



November 12, 2021

**MEMORANDUM**

**TO:** VRS Board of Trustees

**FROM:** Patricia S. Bishop  
Director

**RE:** Agenda Materials for November 16<sup>th</sup> Board Meeting

We are looking forward to the November 16<sup>th</sup> in-person Board meeting beginning at 1:00 pm in the VRS Boardroom. Enclosed is the agenda and meeting materials.

Out of an abundance of caution and to limit contact with others, we will not be providing lunches and, therefore, lunch will be on your own. We apologize in advance for any inconvenience, but feel this is the safest decision given current events.

Due to the pandemic, listed below are some important reminders:

- As part of a COVID-19 self-screening protocol, please ask yourself if you are experiencing any of the following:
  - A new fever (100.4°F or higher) or a sense of having a fever.
  - A new cough that cannot be attributed to another health condition.
  - New shortness of breath or difficulty breathing that cannot be attributed to another health condition.
  - New chills that cannot be attributed to another health condition.
  - A new sore throat that cannot be attributed to another health condition.
  - New muscle aches (myalgia) that cannot be attributed to another health condition, or that may have been caused by a specific activity (such as physical exercise).
  - A new loss of taste or smell.
  - Have you had a positive test for the virus that causes COVID-19 disease within the past 10 days?
  - In the past 14 days, have you had close contact (within about 6 feet for 15 minutes or more) with someone with suspected or confirmed COVID-19?

If you are experiencing any of the above symptoms, please do not attend the meeting in-person.

• Consistent with CDC and Richmond/Henrico Department of Health guidance, masks will be required for all Board members, VRS staff and visitors. Disposable masks will be provided as needed.

• Parking – For our new Board members who have not attended an in-person meeting, parking is available in the Bank of America deck accessed from Cary Street; a page with detailed instructions is attached. VRS covers the cost of your parking for Board and Committee meetings,

and I will have parking vouchers at the meeting. In addition, reserved parking spaces are also available for Board members in the sub-basement level of the VRS parking deck located at 1200 E. Main Street.

To park in the VRS parking deck, you will need to enter the Bank Street entrance on the right side by swiping your VRS ID badge in front of the card reader to open the gate. Once you enter the deck keep straight, make a left, followed by 4 additional left turns which will put you in the sub-basement area of the parking deck. The reserved Board/Committee spaces are marked with a yellow sign. Once you park, please enter the glass doors, by swiping your VRS ID badge in front of the card reader, get on the elevator and press G which will take you to the Ground floor level of the building where the security guard is located along with the entrance/exit door to Main Street.

For your reference, the Benefits and Actuarial Committee will be meeting on Monday, November 15<sup>th</sup> at 1:00 p.m. and the Administration and Personnel Committee on November 16<sup>th</sup> at 12:30 p.m.

Again, we look forward to seeing you at the Board of Trustees meeting on Tuesday. If you have any questions, please feel free to contact me.

#### Attachments

cc: The Honorable K. Joseph Flores, Secretary of Finance  
June Jennings, Office of the Secretary of Finance  
Craig Burns, Department of Taxation  
Michael Jay, House Appropriations Committee  
Adam Rosatelli, Senate Finance Committee  
Zack Borgerding, Auditor of Public of Accounts  
Jon Howe, Department of Planning and Budget  
Dean Lynch, VA Association of Counties  
Katie Boyle, VA Association of Counties  
Bea Snidow, VA Education Association  
Jamie Bitz, Joint Legislative Audit & Review Commission  
Kimberly Sarte, Joint Legislative Audit & Review Commission  
Hal Greer, Joint Legislative Audit & Review Commission  
Elizabeth Bushnell Myers, Office of the Attorney General  
Jessica Ackerman, VA Municipal League  
Lawrence Kochard, VRS Investment Advisory Committee  
Bonnie Atwood, VA Retired Teachers Association



**Board of Trustees Meeting**  
**VRS, 1111 E. Main St., 3rd Floor Board Room**  
**Tuesday, 11/16/2021**  
**1:00 - 3:30 PM ET**

**I. Approve Minutes**

- **October 14, 2021**

*Board Minutes 10.14.21 - Page 4*

**II. Report of the Investment Advisory Committee**

**III. Report of the Chief Investment Officer**

*Asset Allocation Report 9.30.21 - Page 9*

*Daily Asset Allocation Report 11.9.21 - Page 10*

*Performance Summary 9.30.21 - Page 11*

*Plan Tracking Error 9.30.21 - Page 12*

*New Investments and Terminations - Page 13*

**IV. Report of the Benefits and Actuarial**

*Report of the B&AC - Page 14*

- **RBA – Certify Contribution Rates for Political Subdivisions, the Health Insurance Credit for Certain Political Subdivisions, the Virginia Local Disability Program and the Line of Duty Act Fund, Effective for FY 2023 and FY 2024**

*RBA\_RatesForPoliSubs\_HIC\_VLDP\_LODA - Page 17*

*Locals2021\_Board - Page 19*

*LODA2021\_Board - 170.1 Part B FINAL - Page 65*

**V. Report of the Administration and Personnel Committee**

*Report of the A&PC - Page 83*

- **RBA – Appointment of Defined Contribution Plans Advisory Committee Member**

*RBA - Approve Appointment of DCPAC Member - Page 84*

*Bio for Ned Smither - Page 85*

**VI. Proxy Voting Discussion (Corporate Governance Report)**

*Corporate Governance Report FY2021 - Page 86*

*Exhibit 1 - Proxy Voting and Securities Litigation Policy - September 2018 - Page 89*

*Exhibit 2 - 2021 US Proxy Voting Guidelines - Page 98*

*Exhibit 3 - Managers Not Using ISS\_FY2021 - Page 170*

**VII. Operational Update Series: Annual Report Development**

*Annual Report Development Presentation - Page 171*

**VIII. Report of the Director**

*New Coverage Elections for November - Page 181*

*FY 2022 Agency Roadmap Update - October - Page 182*

**IX. Litigation Update (Closed Session)**

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## Minutes

A regular meeting of the Virginia Retirement System Board of Trustees was held on October 14, 2021 in Richmond, Virginia with the following members participating:

Board members:

O'Kelly E. McWilliams, III, Chair  
Joseph W. Montgomery, Vice Chair  
Hon. J. Brandon Bell, II  
John M. Bennett  
Michael P. Disharoon  
William A. Garrett  
Dr. Susan T. Gooden, Ph.D.  
W. Brett Hayes  
Troilen G. Seward, Ed.S.

VRS Staff:

Patricia Bishop, Ron Schmitz, Jennifer Schreck, John Alouf, Rory Badura, Parham Behrooz, Ty Bowers, Caroline Cardwell, Deardrian Carver, Jeanne Chenault, Michael Cooper, Harriet Covey, Juanita Cribbs, Kevin Cronin, Sara Denson, Valerie Disanto, Jon Farmer, Laurie Fennell, Josh Fox, JT Grier, Kelly Hiers, Dane Honrado, KC Howell, Robert Irving, Wendy Jenkins, Kristina Koutrakos, LaShaunda King, Matthew Kubisiak, Matt Lacy, Chung Ma, Curt Mattson, Steve McClelland, Walker Noland, Greg Oliff, Angela Payne, Steve Peterson, Paula Reid, Mark Rein, Dan Schlussler, Michael Scott, Jillian Sherman, Virginia Sowers, Dan Whitlock, Cindy Wilkinson and Demory Williamson.

Guests:

Larry Langer, Alisa Bennett, and Brad Wild, Cavanaugh Macdonald Consulting, LLC; Elizabeth Myers, Office of the Attorney General; Adam Rosatelli, Senate Finance and Appropriations Committee; Michael Jay, House Appropriations Committee; Zach Borgerding and Justin Ferrell, Auditor of Public Accounts; Latosha Johnson, Department of Planning and Budget; Jamie Bitz, Joint Legislative Audit and Review Commission; Tyler Sanders, University of Richmond; Bea Snidow, Virginia Education Association; Alex Gottschalk, City of Virginia Beach; Charity Zellmer, Virginia Beach City Schools; Janet Areson, Virginia Municipal League; Lauren Albanese, Financial Investment News; Jennifer O'Dell, Laborers International Union of North America; Cyril Espanol and Aaron Weitzman, PEI Media; and Steff Chavez, Mandate Wire.

The meeting convened at 1:00 p.m.

### Opening Remarks

O'Kelly E. McWilliams, III, called the meeting to order and welcomed everyone to the October 14, 2021 meeting of the Virginia Retirement System Board of Trustees.

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### **Approval of Minutes**

Upon Ms. Seward's motion, with a second by Mr. Montgomery, the VRS Board of Trustees approved the minutes of the September 21, 2021 meeting.

### **Report of the Chief Investment Officer**

Ron Schmitz, Chief Investment Officer, began his report with a market overview and discussed asset allocation, total fund portfolio performance and tracking error, concluding that risk measures are all within Board-approved levels. Next, Mr. Schmitz discussed the New Investment and Terminations report, the Diverse Investment Manager Engagement (DIME) report, and the External Investment Manager Referral report.

Mr. McWilliams thanked Mr. Schmitz for his report.

### **Report of the Benefits and Actuarial Committee**

The Board received the report of the Benefits and Actuarial Committee and placed it on file.

### APPROVAL OF MINUTES

Mr. Garrett began his report by noting the Committee approved the minutes of its September 1, 2021 meeting.

### 2021 ACTUARIAL VALUATION RESULTS FOR FIVE STATEWIDE RETIREMENT PLANS, GROUP LIFE INSURANCE, STATE AND TEACHER RETIREE HEALTH INSURANCE CREDIT, AND THE VIRGINIA SICKNESS AND DISABILITY PROGRAM (INCLUDES SELF-FUNDED LONG-TERM CARE)

Larry Langer and Alisa Bennett from the VRS plan actuary, Cavanaugh Macdonald Consulting, LLC, presented the June 30, 2021 actuarial valuations for the Five Statewide Retirement Plans (Teachers, State Employees, JRS, SPORS, and VaLORS). In addition, the results of the Other Post-Employment Benefit Programs (OPEBs), including Group Life Insurance, Health Insurance Credit, and the Virginia Sickness and Disability Program, which includes self-funded Long-Term Care, were presented.

Key points from the presentation include:

- The June 30, 2021 valuations are used to set the contribution rates for fiscal years 2023 and 2024.
- Since the previous valuation, there have been several significant changes to assumptions and plan experience that differed from what was assumed, which will impact future contribution rates. Factors impacting the results include:
  - Assumption changes
  - Investment return
  - Salary increases
  - Demographic changes

- The most significant change was to the mortality assumptions, which included moving to a generational mortality improvement scale. This generally increased liabilities for pension plans and had mixed results on OPEB plans.
- The 2021 investment return of 27.5% had an immediate positive impact on funded status on the market value of asset basis. The investment gain is phased in over a five-year period due to actuarial smoothing of assets for funding calculations.
- The Governor's budget included 5% salary increases for State employees and 8% salary increases for SPORS members, along with additional compression increases for eligible SPORS members.
- Headcounts for the State, Teachers, and VaLORS plans decreased from the prior year. There were generally more terminations, deaths and refunds than expected, and fewer new hires. This may be due in part to the state being under a hiring freeze for much of the valuation period.
- In addition, two plans received additional funding provided by the budget in June 2021. The Teacher plan received an ad-hoc contribution of \$61.3 million, which was applied to the 10-year deferred contribution balance, and the State HIC plan received an ad-hoc contribution of \$38.7 million.

Upon a motion by Mr. Garrett, with a second by Mr. Bennett, the VRS Board of Trustees approved the following action:

***Request for Board Action 2021-09-23:*** After considering the recommendations of its actuary, the Board certifies the rates for the five Statewide Retirement Plans (State Employees, Teachers, JRS, SPORS, and VaLORS) and the associated OPEBs; Group Life Insurance (GLI); Health Insurance Credit (HIC); and the Virginia Sickness and Disability Program (VSDP), including self-funded Long-Term Care, all effective July 1, 2022.

#### INFORMATION ITEM

Rory Badura, Senior Staff Actuary, provided a brief overview of strategies to enhance funding, which included shortening amortization periods for legacy unfunded liabilities, using level dollar rather than percentage of pay amortization, as well as maintaining higher rates following years in which the plan has favorable plan experience.

#### B&A Committee Meeting Schedule:

- November 15, 2021 at 1:00 p.m. (Local Valuations and Line of Duty Act)

Mr. McWilliams thanked Mr. Garrett for his report.

Mr. McWilliams noted that staff prepared a letter communicating the contribution rates for the statewide plans to be submitted to the Governor and the Chairs of the House Appropriations and the Senate Finance and Appropriations committees.

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### Operational Update Series: Financial Wellness

Ms. Bishop next introduced Deardrian Carver, Chief Customer Relations Officer, and Virginia Sowers, Communications Strategy Manager, who presented an overview of VRS' Financial Wellness Program.

Ms. Carver advised that VRS partnered with iGrad, a San Diego-based financial technology company, to develop practical and interactive content that is self-paced and tailored to VRS member personas. Since its launch in 2017, the Financial Wellness Program continues to expand and engage members and retirees with short articles, videos, educational games, calculators and visual graphics. Users can browse a variety of topics such as budgeting, saving and taxes, as well as tools to customize credit card or student loan pay down plans. Content is continuously refreshed and personalized to an individual's designated retirement plan and life-stage, including educational resources for retirees to maintain financial health in their post-retirement years.

Ms. Sowers provided an overview of the Public Relations and Customer Relations teams' promotional and outreach efforts. Users can easily access the Financial Wellness Program through a link on the VRS website. The program is promoted through frequent posts on social media, in-person and virtual webinars, and highlights in employer, member, and retiree newsletters. Through collaboration with the Department of Human Resource Management, the Financial Wellness Program is regularly included in the DHRM newsletter that is distributed to all state employees each month. Ms. Sowers reported that VRS received Eddy Awards in 2019 and 2021 after the success of the program was recognized by *Pensions and Investments Magazine*.

Mr. McWilliams thanked Ms. Carver and Ms. Sowers for their presentation.

### Legislative Package for the 2022 General Assembly Session

Cindy Wilkinson, Director of Policy, Planning and Compliance, presented the proposed legislative package for the 2022 General Assembly Session to the Board. She advised that the proposal would streamline the administration of each component of the Hybrid Retirement Plan by separating the defined benefit and defined contribution rates. The proposal includes separating the defined contribution component of the Hybrid Plan from the total employer rate, which is currently a blend of defined benefit and defined contribution rates. This would reduce the administrative burden of reconciliation efforts as the Hybrid Plan becomes the dominant retirement plan. Members would also have increased flexibility to change voluntary contribution amounts more often and those contributions would be invested more quickly.

Ms. Wilkinson advised that the proposed legislation would be introduced in the 2022 General Assembly session with a delayed implementation date of July 1, 2024, to allow for communications and implementation for both VRS and participating employers.

Mr. McWilliams thanked Ms. Wilkinson for her presentation.

Upon a motion by Mr. Montgomery, with a second by Ms. Seward, the VRS Board of Trustees approved the proposed legislative package for the 2022 General Assembly Session.

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### Report of the Director

Trish Bishop, VRS Director, reviewed the New Coverage Elections and an update on the Agency Roadmap for FY 2022. She advised that all projects are progressing as planned apart from a scheduling delay related to the Cloud Migration project. Staff will continue to monitor these projects and provide updates as they become available.

Ms. Bishop advised that VRS received an award of merit from the Virginia Public Relations Society Awards Program for the “Abide by the Guide” campaign and the redesign of the agency website. In addition, VRS received an award of excellence for the Financial Wellness Backpack Series that targets younger members to emphasize the importance of saving for the future. VRS was awarded the Certificate of Achievement for Excellence in Financial Reporting for the 39<sup>th</sup> consecutive year by the Government Finance Officers Association of the United States and Canada (GFOA). Lastly, Ms. Bishop noted that VRS received an award from the Commonwealth of Virginia Campaign (CVC) for the “Why I Give” video that focused on giving back to the community and serving those who serve others.

Mr. McWilliams thanked Ms. Bishop for her report.

### Other Business

Lastly, Mr. McWilliams reviewed the upcoming meeting schedule:

- Investment Advisory Committee – November 10<sup>th</sup> at 10:00 a.m.
- Benefits and Actuarial Committee – November 15<sup>th</sup> at 1:00 p.m.
- Administration and Personnel Committee – November 16<sup>th</sup> at 12:30 p.m.
- Board of Trustees – November 16<sup>th</sup> at 1:00 p.m.

### Adjournment

There being no further business and following a motion by Mr. Montgomery, with a second by Mr. Garrett, the VRS Board of Trustees agreed to adjourn the meeting at 2:23 p.m.

