Commercial relationship** — A director, or an immediate family member, who engages in commercial, real estate or other similar deals, including perquisite type grants from the company. We believe a director who receives these sorts of payments from the company will have to make unnecessarily complicated decisions that may pit their interests against those of the shareholders they serve.

²⁴ This means boards of listed companies or other large unlisted companies that may take up a significant portion of a director's time.

²⁵ We will similarly note if an executive director serves as a NED of another major board.

EXPERIENCE

We look carefully at the backgrounds of individuals who are up for election or re-election to the board to ensure they contribute appropriate skills and diverse backgrounds. We also look at the backgrounds of those who serve on the key committees of the board to ensure they have the required skills and diverse backgrounds to make informed and well-reasoned judgments about the subject matter for which the committee is responsible.

Voting Recommendations on the Basis of Experience:

We typically recommend shareholders vote against the election or re-election of directors who do not meet the above criteria.

BOARD SKILLS MATRIX

The CGF Guidelines list a skills matrix as 'one effective tool to demonstrate to shareholders how skills across the boardroom link to the oversight of company operations and strategy.' CGI Glass Lewis believes that a board skills matrix can be a valuable tool for a board to ensure that it has an appropriate mix of skills and experience amongst current directors. Additionally, the board skills matrix can help formalise the director nomination and succession planning processes. In both cases, we believe disclosure of such is meaningful to shareholders.

CGI Glass Lewis will independently evaluate the skills and experience across individual directors based on publicly available information and will identify any apparent gaps.

Voting Recommendations on the Basis of Board Skills:

If a board has not addressed major issues of board composition, including the composition and mix of skills and experience of the independent element of the board, we will consider recommending voting against the nomination committee chair, or the equivalent (e.g., board chair).

PERFORMANCE

Voting Recommendations on the Basis of Performance:

We disfavour directors who have a track record of poor performance in fulfilling their responsibilities to shareholders at any company where they have held a non-executive or executive position. We typically recommend shareholders vote against the election or re-election of directors who have served on boards or as executives of companies with a track record of:

- Poor attendance,²⁶
- Poor audit or accounting related practices,
- Poor nomination process,
- Poor remuneration practices,
- Poor risk management practices,
- Poor management of environmental and social issues, and/or
- Other indicators of poor performance, mismanagement or actions against the interests of shareholders.²⁷

²⁶ A director who fails, without an acceptable explanation, to attend at least 75% of the board meetings and respective committee meetings. However, where a director has served for less than a full year, we will not recommend voting against the director for poor attendance.

²⁷ An example of this would be the use of a show of hands (instead of a poll vote) to determine whether a resolution was passed if the proxy votes indicate the resolution might not have passed.

We may recommend against a director who has served on the board at least one full term (i.e., three years) of a company with poor share price/financial performance where this performance cannot be explained by market forces or otherwise objectively justified.

BOARD COMMITTEES

NZX Listing Rule 3.6.1 requires a company have an audit committee. CGI Glass Lewis also expects all NZX-listed companies, whether or not they are within the NZX50, to have an audit committee.

CGI Glass Lewis further expects all NZX50 companies (other than those that are externally managed) to establish a nomination committee and a remuneration committee. This belief is supported by the Code, which states that companies should establish nomination and remuneration committees.²⁸

We recognise, however, it may be more practical for smaller companies outside the NZX50 to establish a combined nomination and remuneration committee. We also recognise that it may be impractical for companies outside the NZX50 to have committees other than an audit committee if the company has a small board. Where, however, companies do not have nomination and/or remuneration committees, we still expect meaningful nomination and remuneration procedures to be disclosed in the company's corporate governance statement.