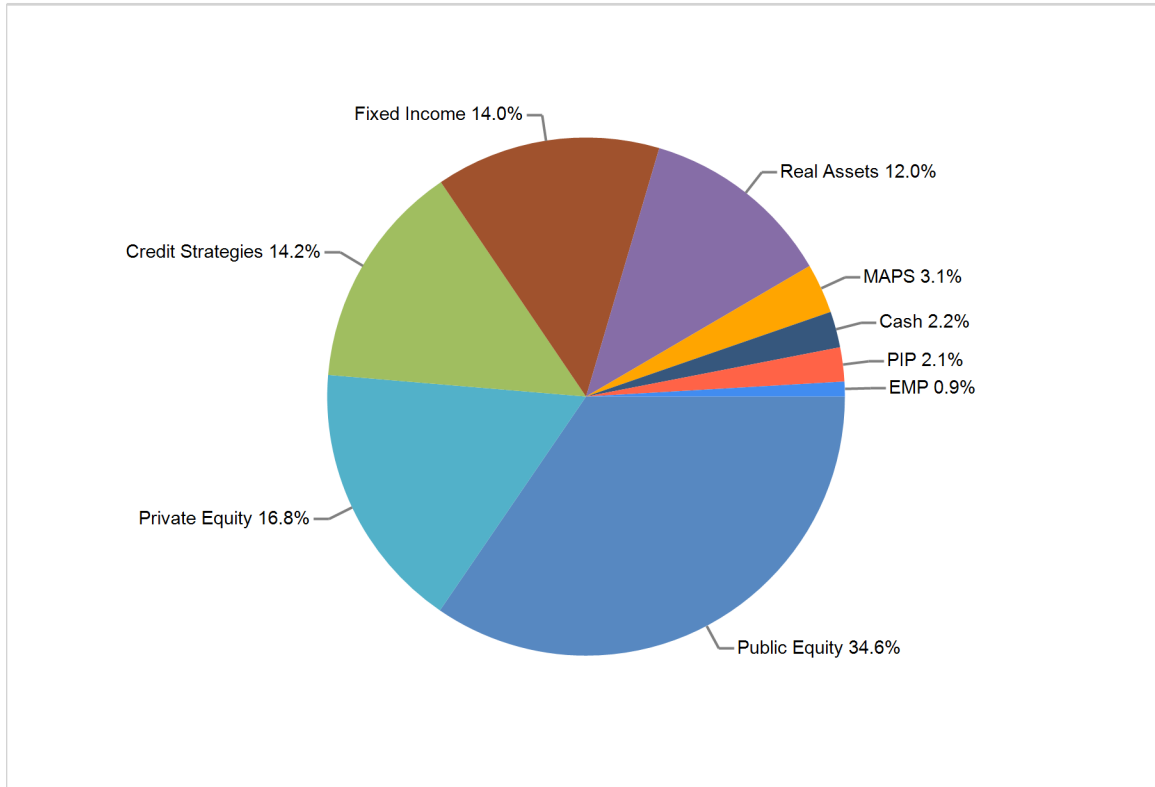
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Chair

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Secretary





	<u>Current \$Bil</u>	<u>Current Weight</u>	<u>Policy Weight</u>	<u>Variance</u>	<u>Allowable Range</u>		<u>Internal %</u>
<b>Total Fund</b>	<b>103.7</b>						<b>27.4%</b>
<b>Public Equity</b>	<b>35.8</b>	<b>34.6%</b>	<b>36.0%</b>	<b>-1.4%</b>	<b>-5%</b>	<b>+5%</b>	<b>37.3%</b>
<b>Fixed Income</b>	<b>14.6</b>	<b>14.0%</b>	<b>15.0%</b>	<b>-1.0%</b>	<b>-3%</b>	<b>+5%</b>	<b>95.1%</b>
<b>Credit Strategies</b>	<b>14.7</b>	<b>14.2%</b>	<b>14.0%</b>	<b>0.2%</b>	<b>-5%</b>	<b>+5%</b>	
RS Credit	5.5	5.3%	5.6%	-0.3%			
NRS Credit	9.2	8.8%	8.4%	0.4%			
<b>Real Assets</b>	<b>12.5</b>	<b>12.0%</b>	<b>14.0%</b>	<b>-2.0%</b>	<b>-5%</b>	<b>+5%</b>	<b>9.6%</b>
Public RE	1.2	1.2%					99.9%
Private RE	7.3	7.1%					
Other RA	3.9	3.8%					
<b>Private Equity</b>	<b>17.4</b>	<b>16.8%</b>	<b>14.0%</b>	<b>2.8%</b>	<b>-5%</b>	<b>+5%</b>	
<b>MAPS</b>	<b>3.2</b>	<b>3.1%</b>	<b>4.0%</b>	<b>-0.9%</b>	<b>-2%</b>	<b>+2%</b>	
DSTRAT	1.7	1.7%					
RBI	1.5	1.4%					1.8%
<b>PIP</b>	<b>2.2</b>	<b>2.1%</b>	<b>2.0%</b>	<b>0.1%</b>	<b>-2%</b>	<b>+2%</b>	
<b>EMP</b>	<b>1.0</b>	<b>0.9%</b>	<b>0.0%</b>	<b>0.9%</b>		<b>+3%</b>	
<b>Cash</b>	<b>2.3</b>	<b>2.2%</b>	<b>1.0%</b>	<b>1.2%</b>	<b>-1%</b>	<b>+4%</b>	

	<u>Current \$Bil</u>	<u>Current Weight</u>	<u>Policy Limit</u>
<b>Hedge Funds</b>	<b>11.5</b>	<b>11.1%</b>	<b>15.0%</b>

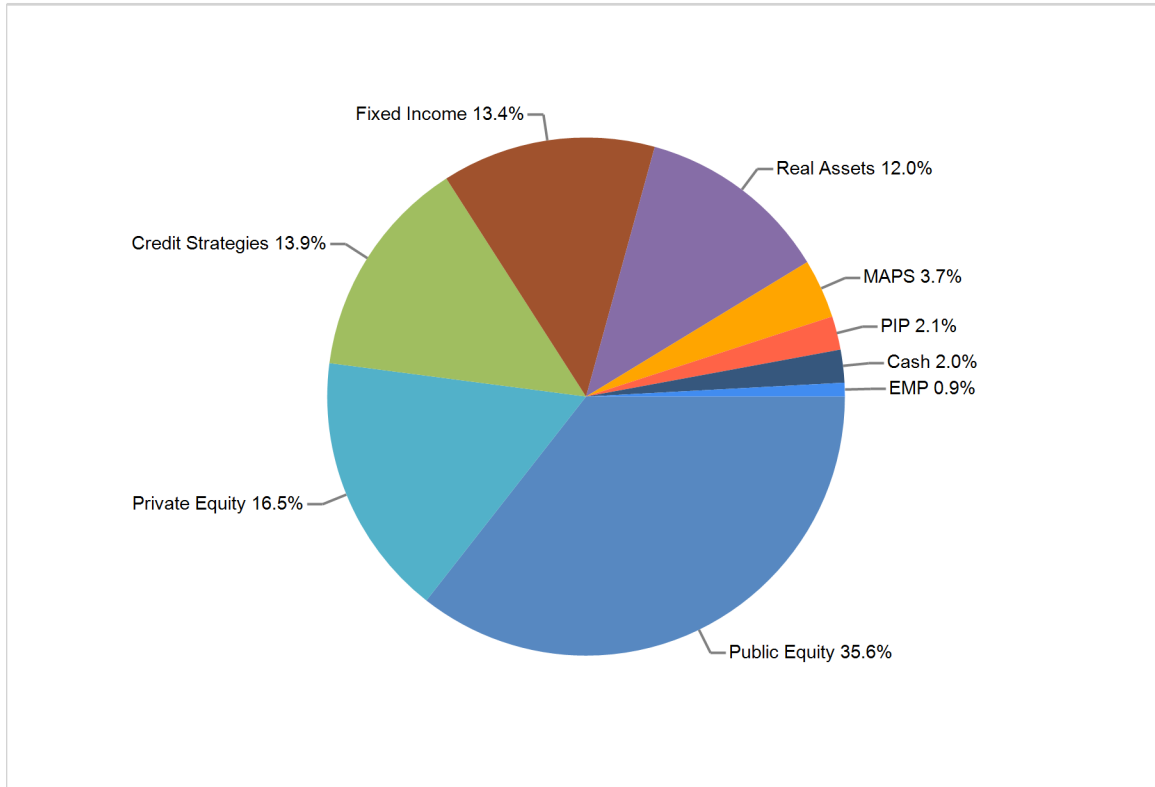
<b>3 Year Tracking Error</b>	
Total Fund:	<b>3.26%</b>
Total Public:	<b>1.10%</b>

\*Total Fund includes the following amt held by the Treasurer of VA: \$ 256 million

• The values shown for each asset class on this report may differ from the VRS Monthly Performance Report due to adjustments related to derivative positions in the Rebalance Account, pending transactions, and certain accruals. The values on this report are a more descriptive representation of the Virginia Retirement System's true economic exposure to each asset class.( 3 adjustments applied )

\*Total Fund and Total Public tracking error are calculated using monthly returns, then annualized

\* Differences in totals are due to rounding.



	Current \$Bil	Current Weight	Policy Weight	Variance	Allowable Range	Internal %
<b>Total Fund</b>	<b>105.2</b>					<b>27.6%</b>
<b>Public Equity</b>	<b>37.5</b>	<b>35.6%</b>	<b>36.0%</b>	<b>-0.4%</b>	<b>-5% +5%</b>	<b>38.2%</b>
<b>Fixed Income</b>	<b>14.1</b>	<b>13.4%</b>	<b>15.0%</b>	<b>-1.6%</b>	<b>-3% +5%</b>	<b>94.9%</b>
<b>Credit Strategies</b>	<b>14.6</b>	<b>13.9%</b>	<b>14.0%</b>	<b>-0.1%</b>	<b>-5% +5%</b>	
RS Credit	5.4	5.1%	5.6%	-0.5%		
NRS Credit	9.2	8.7%	8.4%	0.3%		
<b>Real Assets</b>	<b>12.7</b>	<b>12.0%</b>	<b>14.0%</b>	<b>-2.0%</b>	<b>-5% +5%</b>	<b>10.1%</b>
Public RE	1.3	1.2%				99.9%
Private RE	7.3	7.0%				
Other RA	4.0	3.8%				
<b>Private Equity</b>	<b>17.4</b>	<b>16.5%</b>	<b>14.0%</b>	<b>2.5%</b>	<b>-5% +5%</b>	
<b>MAPS</b>	<b>3.9</b>	<b>3.7%</b>	<b>4.0%</b>	<b>-0.3%</b>	<b>-2% +2%</b>	
DSTRAT	2.4	2.3%				4.7%
RBI	1.5	1.4%				2.0%
<b>PIP</b>	<b>2.2</b>	<b>2.1%</b>	<b>2.0%</b>	<b>0.1%</b>	<b>-2% +2%</b>	
<b>EMP</b>	<b>0.9</b>	<b>0.9%</b>	<b>0.0%</b>	<b>0.9%</b>	<b>+3%</b>	
<b>Cash</b>	<b>2.2</b>	<b>2.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>-1% +4%</b>	

	Current \$Bil	Current Weight	Policy Limit
<b>Hedge Funds</b>	<b>11.5</b>	<b>11.0%</b>	<b>15.0%</b>

3 Year Tracking Error	
Total Fund:	<b>3.26%</b>
Total Public:	<b>1.10%</b>

\*Total Fund includes the following amt held by the Treasurer of VA: \$ 120 million

• The values shown for each asset class on this report may reflect adjustments related to derivative positions in the Rebalance Account, pending transactions and certain accruals, in order to provide a more descriptive representation of the true economic exposure to each asset class ( 5 adjustments applied )

\*Total Fund and Total Public tracking error are calculated using monthly returns, then annualized

\* Differences in totals are due to rounding.

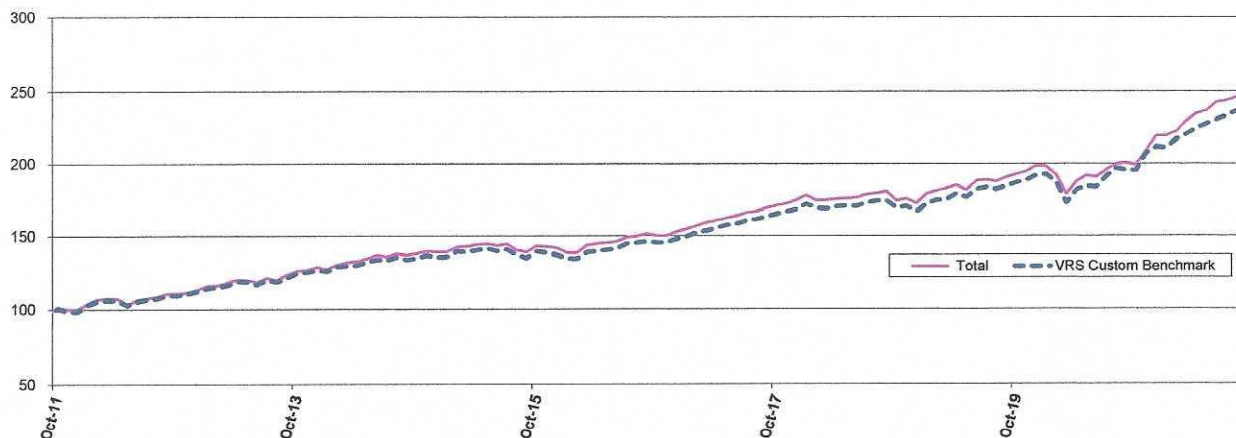
**PERFORMANCE SUMMARY**  
**Rolling Periods Ending**  
**September 30, 2021**



**TOTAL FUND PERFORMANCE**

	10 Yr	5 Yr	3 Yr	1 Yr	Qtr	Month	Fiscal YTD	Cal YTD	Market Value (\$MM)
<b>Total Public Equity Strategies</b>	<b>12.0</b>	<b>12.3</b>	<b>11.8</b>	<b>31.3</b>	<b>-0.5</b>	<b>-3.4</b>	<b>-0.5</b>	<b>13.6</b>	<b>35,834</b>
<i>Benchmark</i>	12.1	13.1	12.8	29.4	-1.0	-4.0	-1.0	11.7	
<b>Total Fixed Income</b>	<b>4.0</b>	<b>4.1</b>	<b>7.0</b>	<b>1.8</b>	<b>0.1</b>	<b>-0.8</b>	<b>0.1</b>	<b>-0.3</b>	<b>13,601</b>
<i>Benchmark</i>	3.1	3.0	5.5	-0.1	0.1	-0.9	0.1	-1.3	
<b>Total Credit Strategies</b>	<b>7.6</b>	<b>7.6</b>	<b>8.3</b>	<b>16.2</b>	<b>2.3</b>	<b>1.6</b>	<b>2.3</b>	<b>9.6</b>	<b>14,711</b>
<i>Benchmark</i>	6.4	5.9	6.3	8.1	1.0	0.3	1.0	3.8	
<b>Total Real Assets</b>	<b>10.4</b>	<b>8.2</b>	<b>7.2</b>	<b>14.0</b>	<b>3.4</b>	<b>2.8</b>	<b>3.4</b>	<b>10.6</b>	<b>12,468</b>
<i>Benchmark</i>	8.8	6.3	5.8	10.2	3.2	0.5	3.2	7.9	
<b>Total Private Equity</b>	<b>16.8</b>	<b>21.6</b>	<b>24.0</b>	<b>55.7</b>	<b>12.5</b>	<b>12.5</b>	<b>12.5</b>	<b>39.0</b>	<b>17,409</b>
<i>Benchmark</i>	14.8	18.1	18.1	41.9	7.3	1.2	7.3	31.1	
<b>Total Private Investment Partnerships</b>	<b>n/a</b>	<b>10.7</b>	<b>11.0</b>	<b>30.6</b>	<b>6.8</b>	<b>6.8</b>	<b>6.8</b>	<b>23.9</b>	<b>2,205</b>
<i>Benchmark</i>	n/a	10.2	10.1	20.1	3.9	0.9	3.9	14.9	
<b>Total Multi-Asset Public Strategies</b>	<b>n/a</b>	<b>n/a</b>	<b>5.7</b>	<b>15.8</b>	<b>0.3</b>	<b>-0.8</b>	<b>0.3</b>	<b>6.6</b>	<b>3,227</b>
<i>Benchmark</i>	n/a	n/a	8.2	12.7	0.1	-1.6	0.1	5.5	
<b>Total Fund</b>	<b>10.0</b>	<b>10.5</b>	<b>11.3</b>	<b>24.3</b>	<b>2.6</b>	<b>1.2</b>	<b>2.6</b>	<b>13.8</b>	<b>103,710</b>
<i>VRS Custom Benchmark</i>	9.3	9.8	10.2	19.3	1.3	-1.3	1.3	10.2	

10-Year Performance  
Indexed to 100

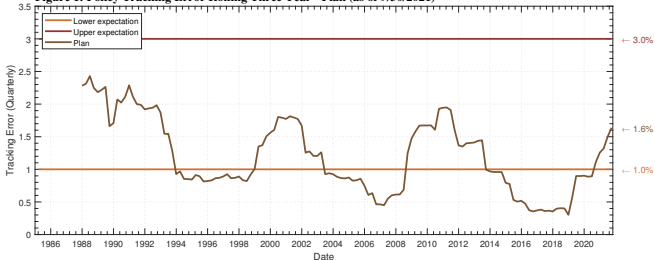


Effective July 2013, the VRS Custom Benchmark is a blend of the Asset Class Benchmarks at policy weights.

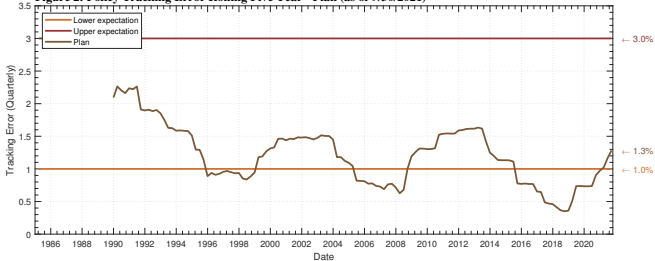
The VRS Cash Account, the Treasurer Short-Term Investment Account, the VRS Rebalancing Account, transition activity and accounts with market values of less than \$1 million are included in the Total Fund's market value. Differences in market value totals are due to rounding.

# Total Fund Tracking Error

**Figure 1: Policy Tracking Error Rolling Three Year - Plan (as of 9/30/2021)**



**Figure 2: Policy Tracking Error Rolling Five Year - Plan (as of 9/30/2021)**



The VRS Defined Benefit Plan Investment Policy Statement established the total fund tracking error range as the allowable observed tracking error calculated quarterly using 5 years of history.

Program	Action	Effective Date	Commitment/ Current Value	Funding/ Defunding Period	Description
Credit Strategies	Hired	10/26/2021	\$300 Million	4 Years	<b>Ares Special Opportunities Fund II</b> – A middle market stressed and distressed credit fund in both the private and public markets.

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## Report

The Benefits and Actuarial Committee met on November 15, 2021 and took up the following matters:

### **APPROVAL OF MINUTES**

The Committee approved the minutes of its October 13, 2021 meeting.

### **2021 ACTUARIAL VALUATION RESULTS FOR POLITICAL SUBDIVISION RETIREMENT PLANS, THE VIRGINIA LOCAL DISABILITY PROGRAM (VLDP), LOCAL HEALTH INSURANCE CREDIT (HIC), AND THE LINE OF DUTY ACT (LODA) FUND**

Larry Langer and Alisa Bennett from the VRS plan actuary, Cavanaugh Macdonald Consulting, LLC, presented the June 30, 2021 actuarial valuation results for the Political Subdivision Retirement Plans, the Virginia Local Disability Program (VLDP), the Local Health Insurance Credit (HIC), and the Line of Duty Act (LODA) fund.

Key points from the presentation include:

- The June 30, 2021 valuations are used to set the contribution rates for fiscal years 2023 and 2024.
- Since the prior valuation, there have been several significant changes to assumptions as well as plan experience that differed from what was assumed, which impacted contribution rates. Factors impacting the results include:
  - Assumption changes
  - Investment return
  - COLAs less than expected
  - Demographic changes
- The most significant change was to the mortality assumptions, which included moving to a generational mortality improvement scale. This generally increased liabilities for pension plans and had mixed results on OPEB plans.
- The 2021 investment return of 27.5% had an immediate positive impact to funded status on the market value of asset basis. The gain is phased in over a five-year period due to actuarial smoothing of assets for funding calculations.

#### Pensions

- In aggregate, the employer contribution rates for political subdivision pension plans had a small increase from 8.33% during the last rate-setting to 8.79% as of the current valuation. Actual impacts will vary by employer, but a majority of plans will have a change in contribution rate of less than 1%.
- Funded status in aggregate increased from 86.4% as of June 30, 2020 to 87.2% as of June 30, 2021 on an actuarial value of assets basis. Nearly two-thirds of the local pension plans are at

least 90% funded on an actuarial value of assets basis. On a market value basis, nearly 90% of plans are 90% funded.

#### OPEBs

- The average contribution rate for HIC for political subdivisions increased from 0.64% to 0.72%. This is mostly due to payroll increasing less than expected, as well as more schools electing the extra \$1.00 benefit and the Additional Funding Contribution and “At-Risk” Surcharge. However, rates will vary by employer.
- Funded status for the HIC for political subdivisions in aggregate continued to trend upward rising from 31.9% as of June 30, 2020 to 40.2% as of June 30, 2021.
- Contribution rates for VLDP for Teachers and Political subdivisions remained relatively level compared to the prior rate setting. Funded ratios increased for both VLDP plans rising to 98.6% for VLDP Teachers and to 112.0% for VLDP political subdivisions.

Alisa Bennett of Cavanaugh Macdonald Consulting, LLC, provided the results for the Line of Duty Act (LODA) fund.

- Due to actions taken by the General Assembly in the 2021 session, the LODA premium rate increased by \$5.24 for FY 2022 to \$722.55 in response to additional presumptions and conditions covered under the Workers’ Compensation Act.
- Due to the “pay-as-you-go” funding required by statute for the LODA fund, we generally expect LODA premiums to increase each rate setting due to increases in covered members and increases in the cost of health care.
- For FY 2023 and FY 2024 the LODA premium rate will decrease to 681.84 per full-time equivalent (FTE).
- The rate decrease is due in large part to investment income and an end of year asset balance of \$7.5 million. The excess assets will be used to offset costs for fiscal years 2023 and 2024.
- Investment income overshadowed small increases in liabilities due to assumption changes related to the experience study as well as an unanticipated increase of 14.50% in the Medicare Part B premium.
- No explicit changes related to COVID-19 were incorporated at this time due to the level of uncertainty regarding the impact of both plan costs and contribution levels going forward.

Following some discussion, the Committee recommended approval of the following action to the full Board of Trustees:

***Request for Board Action:*** *Approve contribution rates for political subdivisions, the Health Insurance Credit for certain political subdivisions, the Virginia Local Disability Program and the Line of Duty Act Fund, effective for FY 2023 and FY 2024.*

**INFORMATION ITEM**

2022 B&A Committee Meeting Schedule:

- February 9 at 1:00 p.m.
- June 6 at 1:00 p.m.
- October 17 at 1:00 p.m.
- November 14 at 1:00 p.m.

Submitted to the Board of Trustees on November 16, 2021.

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William A. Garrett, Chair  
Benefits and Actuarial Committee





**Approve contribution rates for political subdivisions, the Health Insurance Credit for certain political subdivisions, the Virginia Local Disability Program and the Line of Duty Act Fund, effective for FY 2023 and FY 2024.**

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**Requested Action**

After considering the recommendations of its Plan Actuary, the Board accepts the June 30, 2021 valuation report for political subdivisions and the Health Insurance Credit (HIC) for certain political subdivisions; approves a contribution rate of 0.36% for constitutional officers, a rate of 0.37% for social services employees, and a contribution rate of 0.32% for general registrars; approves a contribution rate of 0.47% for the Virginia Local Disability Program (VLDP), including self-funded Long-Term Care for Teachers and a rate of 0.85% for VLDP, including self-funded Long-Term Care for Political Subdivisions; and approves a full-time equivalent premium rate of \$681.84 for the Line of Duty Death and Health Benefits Trust Fund (Fund), all for both FY2023 and FY2024, to be effective July 1, 2022.

**Rationale for Requested Action**

The certified employer contribution rates reflect the assumptions and provisions in effect as of June 30, 2021 including the assumed rate of return of 6.75%.

The employer contribution rates will go into effect on July 1, 2022.

Under *Code of Virginia* § 51.1-1403(A), the cost of HIC for retired local officers, retired general registrars (and the retired employees of each), and retired employees of a local social services board is borne by the Commonwealth and not the political subdivisions.

The Line of Duty Act (LODA) provides benefits to eligible first responders who die or become disabled in the line of duty. VRS administers, manages and invests the Fund. VRS is responsible for determining costs for the Fund in order to provide benefit payments and for collecting required contributions from participating employers.

*Code of Virginia* § 9.1-400.1(D) requires participating employer contributions to the Fund to be determined by the Board on a current disbursement basis (pay-as-you-go). Contributions fund the claims and administrative expenses for participating employers. The FY2023 and FY2024 premium rate of \$681.84 is based on a participating FTE count of 19,087.20.

**Authority for Requested Action**

*Code of Virginia* §§ 51.1-124.22(5) and -145 authorize the Board to determine the required contribution rate for the various employer groups in the Retirement System. *Code of Virginia* § 9.1-400.1 authorizes the Board to set the employer contribution rates for the Line of Duty Death and Health Benefits Trust Fund.

The above action is approved.

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O'Kelly E. McWilliams, III, Chair  
VRS Board of Trustees

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Date



**Cavanaugh Macdonald**  
CONSULTING, LLC

*The experience and dedication you deserve*



# Virginia Retirement System Political Subdivisions June 30, 2021 Actuarial Valuations

November 16, 2021

Larry Langer, ASA, FCA, MAAA, EA  
Principal and Consulting Actuary

Alisa Bennett, FSA, FCA, MAAA, EA  
President



- The Actuarial Valuation Process and Purpose
  
- June 30, 2021 Results:
  - Employer Contribution Rates
  - Funded Status
  - Unfunded Actuarial Accrued Liability
  
- Plan by Plan Analysis
  
- Appendix

# Purpose of the June 30, 2021 Actuarial Valuation



- The actuarial valuation provides a basic source document for information regarding actuarially determined contributions (employer rates) as well as the funded status of pension and other post-employment benefit (OPEB) plans.
  
- The June 30, 2021 valuations will be used to set contribution rates for the two-year period from July 1, 2022 through June 30, 2024
  - Odd year valuations are for rate setting.
  - Even year valuations are for informational purposes.

# Purpose of the June 30, 2021 Actuarial Valuation



- Each fall, CMC presents results over two Board meetings:

Pension	Other Post Employment Benefits (OPEB)
Virginia Retirement System <ul style="list-style-type: none"> <li>▪ State Employees</li> <li>▪ Teachers</li> <li>▪ <b>Political Subdivisions</b></li> </ul> Virginia Law Officers (VaLORS) State Police Officers (SPORS) Judges (JRS)	Group Life Insurance Fund Retiree Health Insurance Credit (HIC) <ul style="list-style-type: none"> <li>▪ State Employees</li> <li>▪ Teachers</li> <li>▪ <b>Political Subdivisions</b></li> <li>▪ <b>Constitutional Officers</b></li> <li>▪ <b>Social Services Employees</b></li> <li>▪ <b>Registrars</b></li> </ul> Virginia Sickness and Disability Program (VSDP) <b>Virginia Local Disability Program (VLDP)</b> <ul style="list-style-type: none"> <li>▪ Teachers</li> <li>▪ <b>Political Subdivisions</b></li> </ul> Line of Duty Act Fund (LODA)

- We present results for the plans **in bold** in November; the remainder were presented in October.
- LODA results are in a separate presentation.

**Basic funding equation for benefits:**

$$\mathbf{C + I = B + E}$$

**Contributions + Investment returns = Benefits + Expenses**

- Over the long term, actual investment returns, benefits and expenses determine the amount of contributions.
- Over the short term, estimated investment returns, benefits and expenses developed in an actuarial valuation will determine the amount of contribution.

# The Actuarial Valuation Process



- The actuarial valuation process can be viewed as a budgeting process. Like a budget, we make use of information we know as of a certain date, and using assumptions, we estimate what we think will happen in the future.
- Member data, asset data and benefit provisions are provided by Staff. Thank you!!
- Assumptions and funding methodology are determined by the Board of Trustees, Code of Virginia and GASB, with input from the actuary and other professionals.

## Inputs

Member Data  
Asset Data  
Benefit Provisions  
Assumptions  
Funding Methodology



## Results

Actuarial Value of Assets (AVA)  
Actuarial Accrued Liability (AAL)  
Net Actuarial Gain or Loss  
Funded Ratio/UAAAL  
Employer Contribution Rates  
Projections



# Executive Summary

# Executive Summary

- Since the prior valuation, there have been several significant changes to assumptions as well as plan experience that differed from what was assumed which will impact future contribution rates.
- Significant factors that impacted results:
  - Assumptions changes
  - Investment return
  - COLAs less than expected
  - Demographic changes
    - Possible COVID Impacts?
      - Headcounts are down in several plans
      - Higher terminations, deaths, and refunds
      - Fewer new hires
  - Political subdivisions which had changes in coverage since the last valuation
  - HIC political subdivisions saw increases in averages due to payroll increasing less than expected, more schools electing the extra \$1 benefit and more plans with surcharges.
- The impact of these events had mixed results across plans as we will see on the following slides.

## Experience Study Recommendations

- Most significant change was to the mortality assumptions
  - PUB-2010 with generational mortality improvement scale
  
- Generally increased liabilities for pension plans and had mixed results on OPEB plans

# Executive Summary



- Changes in assumptions recommended by CMC and adopted by the Board in April 2021 increased liabilities for pension plans.
- Changes in assumptions had larger impact on plans with Hazardous Duty members.

System	Actuarial Accrued Liability		
	Before Assumption Changes	After Assumption Changes	% Change in Liability
State	\$ 26,326,136	\$ 26,727,971	1.53%
Teachers	\$ 51,871,407	\$ 52,747,596	1.69%
SPORS	\$ 1,267,565	\$ 1,326,646	4.66%
VaLORS	\$ 2,339,223	\$ 2,407,153	2.90%
JRS	\$ 681,969	\$ 733,408	7.54%
Political Subdivisions	\$ 26,217,770	\$ 27,161,308	3.60%
Total	\$ 108,704,070	\$ 111,104,082	2.21%

# Executive Summary



- Changes in assumptions recommended by CMC and adopted by the Board in April 2021 had mixed impact on OPEB plan liabilities.
- Method change to mid-year decrements for all plans except Teachers lowered costs for VLDP Political Subdivisions due to the limited term nature of the benefit.

Plan	Actuarial Accrued Liability		
	Before Assumption Changes	After Assumption Changes	% Change in Liability
Group Life	\$ 3,717,938	\$ 3,524,464	-5.20%
HIC State	\$ 1,033,299	\$ 1,044,663	1.10%
HIC Teachers	\$ 1,457,810	\$ 1,471,397	0.93%
VSDP	\$ 254,646	\$ 250,103	-1.78%
HIC Political Subdivisions	\$ 81,265	\$ 82,791	1.88%
HIC Constitutional Officers	\$ 32,715	\$ 33,241	1.61%
HIC Social Service Employees	\$ 14,592	\$ 14,833	1.65%
HIC Registrars	\$ 581	\$ 590	1.55%
VLDP Teachers	\$ 4,799	\$ 5,102	6.31%
VLDP Political Subdivisions	\$ 5,520	\$ 5,005	-9.33%
Total	\$ 6,603,165	\$ 6,432,189	-2.59%

## Investment Return for 2021

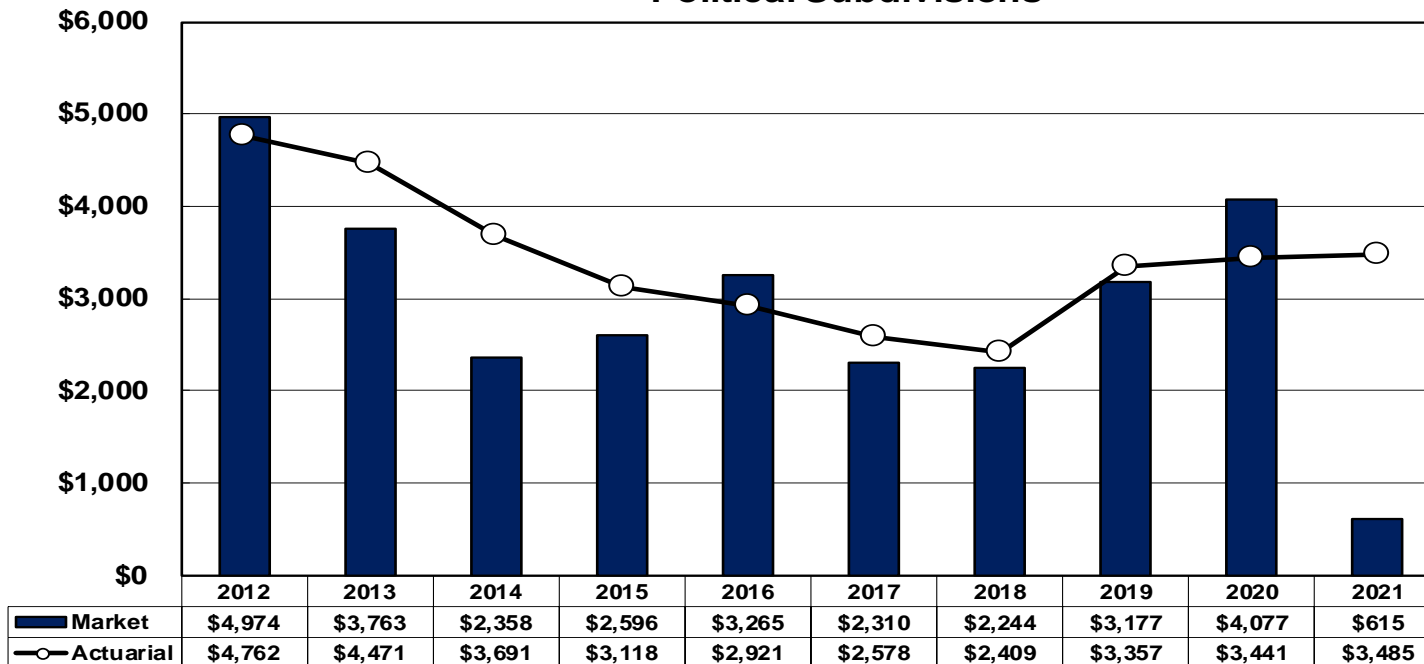
- Fiscal year investment return for 2021 was 27.5%
- Immediate positive impact to funded status on market value of asset basis
- Investment gain is phased in over a five-year period due to actuarial smoothing of assets for funding calculations

# Executive Summary



- Since the actuarial value of assets smooths in the excess gains over a four-year period, the unfunded liabilities on an actuarial value of assets basis should trend downward toward the unfunded liabilities on a market value basis if all other assumptions are met.

**Political Subdivisions**



## Demographic Changes

- Active headcounts are down in aggregate for Political Subdivisions, but varied across employers
- Generally, the impact of demographic changes on the valuation results was less than the impact of the change in assumptions, market returns being more than expected and COLAs being less than expected



## Demographic Changes

System	Active Counts		
	2020	2021	% Change in Active Counts
State	\$ 75,069	\$ 73,686	-1.80%
Teachers	\$ 150,681	\$ 149,793	-0.60%
SPORS	\$ 1,924	\$ 1,947	1.20%
VaLORS	\$ 8,554	\$ 7,823	-8.50%
JRS	\$ 449	\$ 453	0.90%
Political Subdivisions	\$ 110,854	\$ 108,613	-2.00%

## HIC Political Subdivisions Experience

- The average contribution rate for HIC Political Subdivisions increased from 0.64% to 0.72%
  - Demographic experience caused an increase of 0.03%
    - This is mostly due to payroll not increasing as much as expected (1.3% versus 3% assumed)
    - The election of 12 new schools offering the extra \$1 benefit also contributed to the increase
  - Additional Funding Contribution and “At-Risk” Surcharge experience caused an increase of 0.04%
    - There are 12 employers that required an additional funding contribution due to GASB cross-over calculation. This is up from 10 employers who required additional contribution last rate-setting.
      - All 12 with an additional funding contribution are school locations, and of those, 8 were not participating prior to HB 1513 being enacted.
    - There are 62 employers with an “at-risk” surcharge compared to 119 during the last rate-setting. The “at-risk” surcharge is applied to plans with low funded levels in an effort to bring the funded level to a more sustainable level.
  - The remaining increase was due to the changes in assumptions related to the experience study.

# Results

# Employer Contribution Rate Pension Plans

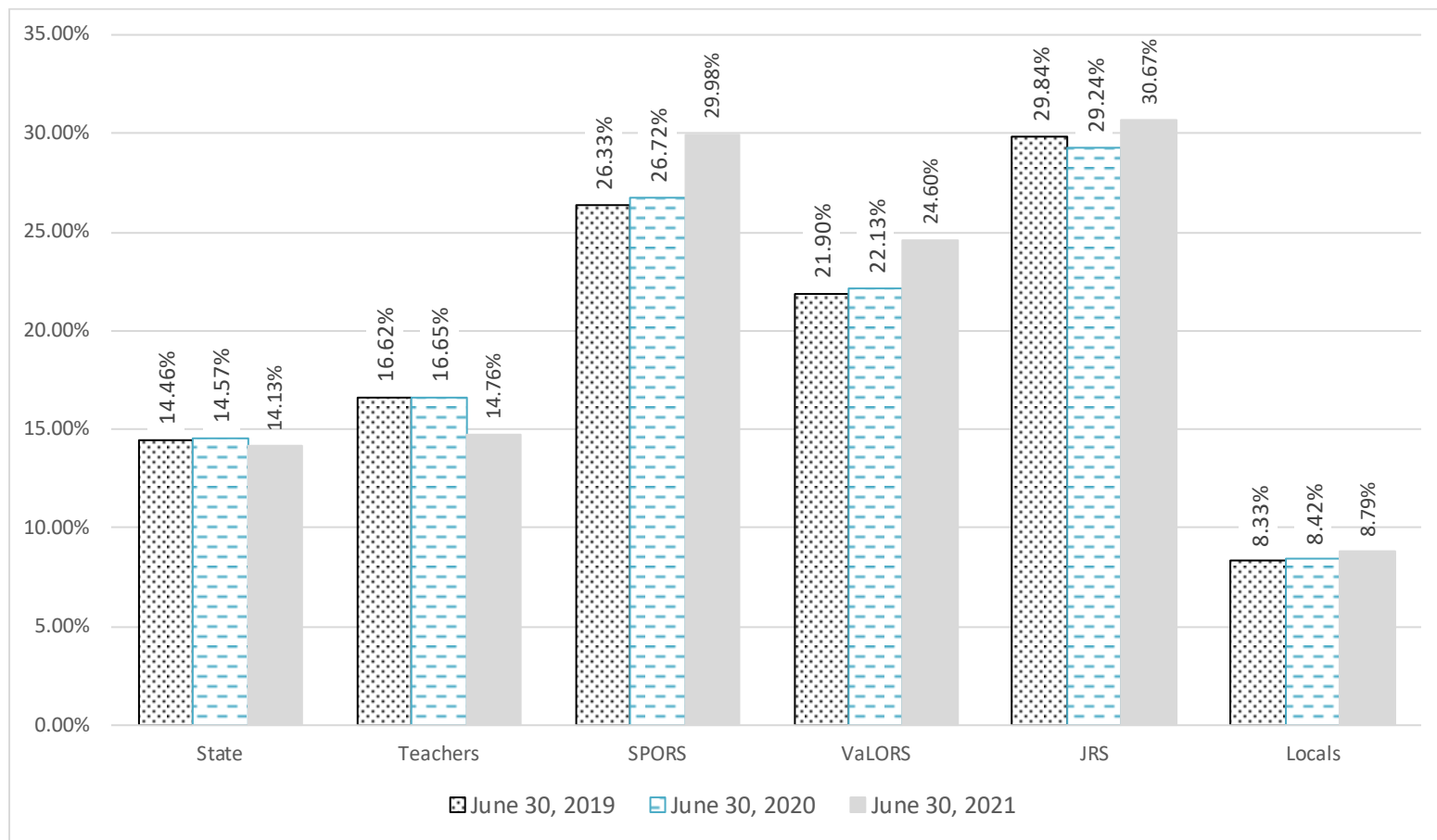
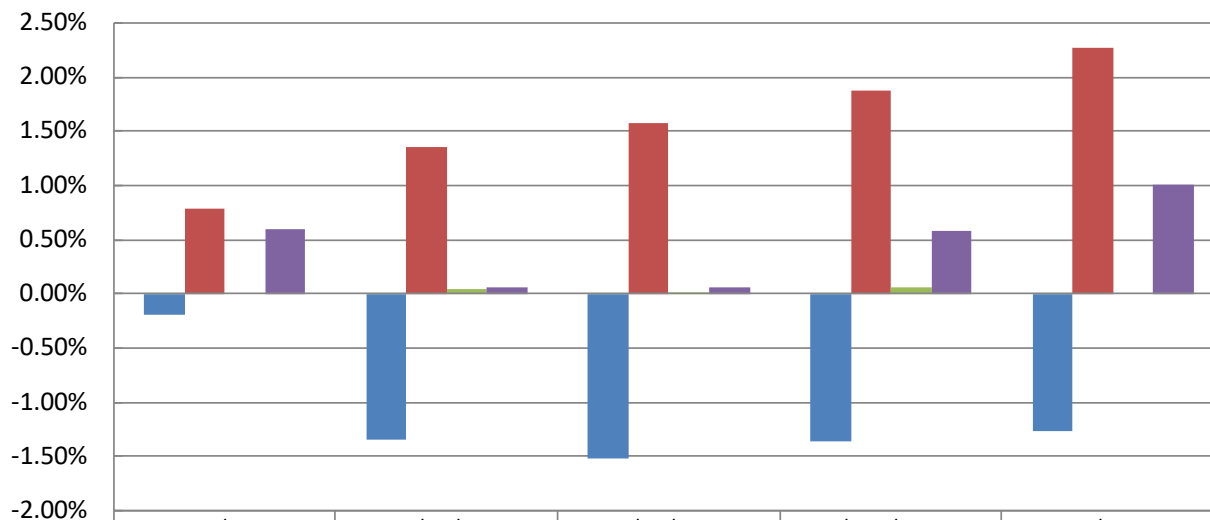


Chart of employer contribution results is also shown in appendix on slide 45.