Audit Committee

We are firmly committed to the belief that only NEDs, a majority of whom are independent, should serve on an audit committee.²⁹ In addition, we believe the audit committee should have at least three members (although we will accept only two members in the case of a board of four directors or less).³⁰ Further, the board chair should not also be the audit committee chair.³¹

Voting Recommendations in the Case of Audit Committees:

We will typically recommend voting against an **audit committee chair** who is up for election or re-election if any one of the following occurred:

- If the committee was not structured according to the FMA Guidelines (i.e. only NEDs should serve on an audit committee, a majority of whom, including the committee chair (who should not be the board chair), should be independent).
- If there is a risk that the nature of work undertaken by the audit firm is likely to create a conflict of interest between the company and the audit firm or otherwise likely to impair the independence of the auditor.
- If the fees paid for audit and audit related services are less than 50% of all fees paid to the audit firm (i.e., when Audit + Audit-Related < Tax + Other). CGI Glass Lewis will review the nature and level of the non-audit work to determine if the non-audit work may impact on the independence of the audit firm.
- If an executive or a person who is not subject to election by shareholders is a member of the audit committee.
- If the nature and level of non-audit work is not disclosed.
- If the committee does not have a financial expert (i.e., a chartered accountant, certified practicing accountant or retired CFO).

²⁸ Code Principles 3.8 and 3.11.

²⁹ NZX Listing Rule 3.6.2(c) and FMA Guidelines Principle 3.

³⁰ NZX Listing Rule 3.6.2(b).

³¹ Code Principle 3.7.

- If accounting fraud occurred in the company.
- If financial statements had to be restated due to negligence or fraud.
- If the company repeatedly fails to file its financial reports in a timely fashion.

If the audit committee chair is not up for election or re-election, we will note the breach of CGI Glass Lewis policy in the Proxy Paper and indicate that we will monitor this issue going forward.

We will typically recommend voting against an audit committee member who is up for election or re-election if any one of the following occurred:

- If the audit committee is not majority independent, and the non-independent member of the audit committee is up for election or re-election.
- If there are other governance issues related to that member.
- If the member sits on more than three public company audit committees, unless the audit committee member is a financial expert, in which case the limit is four audit committees.

Remuneration Committee

Principle 3.8 of the Code and Recommendation 3.3 of the new Code stipulate that an issuer should have a remuneration committee which operates under a written charter (unless this is carried out by the whole board). We believe the remuneration committee should have at least three members, although we will accept only two members in the case of a board of four or less.

Voting Recommendations in the Case of Remuneration Committees:

We will typically recommend voting against a **remuneration committee chair** who is up for election or re-election if, during their tenure as chair of that committee, the committee was not structured as above or any one of the following occurred:

- If the committee is not comprised of a majority of independent NEDs with an independent chair.
- If the remuneration committee has failed to demonstrate adequate competence in the handling of its remit on remuneration matters.
- If the remuneration committee did not meet during the year, but should have (e.g., executive remuneration was restructured).
- If an executive is a member of the remuneration committee.

If the remuneration committee chair is not up for election or re-election, we will note the breach of CGI Glass Lewis policy in the Proxy Paper and indicate that we will monitor this issue going forward.

Nomination Committee

Principle 3.11 of the Code and Recommendation 3.4 of the new Code stipulates that an issuer should establish a nomination committee which operates under a written charter (unless this is carried out by the whole board). We believe the nomination committee should have at least three members, although we will accept only two members in the case of a board of four or less.

Voting Recommendations in the Case of Nomination Committees:

We will typically recommend voting against a **nomination committee chair** who is up for election or re-election if, during their tenure as chair of that committee, any one of the following occurred:

- If the nomination committee is not comprised of a majority of independent NEDs³² with an independent chair.
- If, in the opinion of CGI Glass Lewis, the composition of the board reflects material succession planning, renewal or other composition deficiencies over a period of time.
- If the committee nominated or re-nominated an individual who had a significant conflict of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.
- If, without adequate explanation, the board consists of more than 14 directors.
- If the nominating committee did not meet during the year, but should have (e.g., new directors were appointed).
- If the committee has a poor record on the issue of board diversity, has not implemented measures to improve its performance on diversity or has not addressed other major issues of board composition, including the composition and mix of skills and experience of the independent element of the board.

If the nomination committee chair is not up for election or re-election, we will note the breach of CGI Glass Lewis policy in the Proxy Paper and that we will monitor this issue going forward.

The foregoing provisions in respect of the nomination committee apply subject to the exceptions in the case of controlled companies (see below).

BOARD DIVERSITY

NZX Listing Rule 10.4.5 requires NZX-listed entities to include in their annual reports a number of diversity-related disclosures including:

- A quantitative breakdown, as to the gender composition of the company's directors and officers as at the company's financial year-end date and including comparative figures for the previous financial year-end date.³³
- A statement from the board providing its evaluation of the company's performance with respect to its diversity policy (if applicable).³⁴

In addition, Recommendation 2.5 of the new Code stipulates 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.