# Average Change in Employer Contribution Rates by Market Asset Size (2021 vs. 2020) (Dollars in Millions)



	<\$1	\$1-\$5	\$5-\$20	\$20-\$100	>\$100
■ Due to Plan Experience	-0.20%	-1.34%	-1.52%	-1.36%	-1.27%
■ Due to Assumption/Method Change	0.79%	1.36%	1.57%	1.88%	2.27%
■ Due to Plan Amendment	0.00%	0.04%	0.01%	0.06%	0.00%
■ Net Change	0.59%	0.06%	0.06%	0.58%	1.00%

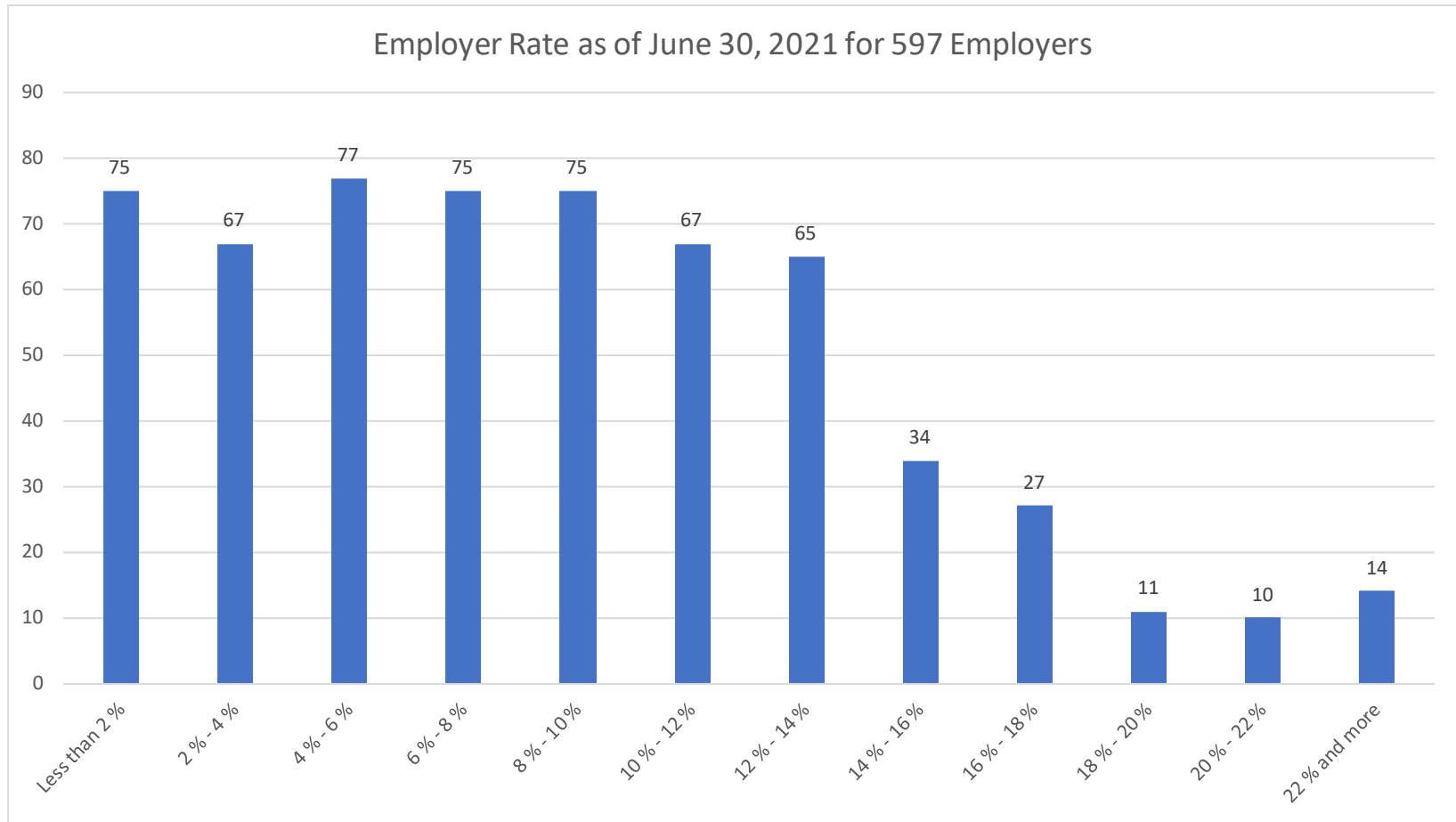
Average change in contribution due to plan experience is -1.24%.

Note: Distribution includes only the 595 employers that have a 2020 rate for comparison. The comparison includes the change in employer Hybrid defined contribution match.

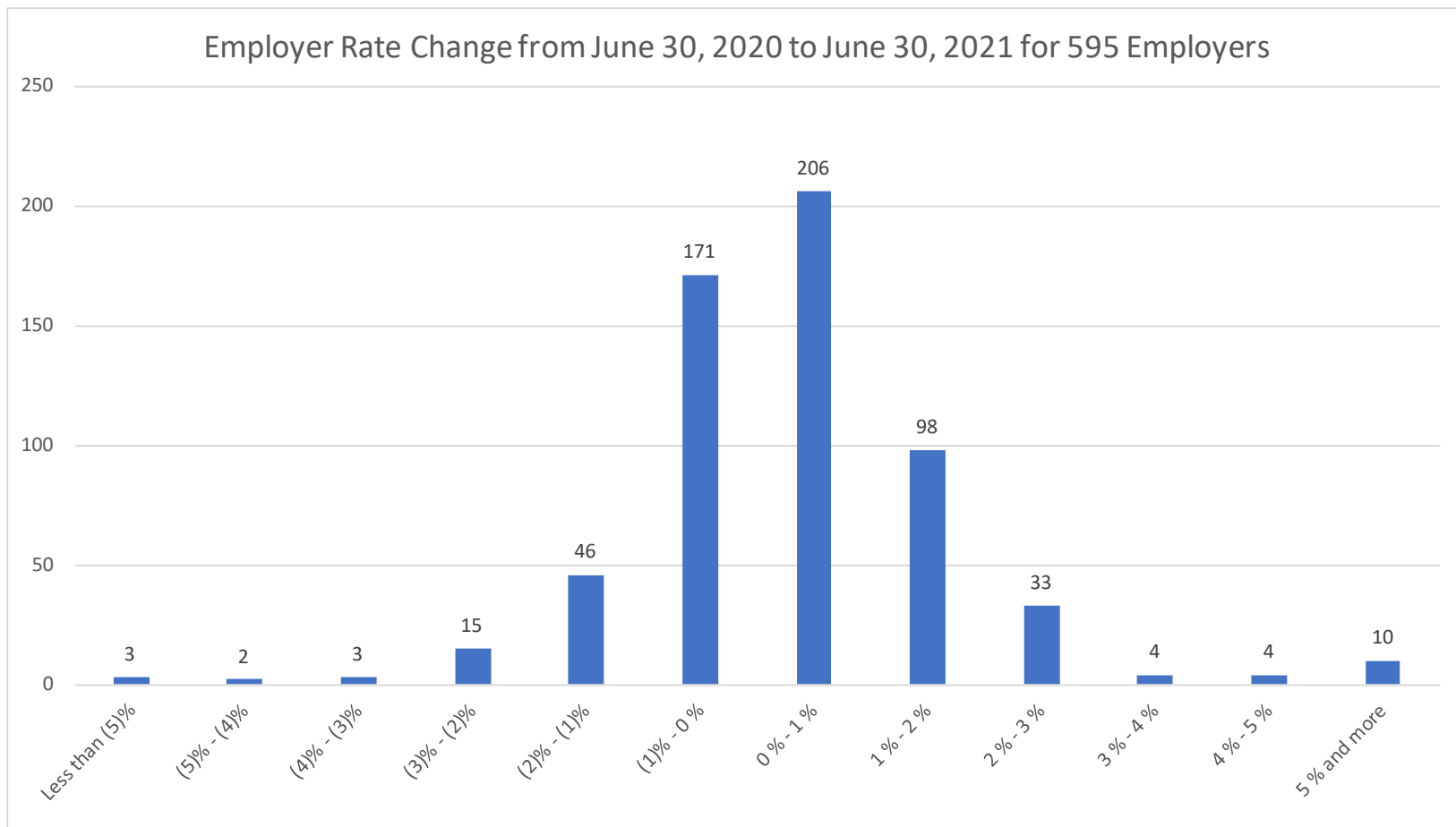
"Plan amendments" generally refer to addition of enhanced hazardous duty coverage.

"Assumption/Method Change" refers to the updated assumptions based on the results of an experience study completed for the four-year period ending June 30, 2020.

# Employer Rate Political Subdivisions



# Employer Rate Change Political Subdivisions



# Employer Contribution Rate OPEB Plans

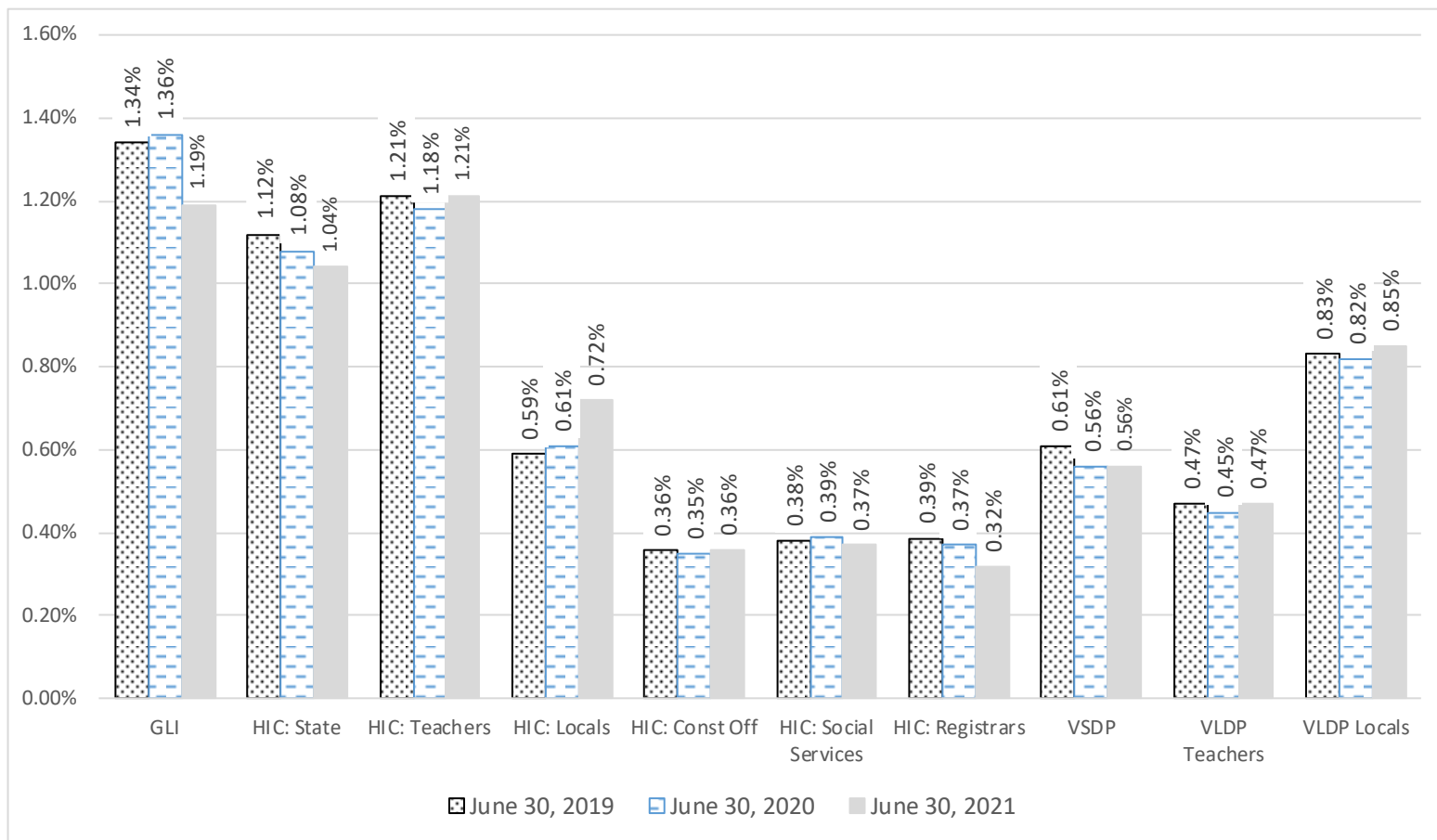
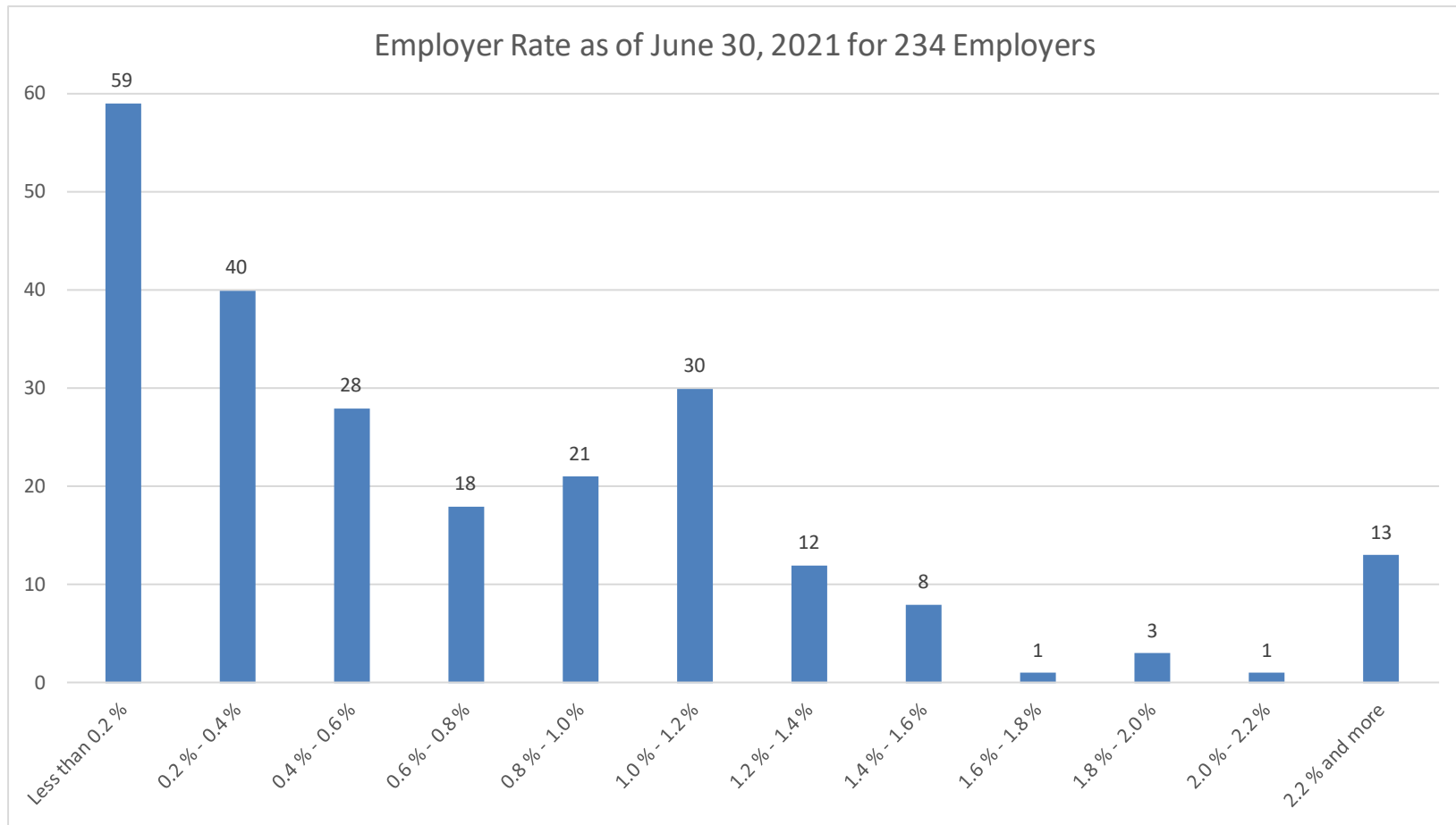


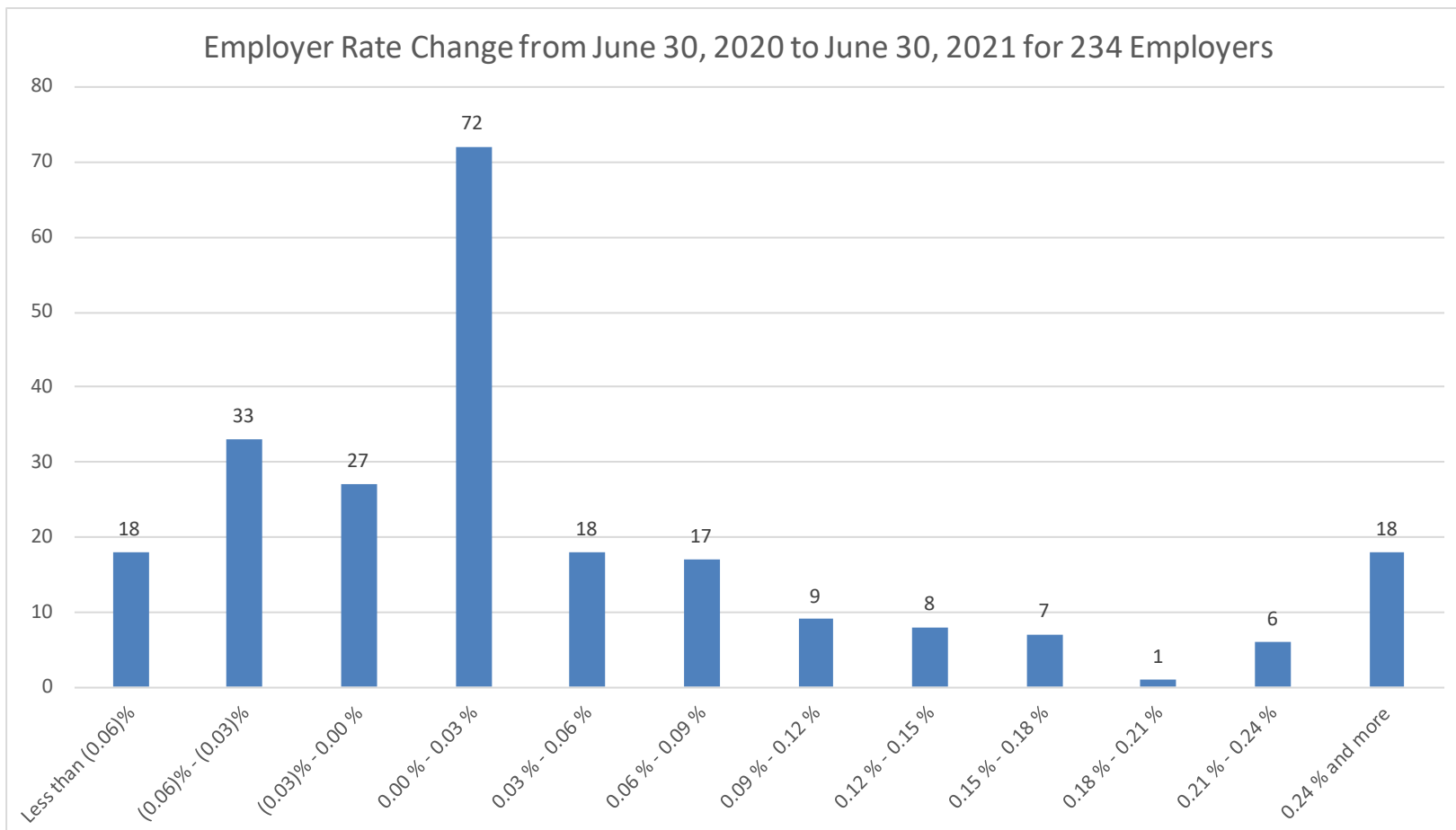
Chart of employer contribution results is also shown in appendix on slide 46.



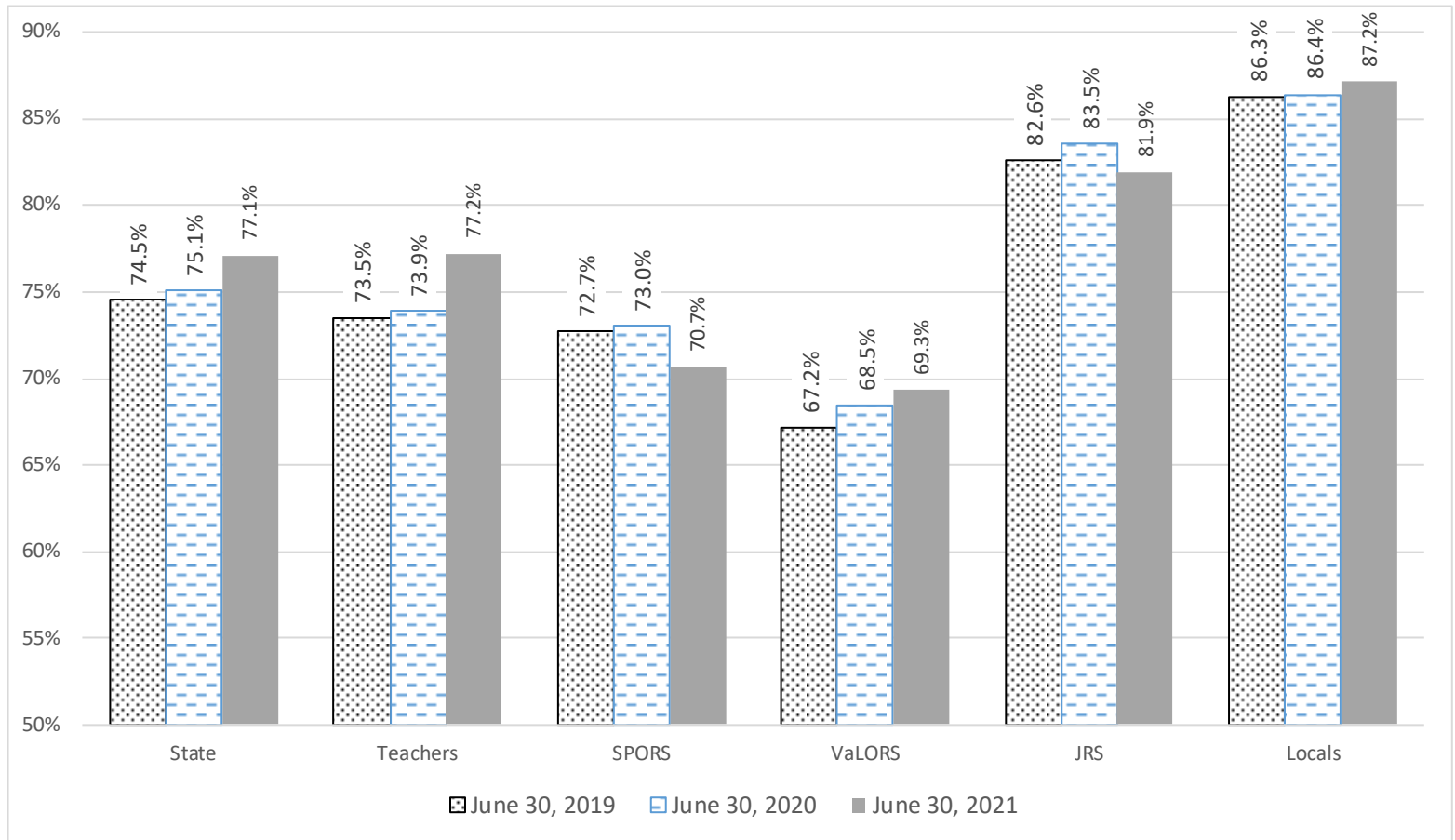
# Employer Rate OPEB HIC Political Subdivisions



# Employer Rate Change OPEB HIC Political Subdivisions



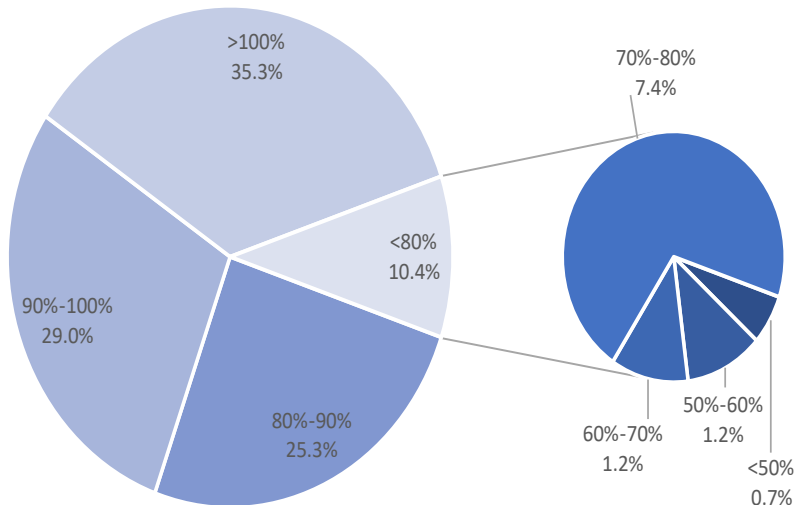
# Funded Ratio on Actuarial Value Pension Plans



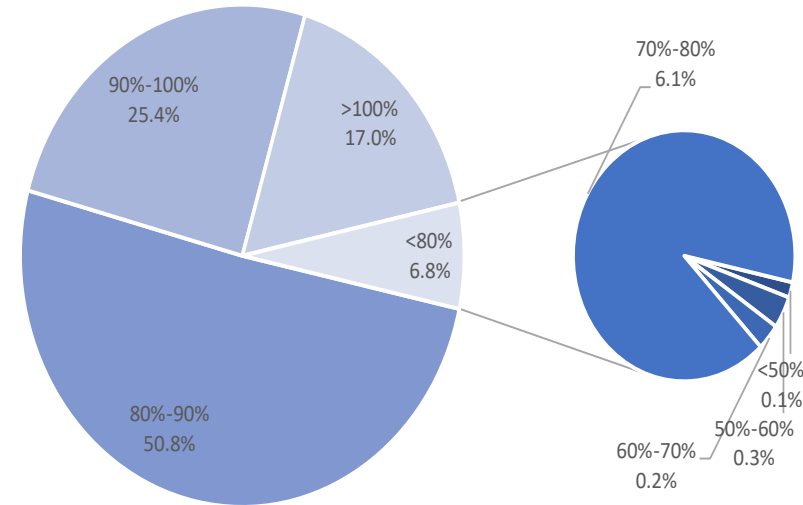
# Funded Ratio Breakdowns Political Subdivisions



AVA Funded Ratio by Political Subdivision



AVA Funded Ratio by Active Member

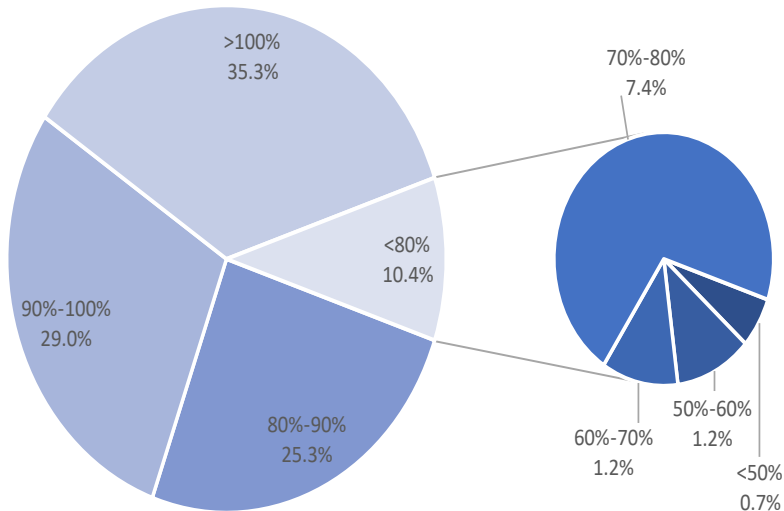


- While the overall funded ratio on actuarial value is 87.2%, the funded ratio varies significantly across the 597 political subdivisions and 108,613 active members as illustrated in the charts above
- Over a third - 35.3% - of political subdivisions are over 100% funded; these tend to be smaller and not have hazardous duty coverage
- Just over half - 50.8% - of active members are covered in political subdivisions that are funded in 80%-90% range.

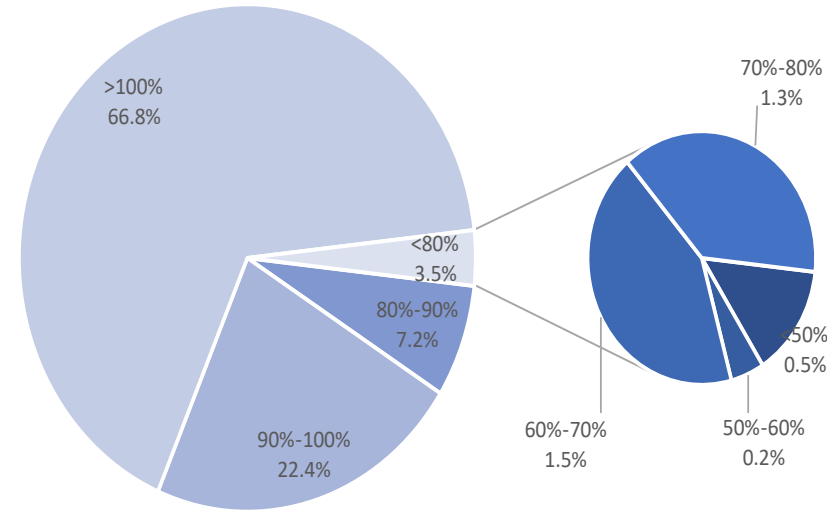
# Funded Ratio Breakdowns Political Subdivisions



AVA Funded Ratio by Political Subdivision

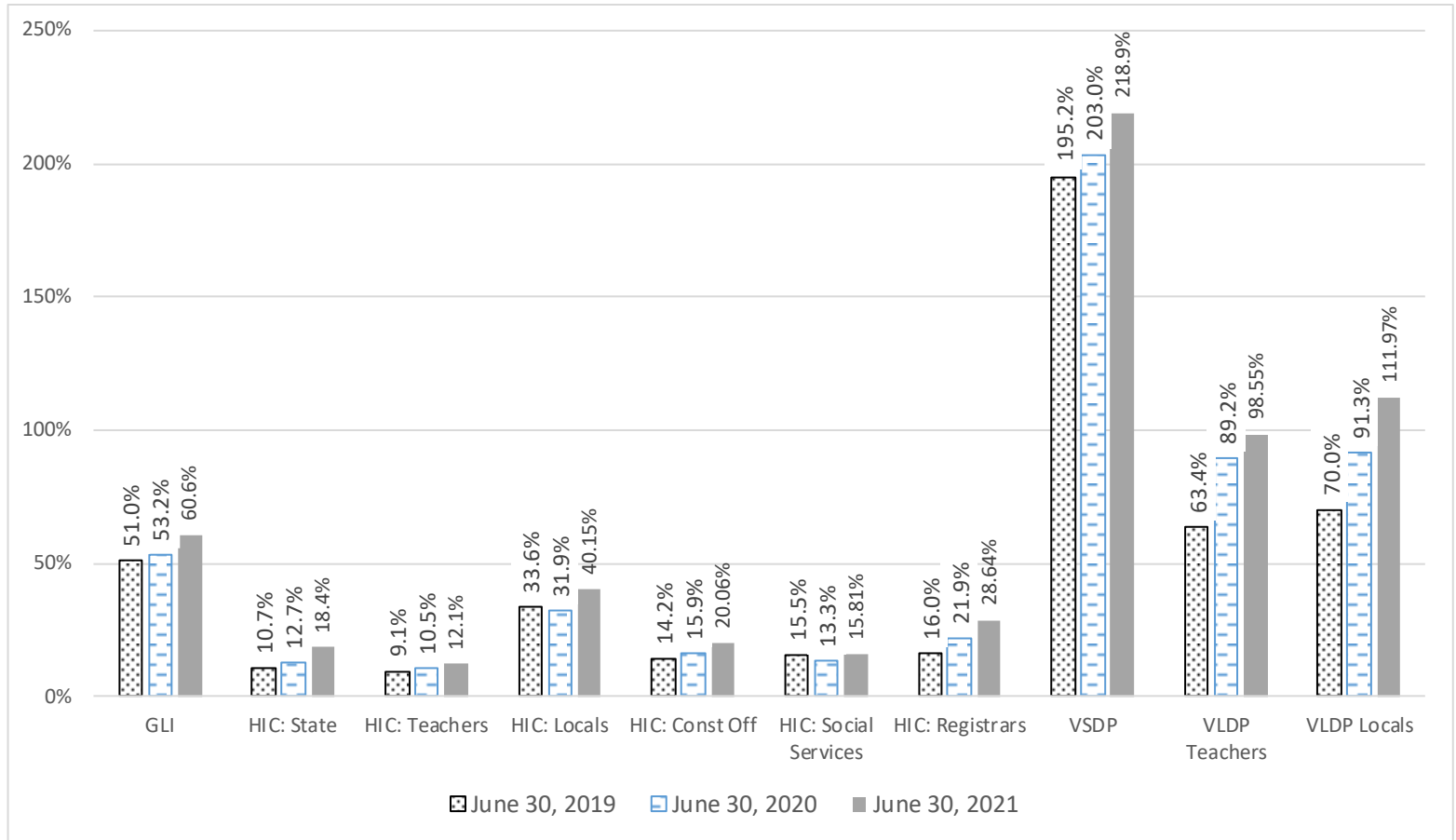


MVA Funded Ratio by Political Subdivision



- On a market basis, funded status improves, with the number of political subdivisions with funded ratio over 100% almost doubling from 35.3% to 66.8%
- This increase indicates the **potential** for lower contributions rates at the next rate setting effective July 1, 2024

# Funded Ratio on Actuarial Value OPEB Plans



# Unfunded Actuarial Accrued Liability on Actuarial Value Basis Pension Plans

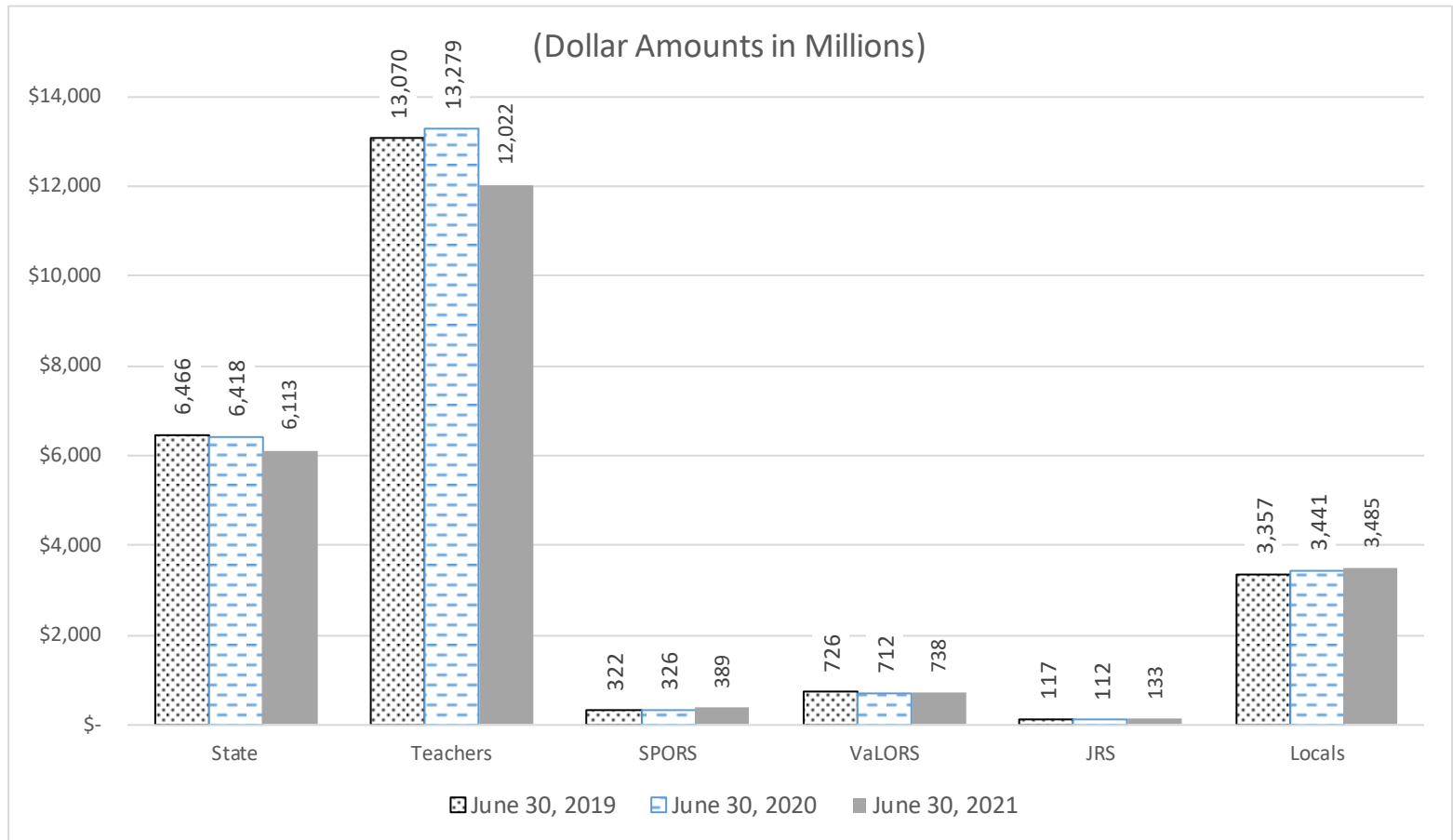


Chart of unfunded liabilities is also shown in appendix on slide 47.