CGI Glass Lewis is of the view that companies should incorporate policies for board diversity and related disclosures in their annual reports or in any other prominent public disclosure. If a particular company has not yet formalised its diversity policy, or elements thereof, we expect a company to provide a cogent explanation on an 'if not, why not' basis.

³² Code Principle 3.11.

³³ NZX Listing Rule 10.4.5(j).

³⁴ NZX Listing Rule 10.4.5(k).

Voting Recommendations on the Basis of Diversity:

If a board has a poor record on the issue of board diversity, has not implemented these reporting provisions or has not addressed other major issues of board composition, including the composition and mix of skills and experience of the independent element of the board, we will consider recommending voting against the nomination committee chair, or the equivalent.

EXTERNAL/SELF NOMINATED CANDIDATES

Voting Recommendations in the Case of External/Self-Nominated Candidates:

In general, CGI Glass Lewis supports the recommendation of the board regarding the election of directors. We do not recommend voting for individuals who offer themselves for election, without the support of the board, except in cases where we believe the addition of such directors would be in the best interests of shareholders.

CGI Glass Lewis does not support the election of any external nominee or other person as a director of an NZX-listed company whose agenda is restricted to a single, or even several, issue(s). In our view, directors are there on behalf of shareholders to deal with all issues expected of a public company director.

CONTROLLED COMPANIES

Controlled companies present an exception to our normal independence recommendations.

Where major shareholders effectively control a company, either with a majority of the voting shares or a substantial holding that is sufficient to confer effective control, CGI Glass Lewis will accept the composition of the board reflecting the makeup of the shareholder population (i.e. the proportion of the independent element of the board should be roughly equal to the proportion of the public equity in the company). Ideally, if the chair is not independent, an appropriately qualified lead independent director should be appointed.

We accept the controlling shareholder, who is often the founder or founding family of the company, can be of crucial importance to the company and generally has substantial personal wealth invested in the company. Consequently, we will rarely recommend shareholders vote against the re-election of the founder or other key principal of the controlling shareholder of a controlled company.

We do not, however, extend that approach to the audit committee of a controlled company. In our view, audit committees of controlled companies need to consist solely of NEDs, a majority of whom are independent. Regardless of the company's controlled status, the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company's financial statements. Allowing a majority affiliated directors to discharge the duties of audit oversight could present an insurmountable conflict of interest.

Ideally, the other key governance committees of a controlled company should be structured with an independent director as committee chair and independent directors as a majority of committee members.

CGI Glass Lewis will normally support boards of controlled companies that give effect to the foregoing and otherwise respect the interests of public investors.

Remuneration

We believe each listed company should design and apply specific remuneration policies and practices that are appropriate to the circumstances of the company and, in particular, will attract and retain competent executives and other staff and motivate them to grow the company's long-term shareholder value. The guidelines in this section reflect our developing views on best practice regarding remuneration in New Zealand.

While NZX-listed companies are not required to put a remuneration report up for shareholder approval, they should have a clear policy for setting remuneration of executives and NEDs at levels that are fair and reasonable in a competitive market for the skills, knowledge and experience required by the company.³⁵ Further, a company's remuneration policy should be disclosed in its annual report or website.³⁶ An issuer should recommend director remuneration to shareholders for approval in a transparent manner. Actual director remuneration should be clearly disclosed in the issuer's annual report.³⁷

CGI Glass Lewis will conduct a general review of a company's remuneration disclosure and practice to determine whether it accords with best practice and/or whether there are major areas of concern that we feel should be flagged for shareholder consideration.

EXECUTIVE REMUNERATION

Companies should clearly differentiate between the remuneration of executive directors and the remuneration of NEDs, when disclosing their remuneration policy.³⁸ Executive remuneration packages should also include an element that is dependent on company and individual performance.³⁹ CGI Glass Lewis expects companies to structure executive incentive schemes that are linked to strategy, are adequately disclosed and that vest over an appropriate time horizon. In addition, we expect quantum amounts to align with performance.

Recommendation 5.3 of the new Code will require the New Zealand listed entities to disclose, in a readable manner, the remuneration arrangements in place for the CEO in its annual report. This should include disclosure of the base salary, short-term incentives and long-term incentives and the performance criteria used to determine performance based payments.

Annual disclosures should address:

- Target amounts set for the year;
- Short term incentive payments made in the year;
- Long term incentive grants made in the year; and
- Long term incentive grants that have vested in the year.

³⁵ FMA Guidelines Principle 5 and Recommendation 5.2 of the new Code.

³⁶ FMA Guidelines Principle 5.

³⁷ Code Recommendation 5.1.

³⁸ FMA Guidelines Principle 5.

³⁹ FMA Guidelines Principle 5.

NON-EXECUTIVE DIRECTOR REMUNERATION

The non-executive element of the board is there to monitor the strategy, performance and pay of the executive arm of the company and to safeguard the interests of shareholders in general. In order to do so effectively, best practice dictates that:

- NEDs should receive adequate remuneration to attract and retain the requisite talent and to encourage them to carry out their role diligently;
- The structure of that remuneration should align the interests of NEDs with the interests of public investors and should not provide any disincentive to independent action by a NED, including the ultimate warning sign to public investors – the NED’s resignation from office; and
- The executive arm (and major shareholders) should have no capacity to influence NEDs on the matter of their remuneration.

THE GRANT OF SECURITIES TO NEDS

NZX Listing Rule 3.5.1 allows directors to be remunerated, in whole or part, by the issue of equity securities, subject to approval by ordinary resolution.

CGI Glass Lewis does not usually support the practice of granting options as part of the remuneration of NEDs because, to align the interests of NEDs with the interests of public investors, equity participation by NEDs should share a similar risk profile to that of public investors. Such an objective is not achieved by share options that provide the NED with a risk-free equity incentive not available to public investors. However, we may make exceptions for companies in an exploration/development phase.

CGI Glass Lewis will analyse equity grants to NEDs on a case-by-case basis.

PROPOSALS TO INCREASE THE CAP ON NEDS’ FEES

Every company should have a formal and transparent method to recommend remuneration to shareholders.⁴⁰

Boards which request shareholder approval for NEDs’ fee cap increases without a full explanation should recognise that shareholders may be reluctant to support them. In particular, requests based on the desire of the board to have “flexibility” to increase fees or the number of NEDs “if appropriate” require more justification.

CGI Glass Lewis will generally support a proposed increase in the NEDs’ fee cap where the gap between the proposed new cap and estimated total annual NEDs’ fees (based on the company’s current or acceptable proposed fee level and taking into account any proposed appointments and/or retirements) does not exceed the equivalent of two annual NEDs’ fees (again, based on the company’s current or acceptable proposed fee level).

⁴⁰ Code Recommendation 2.6.

Governance Structure and the Shareholder Franchise

AMENDMENTS TO THE CONSTITUTION

Amendments to the constitution of NZX-listed companies require shareholder approval as a special resolution (75% majority of votes cast on the resolution).⁴¹

The shareholders of a company may alter or revoke the constitution of the company.⁴²

CGI Glass Lewis evaluates proposed amendments to a company's constitution on a case-by-case basis. We will usually recommend voting for the proposal only when we believe that all of the amendments are in the best interests of shareholders.

SHARE CAPITAL

ISSUE OF SHARES

NZX-listed companies are free to issue new shares or securities convertible into shares ("equity securities") upon the terms contained in their constitutions.

The constitutions of NZX-listed companies typically confer a blanket authority on the board to issue new shares or other equity securities. Under corporate law, they must exercise that authority, as part of their directors' duties, in the best interests of the company and its shareholders as a whole.

However, NZX Listing Rule 7 limits the extent to which an NZX-listed company can issue new shares or other equity securities without shareholder approval on a non-pro-rata basis of its capital in any 12-month period.⁴³

In April 2009, the NZX amended Listing Rule 7 to increase the proportion of shares that may be issued in a 12 month period from 15% of share capital to 20% of share capital without having to go back for shareholder approval, an amendment CGI Glass Lewis views unfavorably due to the increased potential for dilution.

On that basis, we have concerns when a company seeks shareholder approval to amend/replace its constitution to reflect changes made to the NZX Listing Rules in April 2009. In our view, there is a risk this could result in a higher level of dilution to current shareholders and an erosion of shareholder oversight over their economic interests.