# Unfunded Actuarial Accrued Liability on Actuarial Value Basis OPEB Plans

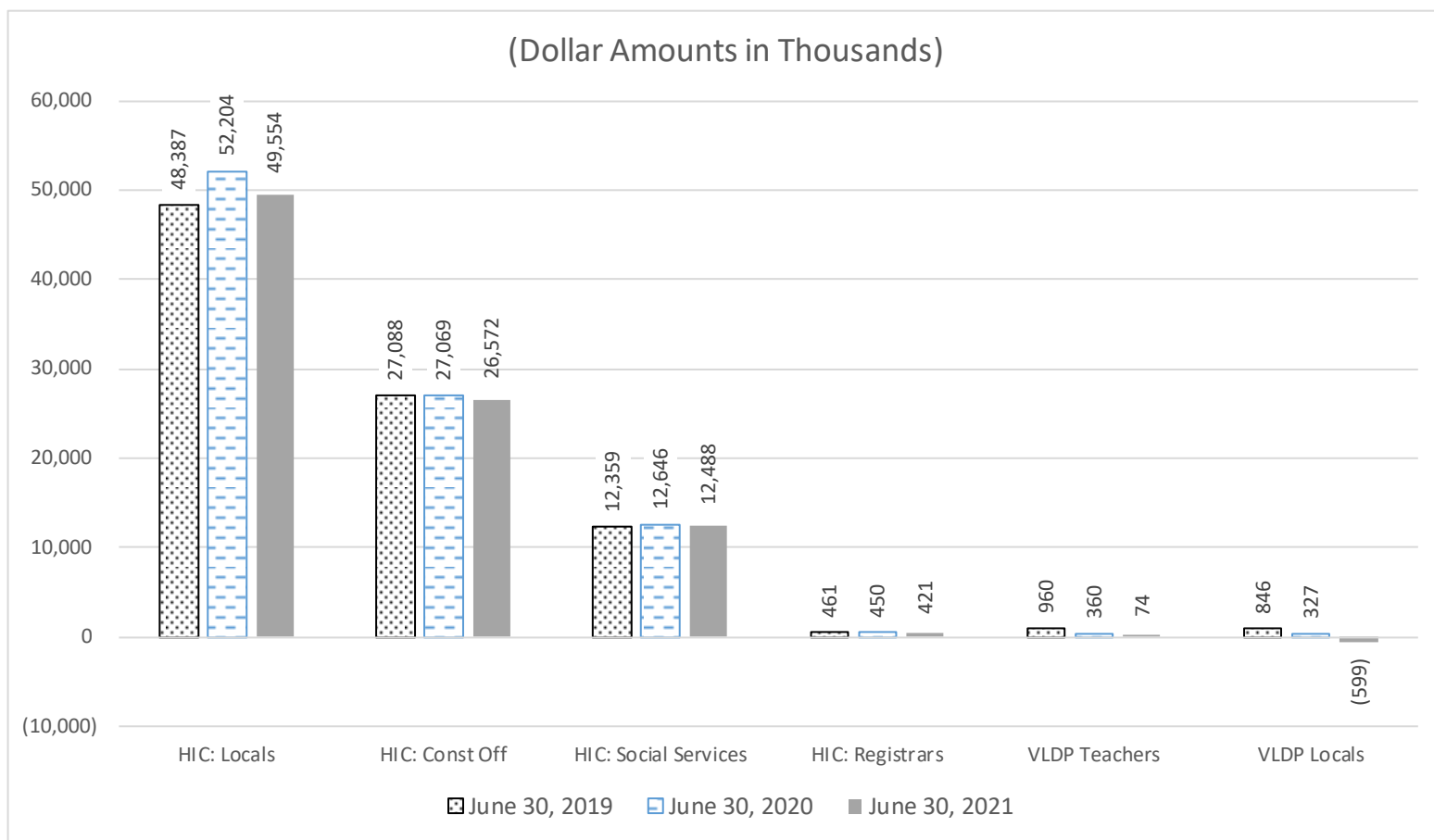
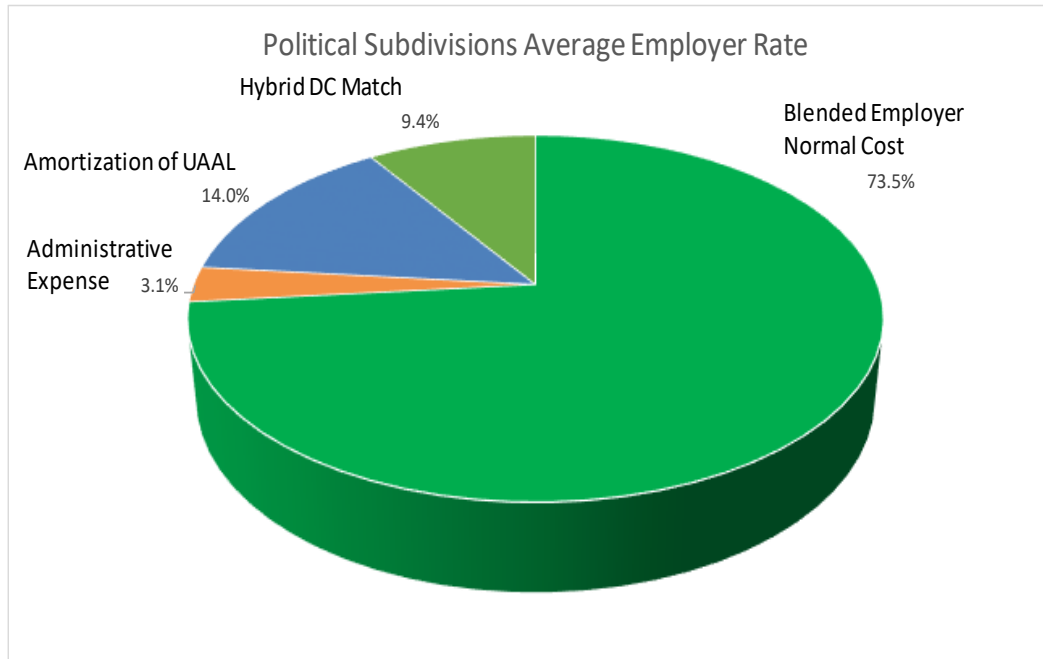


Chart of unfunded liabilities is also shown in appendix on slide 49.



# Source of Change in UAAL

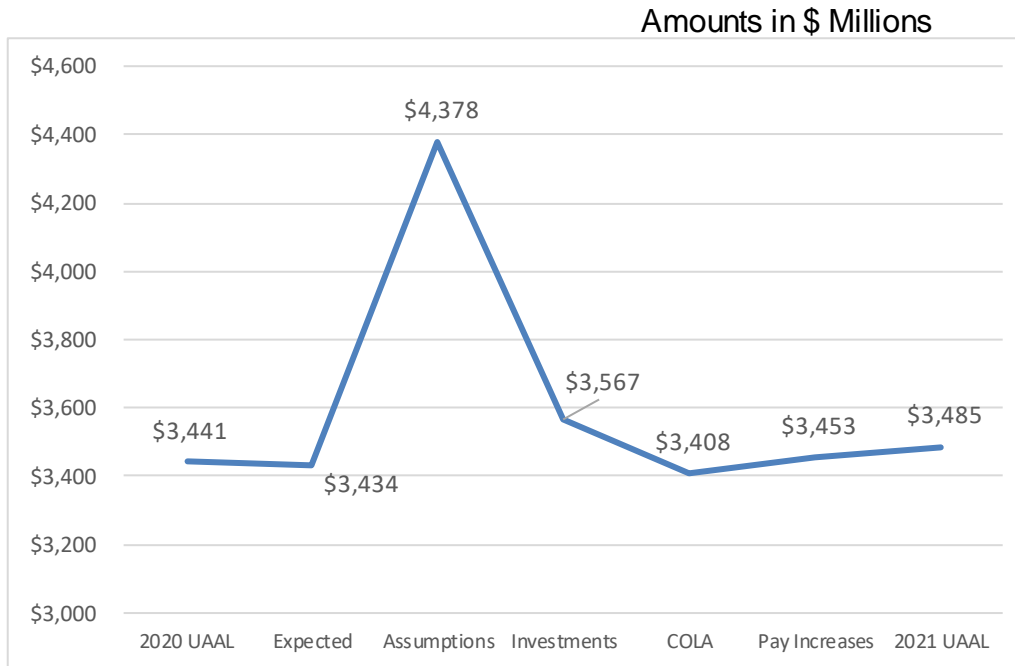
# Breakdown of Employer Costs



- Normal cost rate remains relatively stable and continues to trend downward in plans that have hybrid membership.
- While over 50% of the employer rate for most of the statewide plans is dedicated to paying down unfunded liabilities, only 14% is dedicated to paying down liabilities for the locals in aggregate.
- Understanding the impacts of gains and losses is crucial in managing the pay-off of unfunded liabilities for some Political Subdivisions.

<b>Blended Employer Normal Cost Rate</b>	<b>6.46%</b>
<b>Administrative Expense</b>	<b>0.27%</b>
<b>Amortization of UAAL</b>	<b>1.23%</b>
<b>Total Defined Benefit Rate</b>	<b>7.97%</b>
<b>DC Contribution for Hybrid Members</b>	<b>0.82%</b>
<b>Total Employer Pension Rate</b>	<b>8.79%</b>

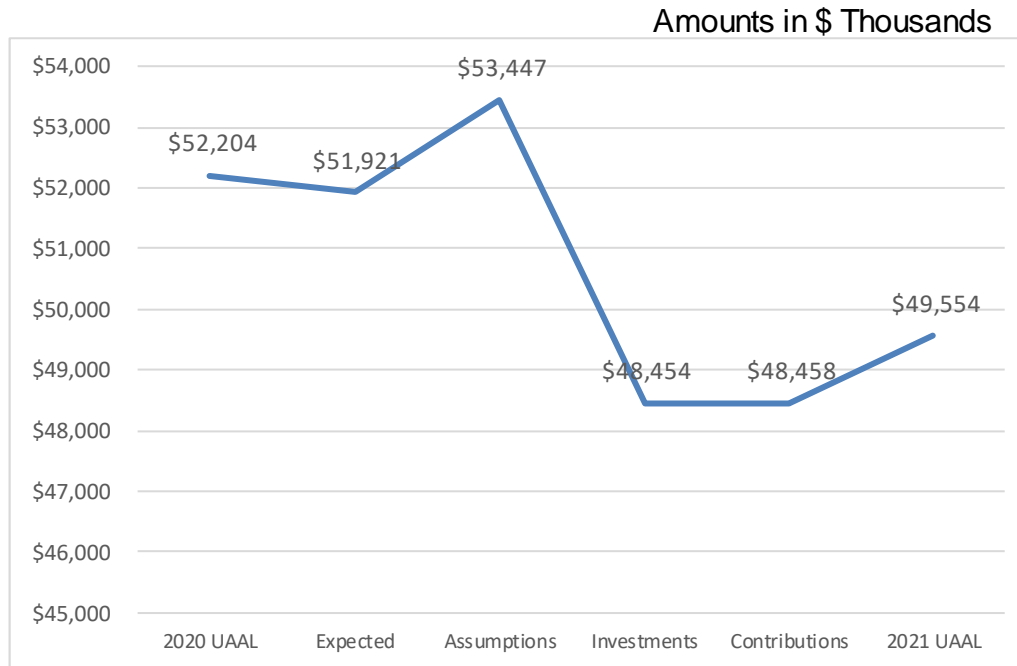
# Change in UAAL due to FYE June 30, 2021 Plan Experience Political Subdivisions



Change in UAAL by Source	
Expected	\$ (7)
Assumptions	944
Investments	(811)
COLA	(159)
Pay Increases	45
All Else	32
<b>Total</b>	<b>44</b>

- The increases in liability associated with assumption and method changes from the experience study were almost offset by the investment gain.
- Change in assumptions had larger impact on plans with Hazardous Duty members.
- Similarly, higher-than-expected pay increases were partially offset by lower-than-expected COLAs.
- The Political Subdivisions also had more retirements than expected which caused a loss of \$70.9 million.

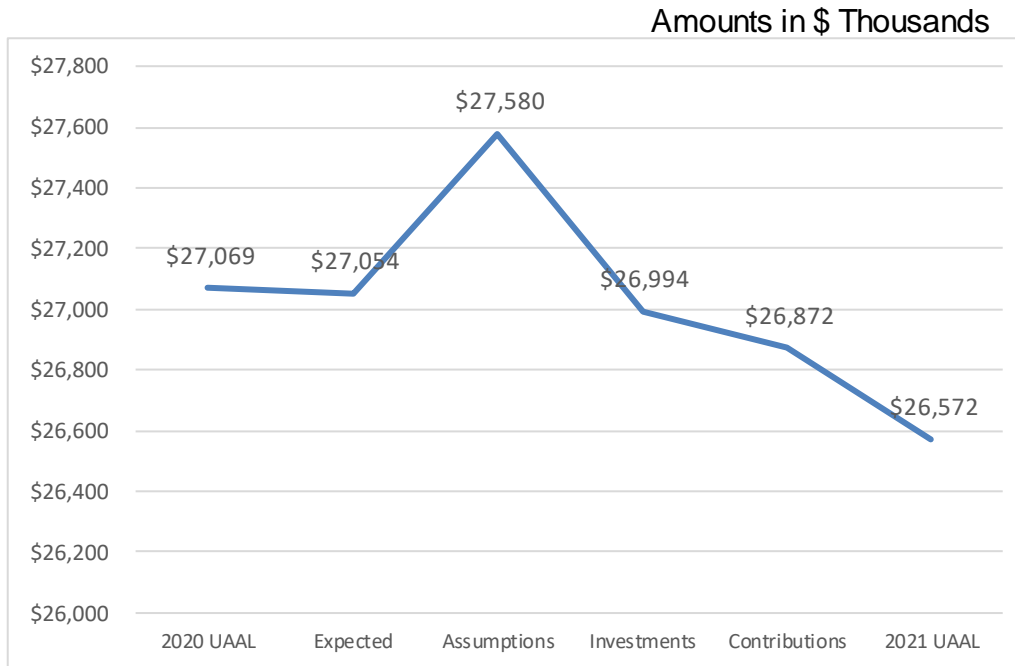
# Change in UAAL due to FYE June 30, 2021 Plan Experience Health Insurance Credit - Political Subdivisions



Change in UAAL by Source	
Expected	\$ (283)
Assumptions	1,526
Investments	(4,993)
Contributions	4
All Else	1,096
<b>Total</b>	<b>(2,650)</b>

- The increases in liability associated with assumption and method changes from the experience study were more than offset by the investment gain.
- All other changes, including the demographic changes, resulted in increasing the liabilities by approximately \$1,096 thousand.

# Change in UAAL due to FYE June 30, 2021 Plan Experience Health Insurance Credit - Constitutional Officers



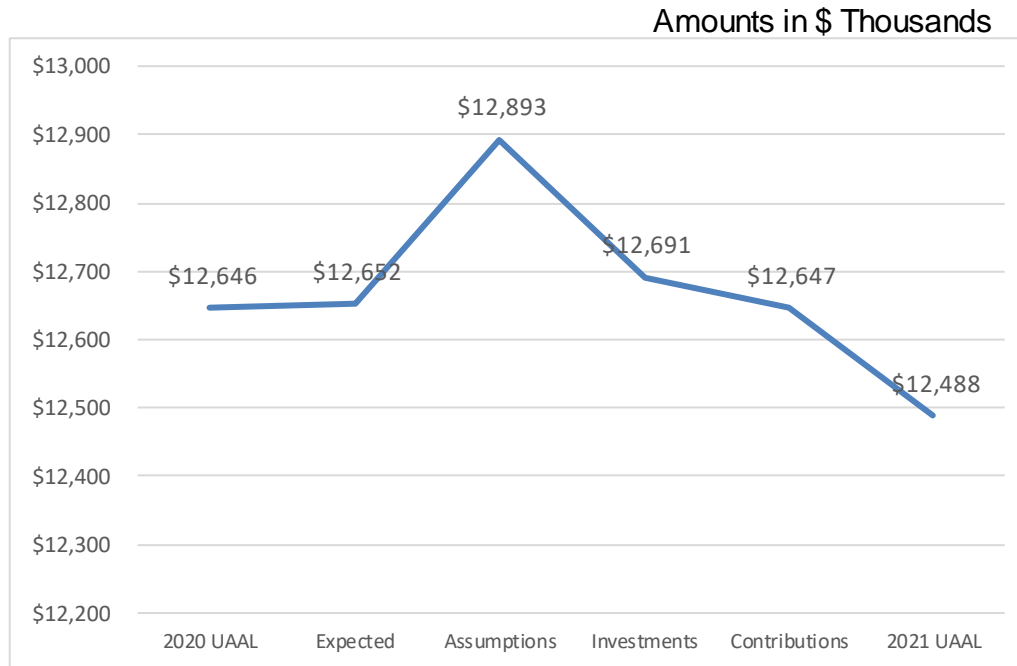
Change in UAAL by Source	
Expected	\$ (15)
Assumptions	526
Investments	(586)
Contributions	(122)
All Else	(300)
<b>Total</b>	<b>(497)</b>

- The increases in liability associated with assumption and method changes from the experience study were more than offset by the investment gain and employer contributions.
- All other changes, including the demographic changes, resulted in lowering the liabilities by approximately \$300 thousand.