Therefore, we will generally recommend shareholders vote against an authority to amend/replace a company's constitution if such a provision is included.

We note, however, that if the company wishes to raise funds above the 15% limit, it can put forth a more specific proposal for shareholder approval at a subsequent general meeting. We will review these proposals on a case-by-case basis taking into account shareholder dilution, the development phase of a company and the explanation provided to shareholders in the related filings.

⁴¹ Companies Act, Part 7 s 106(1)(a).

⁴² Companies Act, Part 5 s 32(2).

⁴³ NZX Listing Rule 7.3.5(a).

REPURCHASE OF SHARES

NZX-listed companies can repurchase up to 15% of their own shares in any 12-month period.⁴⁴ Further, a company may purchase or otherwise acquire shares issued by it if it is expressly permitted to do so by its constitution.⁴⁵

A repurchase plan is often used to increase the company's share price, to distribute excess cash to shareholders or to provide shares for equity-based remuneration plans for employees.

CGI Glass Lewis will usually recommend voting in favour of a proposal to repurchase shares when the plan includes the following three provisions:

- A limit to the number of shares which may be purchased;
- A maximum price which may be paid for each share (as a percentage of the market price); and
- An expiration date of one year.

RISK MANAGEMENT

CGI Glass Lewis believes that directors should have a sound understanding of the material risks faced by the listed entities and how to manage them. The board should regularly verify that the issuer has appropriate processes that identify and manage potential and material risks.

Recommendation 6.1 of the new Code will require issuers to have a risk management framework for their business and the issuer's board should receive and review regular reports. A framework should also be put in place to manage any existing risks and to report the material risks facing the business and how these are being managed. In addition, Recommendation 6.2 of the new Code will require listed entities to disclose how they manage health and safety risks and to report on their health and safety risks, performance and management.

ENVIRONMENTAL AND SOCIAL POLICIES

CGI Glass Lewis believes companies should behave ethically and have regard for the environment and society as a whole. We consider environmental and socially responsible behaviour as part of the management process that companies should undertake in order to maximise shareholder value in the long-term.

Under the new Code, issuers will be required to provide non-financial disclosure at least annually, including considering material exposure to environmental, economic and social sustainability risks and other key risks. The issuers will have to provide an explanation on how they plans to manage those risks and how operational or non-financial targets are measured.⁴⁶

Environmental and Social Issues

While CGI Glass Lewis recognises most environmental and social concerns are best addressed via avenues other than director elections or proxy proposals, when a substantial environmental or social risk has been ignored or inadequately addressed, we may recommend voting against certain members of the board who, in our opinion, have had some influence over these practices.

⁴⁴ NZX Listing Rule 7.6.1.(f)(ii).

⁴⁵ Companies Act, Part 6 s 59(1).

⁴⁶ Recommendation 4.3 of the new Code.

Labour and Human Resources Practices

CGI Glass Lewis believes labour and human resource policies are best left to management and the board, absent a showing of egregious or illegal conduct that might threaten shareholder value. It is our opinion that management is in the best position to determine appropriate practices in the context of its business. Shareholders can hold directors accountable for decisions of the company related to labour issues and human rights through the election of directors.

E&S Research

Early in 2016, Glass Lewis announced partnership with Sustainalytics to integrate environmental, social and governance (“ESG”) factors directly into proxy voting and engagement process. Sustainalytics is a global leader in sustainability research and analysis, serving investors and financial institutions around the world, with 20 years of local experience and expertise in the Responsible Investment and Socially Responsible Investment markets.

Glass Lewis and Sustainalytics also teamed up to integrate ESG factors into the proxy voting and issuer engagement process. Glass Lewis will incorporate Sustainalytics’ ESG research and ratings into our Proxy Papers.

DISCLAIMER

This document is intended to provide an overview of Glass Lewis' proxy voting policies and guidelines. It is not intended to be exhaustive and does not address all potential voting issues. Additionally, none of the information contained herein should be relied upon as investment advice. The content of this document has been developed based on Glass Lewis' experience with proxy voting and corporate governance issues, engagement with clients and issuers and review of relevant studies and surveys, and has not been tailored to any specific person.

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