# Change in UAAL due to FYE June 30, 2021 Plan Experience



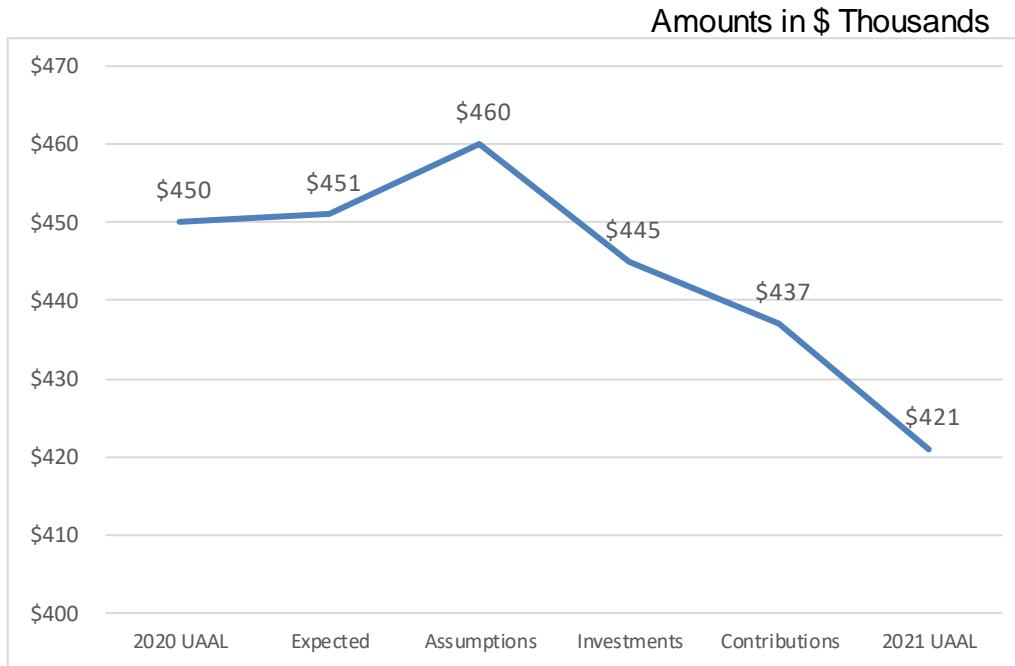
## Health Insurance Credit - Social Services Employees



Change in UAAL by Source	
Expected	\$ 6
Assumptions	241
Investments	(202)
Contributions	(44)
All Else	(159)
<b>Total</b>	<b>(158)</b>

- The increases in liability associated with assumption and method changes from the experience study were more than offset by the investment gain and employer contributions.
- All other changes, including the demographic changes, resulted in lowering the liabilities by approximately \$159 thousand.

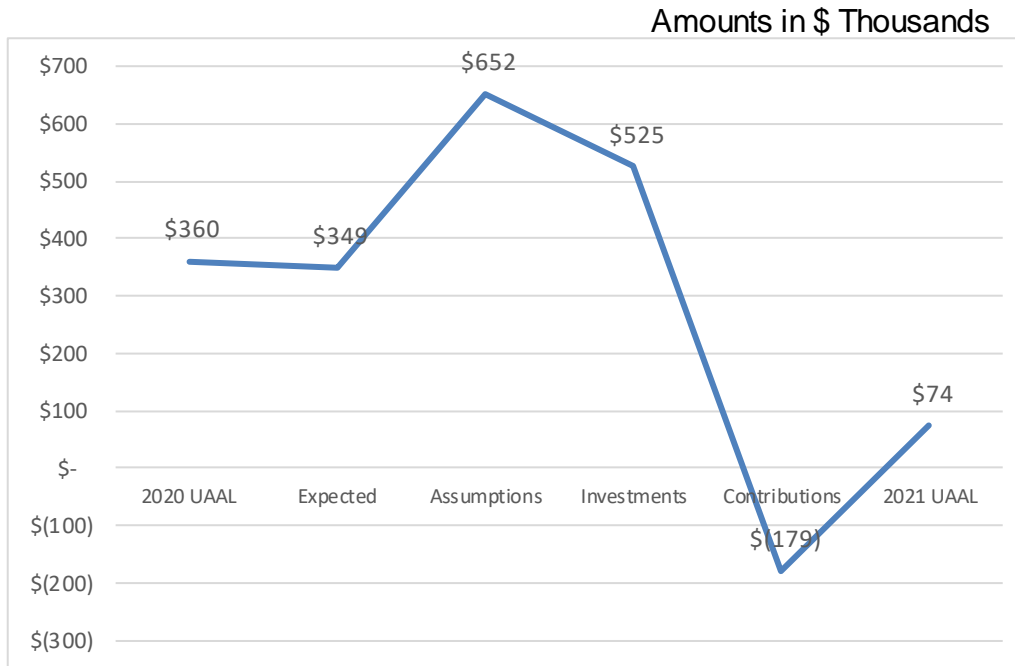
# Change in UAAL due to FYE June 30, 2021 Plan Experience Health Insurance Credit - Registrars



Change in UAAL by Source		
Expected	\$	1
Assumptions		9
Investments		(15)
Contributions		(8)
All Else		(16)
<b>Total</b>		<b>(29)</b>

- The increases in liability associated with assumption and method changes from the experience study were more than offset by the investment gain and employer contributions.
- All other changes, including the demographic changes, resulted in lowering the liabilities by approximately \$16 thousand.

# Change in UAAL due to FYE June 30, 2021 Plan Experience VLDP - Teachers

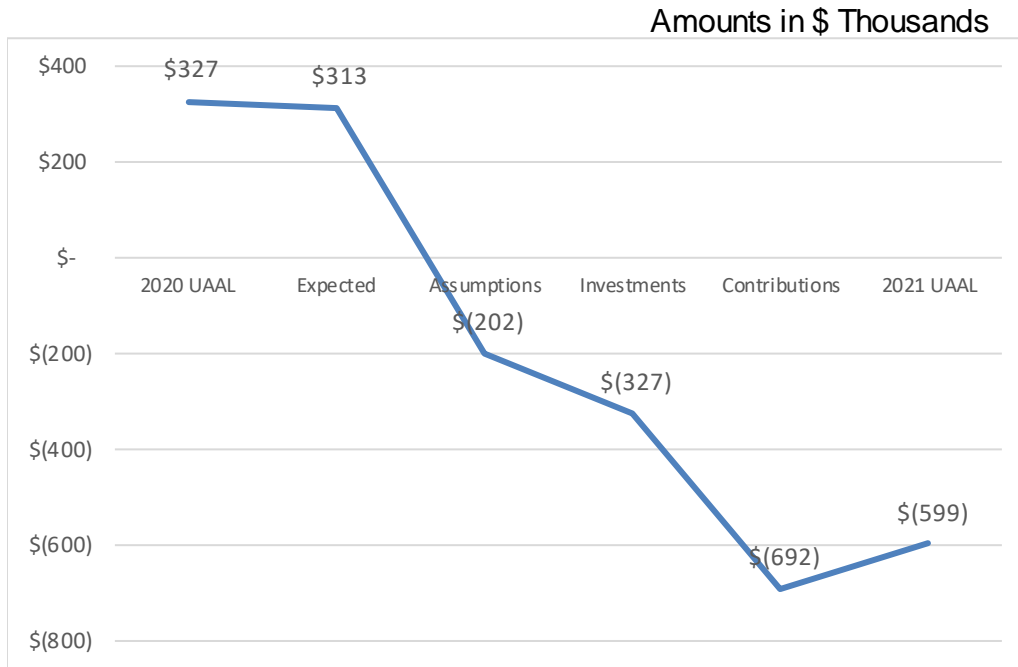


Change in UAAL by Source	
Expected	\$ (11)
Assumptions	303
Investments	(127)
Contributions	(704)
All Else	253
<b>Total</b>	<b>(286)</b>

- The increases in liability associated with assumption and method changes from the experience study were more than offset by the investment gain and employer contributions.
- All other changes, including the demographic changes, resulted in increasing the liabilities by approximately \$253 thousand.



# Change in UAAL due to FYE June 30, 2021 Plan Experience VLDP - Political Subdivisions



Change in UAAL by Source	
Expected	\$ (14)
Assumptions	(515)
Investments	(125)
Contributions	(365)
All Else	93
<b>Total</b>	<b>(926)</b>

- The decreases in liability associated with assumption and method changes from the experience study together with the investment gain and employer contributions lowered liabilities such that there is now a negative unfunded.
- Method change to mid-year decrements lowered costs due to the limited term nature of the benefit.
- All other changes, including the demographic changes, resulted in increasing the liabilities by approximately \$93 thousand.

**Thank you**



**Questions?**

# Appendix

# Detailed Results

# Pension Contribution Rates



Fiscal Years Ending June 30	2019/2020	2021/2022	2023/2024
Actuarial Valuation Date	June 30, 2017	June 30, 2019	June 30, 2021
	Board & General Assembly Approved	Board & General Assembly Approved	Submitted for Approval
<b>Pension Plan</b>			
State	13.52%	14.46%	14.13%
Teachers	15.68%	16.62%	14.76%
SPORS	24.88%	26.33%	29.98%
VaLORS	21.61%	21.90%	24.60%
JRS	34.39%	29.84%	30.67%
Political Subdivisions (Average rates)	7.60%	8.33%	8.79%

Contribution rates for retirement systems are net of 5% and 4% member contribution rates for Plan 1 and 2 and Hybrid Plan respectively.

Employer rate for Hybrid defined contribution component assumes employer match to DC portion of the Hybrid Plan based on DC rates for each individual employer observed during prior fiscal year.

# OPEB Contribution Rates



Fiscal Years Ending June 30,	2019/2020	2021/2022	2023/2024
Actuarial Valuation date	June 30, 2017	June 30, 2019	June 30, 2021
OPEB Plan	Board & General Assembly Approved	Board & General Assembly Approved	Submitted for Approval
Group Life Insurance*	1.31%	1.34%	1.19%
Health Insurance Credit (HIC) Program			
▪ State Employees	1.17%	1.12%	1.04%
▪ Teachers	1.20%	1.21%	1.21%
▪ Participating Political Subdivisions**	0.32%	0.59%	0.72%
▪ Constitutional Officers	0.38%	0.36%	0.36%
▪ Social Service Employees	0.43%	0.38%	0.37%
▪ Registrars	0.39%	0.39%	0.32%
Virginia Sickness and Disability Program (VSDP)	0.62%	0.61%	0.56%
Virginia Local Disability Program (VLDP)			
▪ Teachers	0.41%	0.47%	0.47%
▪ Political Subdivisions	0.72%	0.83%	0.85%

\* The contribution rate for GLI includes an adjustment of .34% for active group life insurance for the 2017 and 2019 valuation dates and an adjustment of .35% for the 2021 valuation date.

\*\* Average of individual rates. The contribution rate includes the impact of HB 1513 (2020).

# Unfunded Pension Liabilities



System	Unfunded Liability Using Actuarial Value of Assets (\$'s Thousands)		
	2020	2021	
		Before Assumption/Plan Changes	After Assumption/Plan Changes
State	\$ 6,417,661	\$ 5,710,835	\$ 6,112,670
Teachers	\$ 13,278,662	\$ 11,145,625	\$ 12,021,814
SPORS	\$ 325,590	\$ 330,233	\$ 389,314
VaLORS	\$ 712,025	\$ 670,421	\$ 738,351
Judicial	\$ 111,633	\$ 81,299	\$ 132,738
Total Statewide Systems	\$ 20,845,571	\$ 17,938,413	\$ 19,394,887
Locals Aggregate	\$ 3,441,151	\$ 2,536,717	\$ 3,485,332
Total Fund	\$ 24,286,722	\$ 20,475,130	\$ 22,880,219

System	Unfunded Liability using Market Value of Assets (\$'s Thousands)		
	2020	2021	
		Before Assumption/Plan Changes	After Assumption/Plan Changes
State	\$ 6,981,267	\$ 3,213,719	\$ 3,615,554
Teachers	\$ 14,385,554	\$ 6,253,529	\$ 7,129,718
SPORS	\$ 351,662	\$ 217,417	\$ 276,498
VaLORS	\$ 758,084	\$ 470,299	\$ 538,229
Judicial	\$ 128,417	\$ 8,817	\$ 60,256
Total Statewide Systems	\$ 22,604,984	\$ 10,163,781	\$ 11,620,255
Locals Aggregate	\$ 4,076,749	\$ (333,429)	\$ 615,186
Total Fund	\$ 26,681,733	\$ 9,830,352	\$ 12,235,441

The Political Subdivisions Aggregate unfunded liabilities do not include Political Subdivisions with no active members.

# Unfunded OPEB Liabilities



System	Unfunded Liability using Actuarial Value of Assets (\$'s Thousands)		
	2020	2021	
		Before Assumption/Plan Changes	After Assumption/Plan Changes
Group Life	\$ 1,677,898	\$ 1,582,751	\$ 1,389,277
HIC State	\$ 894,542	\$ 841,466	\$ 852,830
HIC Teachers	\$ 1,280,589	\$ 1,280,412	\$ 1,293,999
VSDP	\$ (256,367)	\$ (292,733)	\$ (297,276)
HIC Locals	\$ 52,204	\$ 48,028	\$ 49,554
HIC Constitutional Officers	\$ 27,069	\$ 26,046	\$ 26,572
HIC Social Services	\$ 12,646	\$ 12,247	\$ 12,488
HIC Registrars	\$ 450	\$ 412	\$ 421
VLDP Teachers	\$ 360	\$ (229)	\$ 74
VLDP Locals	\$ 327	\$ (84)	\$ (599)

System	Unfunded Liability using Market Value of Assets (\$'s Thousands)		
	2020	2021	
		Before Assumption/Plan Changes	After Assumption/Plan Changes
Group Life	\$ 1,728,029	\$ 1,304,864	\$ 1,111,390
HIC State	\$ 899,066	\$ 825,440	\$ 836,804
HIC Teachers	\$ 1,286,380	\$ 1,263,508	\$ 1,277,095
VSDP	\$ (241,350)	\$ (357,273)	\$ (361,816)
HIC Locals	\$ 52,204	\$ 48,028	\$ 49,554
HIC Constitutional Officers	\$ 27,069	\$ 26,046	\$ 26,572
HIC Social Services	\$ 12,646	\$ 12,247	\$ 12,488
HIC Registrars	\$ 450	\$ 412	\$ 421
VLDP Teachers	\$ 447	\$ (789)	\$ (486)
VLDP Locals	\$ 433	\$ (648)	\$ (1,163)





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# Virginia Retirement System Line of Duty Death and Health Benefits Trust Fund

November 16, 2021

Alisa Bennett, FSA, FCA, MAAA, EA  
*President*



# Overview

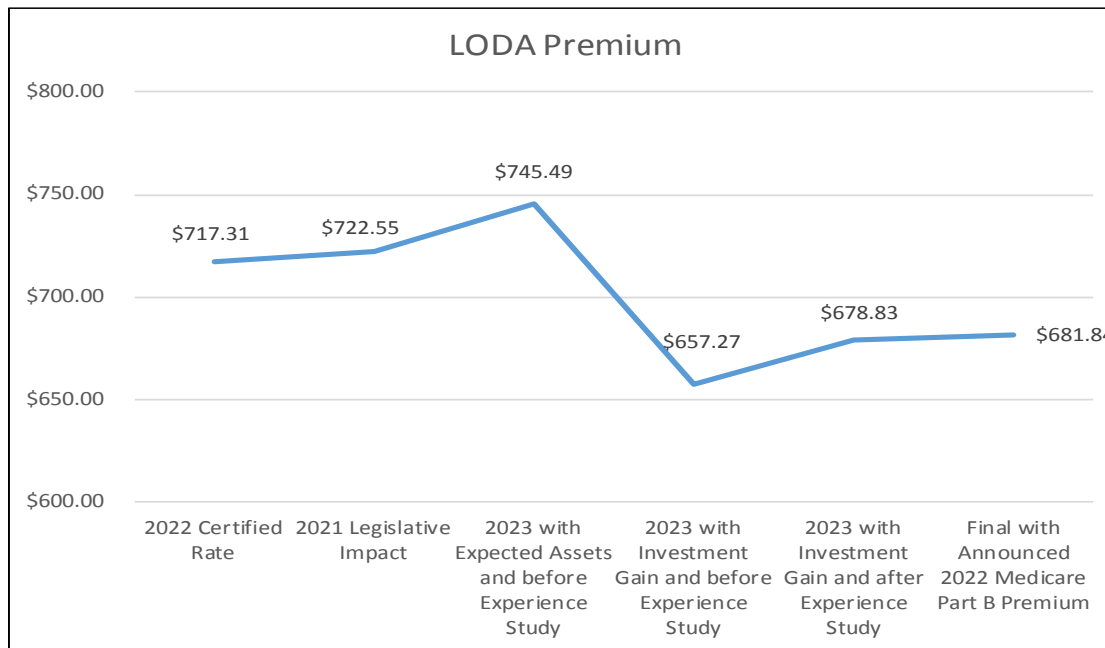


- The June 30, 2021 valuation is used to set contribution rates for fiscal years 2023 and 2024.
- Odd year valuations are for rate setting; even year valuations are for informational purposes
  - FY 2021 and 2022 rate based on June 30, 2019 valuation was \$717.31 per FTE.
  - FY 2022 rate was increased by the general assembly in response to HB 1818 and HB 2207, each of which added additional presumptions:

	Premium per FTE
Results of the June 30, 2019 Valuation Board Certified Rate	\$717.31
Add Hypertension and Heart Disease Presumptions for Eligible EMS Personnel, and Add COVID-19 as Workers' Compensation	<u>5.24</u>
Adjusted LODA Premium Rate	\$722.55

- New rate (FY 2023 and 2024) is \$681.84 per FTE.

## Change in Employer Costs per FTE due to FYE June 30, 2021 Experience and Assumption Changes



- Decrease due to large asset value as of June 30, 2021, which will be spent down over the next two years.
- Experience study assumption changes to rates of deaths and disabilities along with an unanticipated increase in Medicare Part B premium slightly raised expected premium rate.

# Development of LODA Fund Employer Costs Per FTE



## ➤ Pay-As-You-Go Funding

Section 9.1-400.1 of the *Code of Virginia* requires participating employer contributions to be determined by the Board on a current disbursement basis.

### Costs

Death and DHRM health care premium payments

HIC reimbursements (used to offset claims)

Administrative expenses

## ➤ Project benefit payments for future years.

- Covers the cost of health care premiums for current beneficiaries.
- Needs to cover the cost of any new claims that are expected to occur during the year (new health care premiums & death claims).

# Development of LODA Fund Employer Costs Per FTE



- Projected benefit payments based on:
  - Demographics of group as of June 30, 2021.
  - Health care premium rates as of June 30, 2021.
  - Health care trend assumption.
  - Actuarial assumptions for:
    - Future death and disabilities
    - Medicare eligibility, Social Security Disability Eligibility
    - Dependent Coverage
    - Mortality
- Health Insurance Credit (HIC) Program Reimbursements
  - Health Insurance Credits that would have been payable to eligible LODA beneficiaries are transferred to the LODA Fund to offset health care costs provided under the Line of Duty Act.
- Administrative Expenses
  - Assumed to be \$565,000 for fiscal year 2022 with 3% increases in the future.

# Development of LODA Fund Employer Costs Per FTE



- Employer contributions per FTE are set such that assets are expected to be sufficient to cover costs for a two-year period but will be depleted at the end of the two-year period.
- Funding on a “pay-as-you-go” basis, rather than pre-funding of benefits. LODA fund assets are expected to earn 6.75%.
- FTE counts are expected to remain level over two-year period.
- LODA Fund contributions are likely to increase annually.
  - Current disbursement basis (no advance-funding).
  - Dollar per FTE employee contribution basis.
  - Health care inflation (increasing cost basis).
  - Increasing number of beneficiaries/static FTE employee count.

# Costs – Health Care



FY 2022				
Membership Level	LODA Plan Current LODA Employment	LODA Plan Former LODA Employment	Medicare Primary	Medicare Part B Premium
Single	\$1,016	\$1,049	\$293	\$170.10
Two Person	\$1,733	\$1,764	N/A	N/A
Family (3 or more family members)	\$2,458	\$2,486	N/A	N/A

FY 2021				
Membership Level	LODA Plan Current LODA Employment	LODA Plan Former LODA Employment	Medicare Primary	Medicare Part B Premium
Single	\$948	\$979	\$283	\$148.50
Two Person	\$1,618	\$1,647	N/A	N/A
Family (3 or more family members)	\$2,295	\$2,321	N/A	N/A

- For pre-Medicare members premiums increased roughly 7% as expected
- For Medicare eligible members premiums increased 3.5% vs. 5.375% expected
- Projected 2022 Medicare Part B premium increased roughly 14.5% from \$148.50 to \$170.10. This was more than expected.

- No explicit changes were incorporated at this time for COVID-19 due to the level of uncertainty regarding the impact on both plan costs and contribution levels going forward
  
- Potential Impacts:
  - Routine and elective care being deferred
    - Deferrals offset COVID-19 costs for 2020 but could increase costs in 2021 and 2022 due to pent up demand.
  - Direct COVID-19 treatment and prevention costs – still an ongoing situation
  - Addition of COVID-19 to Workers' Compensation presumptions
  - Potential for long term effects on both health costs and disabilities



# FY 2021 Financial Activity



		Amount
1	Accrued Assets as of June 30, 2020	\$ 4,333,000
2	Benefit Payments	\$ 13,094,000
3	Administrative Expenses (includes opt-out members)	979,000
4	<i>Total Expenses (2 + 3)</i>	<u>\$ 14,073,000</u>
5	Employer Contributions	\$ 13,633,000
6	Miscellaneous Revenue (includes reimbursement for opt-out members)	629,000
7	Investment Income	3,031,000
8	<i>Total Revenue (5 + 6 + 7)</i>	<u>\$ 17,293,000</u>
9	Revenue Less Expenses (8 - 4)	\$ 3,220,000
10	Accrued Assets as of June 30, 2021 (1 + 9)	\$ 7,553,000

# Overview - Assets



- Asset balance has been growing over the last two years.
- \$3 million in investment income during FY 2021.
- Since the plan is pay-as-you go, the funding mechanism is to spend down the \$7.5 million balance over the next two years, causing a drop in the proposed FTE rate.
- The FTE rate is projected to start increasing again after the two-year period since the assets are projected to go to \$0.

# Population – Participating Employee Headcount



Employer Group	Fiscal Year Ending 2020		Fiscal Year Ending 2021			
	Employees	FTE Employees	Employees	Weight	FTE Employees	FY 2022 Contributions*
State/VaLORS/SPORS	9,707	9,707.00	9,577	100%	9,577	\$ 6,919,861
National Guard						
Full-Time	1,873	1,873.00	1,044	100%	1,044.00	\$ 1,297,845
Part-Time	6,333	633.30	7,522	10%	752.20	
<i>Total State &amp; National Guard Employees</i>	<i>17,913</i>	<i>12,213.30</i>	<i>18,143</i>		<i>11,373.20</i>	<i>\$ 8,217,706</i>
Participating Political Subdivisions						
Full-Time	7,171	7,171.00	7,106	100%	7,106.00	\$ 5,134,440
Volunteers	2,419	604.75	2,432	25%	608.00	\$ 439,310
<i>Total Political Subdivision Employees</i>	<i>9,590</i>	<i>7,775.75</i>	<i>9,538</i>		<i>7,714.00</i>	<i>\$ 5,573,750</i>
<b><i>Aggregated Total</i></b>	<b><i>27,503</i></b>	<b><i>19,989.05</i></b>	<b><i>27,681</i></b>		<b><i>19,087.20</i></b>	<b><i>\$ 13,791,456</i></b>

\* FY 2022 contribution rate of \$722.55 per FTE employee based upon June 30, 2019 valuation including increases due to legislation

# Population – Number of Current Health Care Beneficiaries

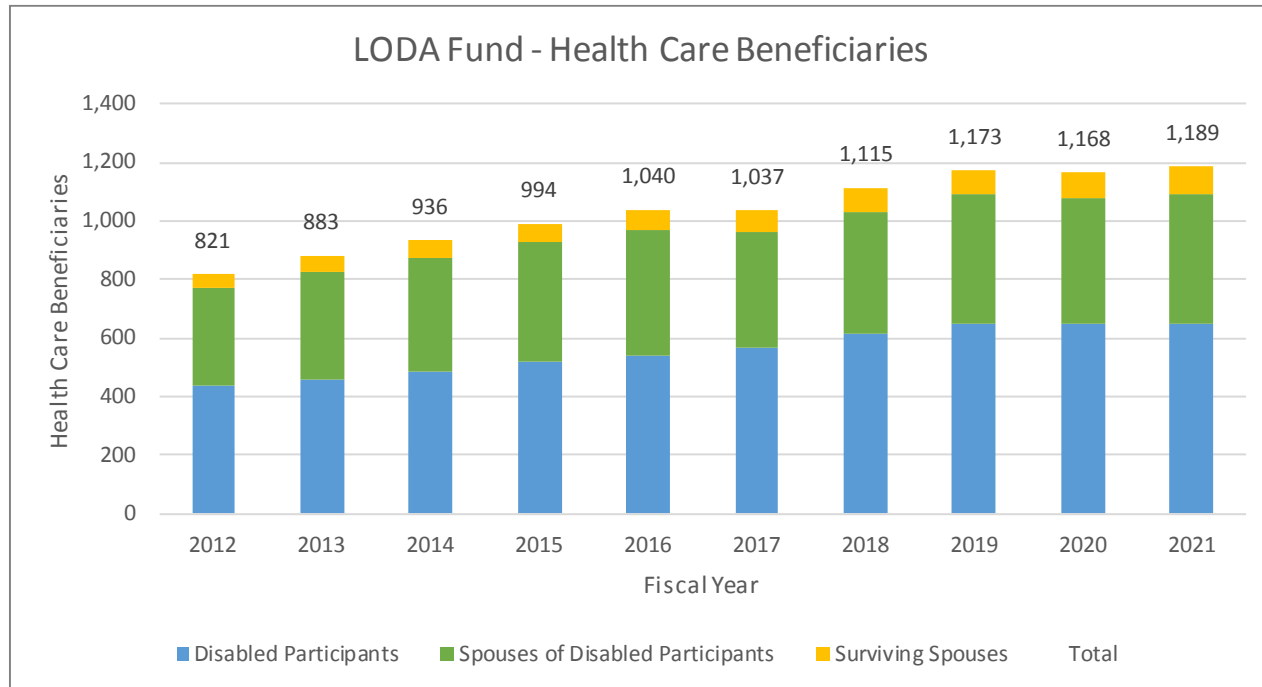


Participating Employer Groups as of June 30, 2021			
Beneficiary Type	State	Political Subdivisions	Aggregated Total
Disabled Participants	250	403	653
Spouses of Currently Disabled Participants	162	278	440
<u>Surviving Spouses</u>	<u>39</u>	<u>57</u>	<u>96</u>
<b>Total</b>	<b>451</b>	<b>738</b>	<b>1,189</b>

Participating Employer Groups as of June 30, 2020			
Beneficiary Type	State	Political Subdivisions	Aggregated Total
Disabled Participants	255	395	650
Spouses of Currently Disabled Participants	164	265	429
<u>Surviving Spouses</u>	<u>40</u>	<u>49</u>	<u>89</u>
<b>Total</b>	<b>459</b>	<b>709</b>	<b>1,168</b>

As some beneficiaries elect to cover dependents, assumed adult costs include the additional costs for the coverage of dependent children.

# Population – Number of Current Health Care Beneficiaries



- Disabled participants increased by an average of 26 each fiscal year from 2013 – 2020. Fiscal year 2021 had a net increase of 3 disabled participants.
- Total beneficiaries increased by an average of 43 each fiscal year from 2013 – 2020. Fiscal year 2021 had a net increase of 21 beneficiaries.

# Summary of Results

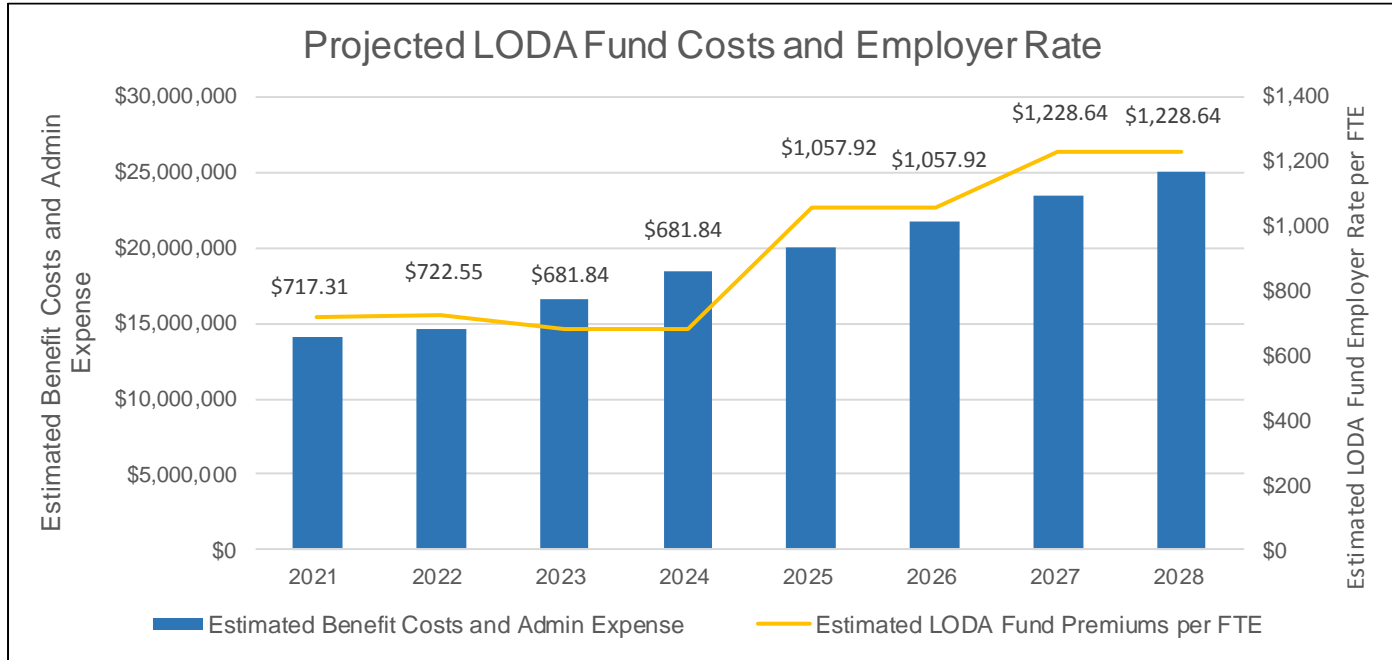
*Estimated per FTE Employee Rates - Pay-As-You-Go Funding*



- The June 30, 2021 valuation is used to set contribution rates for fiscal years 2023 and 2024.
- Comparison of valuation results:

Valuation Date	June 30, 2019 (Board Approved)	June 30, 2020	June 30, 2021
Fiscal Year(s)	2021 and 2022	Informational	2023 and 2024
Number of FTE Employees	19,243	19,989	19,087
Contribution per FTE Employee	\$717.31 and \$722.55	\$758.03	\$681.84

# Projected Cost Estimates



# Thank You



# Questions?



# Appendix

# Projected Cost Estimates

## Actual Employer Contribution Rates



All Participating Employer Groups - June 30, 2021 Valuation Basis								
	Actual	Projected						
	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
FTE Employees	19,989.05	19,087.20	19,087.20	19,087.20	19,087.20	19,087.20	19,087.20	19,087.20
Cash Flow (Per FTE Employee)								
Employer Contribution Rate	\$717.31	\$722.55	\$681.84	\$681.84	\$1,057.92	\$1,057.92	\$1,228.64	\$1,228.64
Benefit Costs	(655.11)	(738.42)	(840.46)	(935.31)	(1,018.65)	(1,103.43)	(1,194.65)	(1,275.85)
Administrative Expenses	(49.00)	(29.60)	(30.49)	(31.38)	(32.33)	(33.32)	(34.32)	(35.36)
Investment Income and Misc. Rev	<u>183.14</u>	<u>49.56</u>	<u>43.62</u>	<u>30.56</u>	<u>35.94</u>	<u>35.94</u>	<u>41.46</u>	<u>41.46</u>
Net Cash Flow	196.34	4.09	(145.49)	(254.29)	42.88	(42.89)	41.13	(41.11)
Cash Flow								
Employer Contributions	\$13,632,927	\$13,791,456	\$13,014,453	\$13,014,453	\$20,192,792	\$20,192,792	\$23,451,235	\$23,451,235
Benefit Costs	(13,094,992)	(14,094,421)	(16,041,981)	(17,852,481)	(19,443,202)	(21,061,347)	(22,802,536)	(24,352,467)
Administrative Expenses	(979,427)	(565,000)	(582,000)	(599,000)	(617,000)	(636,000)	(655,000)	(675,000)
Investment Income and Misc. Rev	<u>3,660,865</u>	<u>945,975</u>	<u>832,489</u>	<u>583,361</u>	<u>685,982</u>	<u>685,982</u>	<u>791,267</u>	<u>791,267</u>
Net Cash Flow	\$3,219,373	\$78,010	(\$2,777,040)	(\$4,853,668)	\$818,572	(\$818,573)	\$784,965	(\$784,965)
End of Year Net Position	\$7,552,697	\$7,630,707	\$4,853,667	\$0	\$818,572	\$0	\$784,965	\$0

\*Reflects estimated reduction in costs from HIC receipts.

*Note: this chart details the computation of the projected future rates as show the chart on slide 13.*

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## Report

The Administration and Personnel Committee met on November 16, 2021 and discussed the following:

### **APPROVAL OF MINUTES**

The Committee approved the minutes of its September 15, 2021 meeting.

### **APPOINTMENT OF DEFINED BENEFIT CONTRIBUTION PLANS ADVISORY COMMITTEE MEMBER**

Trish Bishop, Director, informed the committee that a new appointment to the DCPAC has been identified. Mr. Ned Smither, County Administrator for Powhatan County, has been nominated to fill the unexpired term of Ms. Kathy Seay.

The Committee recommends approval of the following action to the full Board:

***Request for Board Action:*** *The Board approves the appointment of Mr. Edward N. “Ned” Smither to the Defined Contribution Plans Advisory Committee to fill the unexpired term of Kathleen T. Seay, which ends June 20, 2022.*

### **PERSONNEL DISCUSSION**

O’Kelly E. McWilliams, III advised the committee of the forthcoming retirements of the Chief Investment Officer, Ron Schmitz, and the Chief Financial Officer, Barry Faison. Mr. Schmitz joined VRS in October 2011 and has overseen significant growth to the fund while navigating substantial market shifts. Mr. Schmitz will remain with VRS through the end of 2022.

Mr. Faison has served VRS for more than 42 years, including as Chief Financial Officer since December 2001. During Mr. Faison’s tenure, VRS has received the prestigious Government Finance Officers Association of the United States and Canada (GFOA) Certificate of Achievement for Excellence in Financial Reporting for 39 consecutive years. Mr. Faison intends to retire effective July 1, 2022.

The contributions and leadership provided to VRS and the Commonwealth by Mr. Schmitz and Mr. Faison have been immeasurable. VRS is grateful for their service.

Korn Ferry has been hired to lead the national search for VRS’ next CIO. An executive search firm will also be engaged to lead the national search for VRS’ next CFO.

### **QUARTERLY BUDGET UPDATE**

Ms. Bishop reviewed the quarterly budget report with the committee. A copy of the report was also provided to the Committee for its review.

Submitted to the Board of Trustees on November 16, 2021.

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O’Kelly E. McWilliams, III, Chair  
Administration and Personnel Committee



**Appointment of DCPAC member.**

---

**Requested Action**

The Board appoints Edward N. (Ned) Smither to the Defined Contribution Plans Advisory Committee (DCPAC) to fill the unexpired term of Kathleen T. Seay, which ends June 20, 2022.

**Rationale for Requested Action**

Ms. Seay resigned from the DCPAC prior to the end of her current term, which expires on June 20, 2022.

Mr. Smither, who most recently served as the director of finance for Henrico County, began serving as Powhatan County Administrator on August 1, 2020. As County Administrator, human resources and benefits fall under his purview.

Mr. Smither has more than 16 years of local government experience, and in his prior work at Henrico County Mr. Smither was responsible for the management and supervision of the divisions of real estate assessment, management and budget, accounting, purchasing and risk management. Prior to his time at Henrico, Mr. Smither provided financial advisory banking services to many counties within the Commonwealth, assisting with the development of comprehensive 10-year financial plans designed to provide the framework for future operating and capital improvement budget planning.

Mr. Smither earned his undergraduate degree and his Master of Business Administration degree from the University of Richmond.

Mr. Smither is highly qualified and willing to be appointed to the DCPAC, and it is the Board's pleasure to appoint him to the Committee.

**Authority for Requested Action**

*Code of Virginia § 51.1-124.26* authorizes the Board to appoint such other advisory committees as it deems necessary. Each member appointment requires a two-thirds vote of the Board, and advisory committee members serve at the pleasure of the Board.

The above action is approved.

---

O'Kelly E. McWilliams, III, Chair  
VRS Board of Trustees

---

Date

Ned Smither was named County Administrator of Powhatan County in 2020 and oversees the operations of Powhatan's \$130,000,000 annual budget and 250 general government staff. Smither came to Powhatan after an extensive career in public finance including eighteen years in local government and eighteen years as an investment banker in the municipal bond financial advisory and underwriting arena. Prior to joining Powhatan as their County Administrator, Smither served as the Director of Finance for Henrico County, overseeing Henrico's \$390 million debt portfolio and the financial operations of one of Virginia's leading counties. During his tenure as Director of Finance, he managed the issuance of over \$1 billion in debt and a rating upgrade of the County's Water and Sewer operations.

Smither served as a director on the VACo/VML Pooled OPEB Trust Board of Directors and currently serves as the Chairman of the Lewistown Commerce Center Community Development Authority in Hanover County.

Smither received both his bachelor's degree and his MBA from the University of Richmond and lives in Mechanicsville with his wife Sandy.

## MEMORANDUM

DATE: 11/16/2021

TO: VRS Board of Trustees  
Ronald D. Schmitz, CIO

FROM: Dan Whitlock, Director of Global Equity  
Stephen Adelaar, Portfolio Manager – Global Equity

SUBJECT: Fiscal Year 2021 Corporate Governance Report

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This memorandum will serve as the Corporate Governance Report for Fiscal Year 2021. In September 2018, The Board of Trustees adopted a revised Proxy Voting and Securities Litigation Policy (see Exhibit 1). The policy's guiding principle for proxy voting and securities litigation activity is an emphasis on fiduciary responsibility, only taking actions that are in the best interest of the plan's participants and beneficiaries. The policy mandates that a proxy voting provider vote all proxies with allowable exceptions including comingled or mutual funds and certain separate accounts where proxy voting is part of the firm's investment strategy.

### Proxy Voting

Institutional Shareholder Services, Inc. (ISS) continues to be the proxy research and implementation provider for VRS. ISS is currently owned by Deutsche Börse AG, a German financial marketplace exchange that offers listing and trading services. In November 2020, Deutsche Börse acquired a majority stake in ISS from private equity firm Genstar Capital. During FY2021, staff reviewed and evaluated the services provided by ISS and determined that these services continue to meet the needs of VRS (see Exhibit 2 for ISS U.S. proxy voting guidelines).

As of June 30, 2021, nine out of fourteen of Public Equity's external traditional mandates used ISS for proxy voting. Including internal mandates, ISS handled the proxies for 62% of Public Equity's market value. Managers who do not use ISS are noted in Exhibit 3.

### Securities Litigation

Under independent authority granted to VRS in the Appropriation Act to enter into agreements to seek legal advice related to its investments outside the OAG appointment process, VRS appointed the law firms of Bernstein Litowitz Berger & Grossman LLP (Bernstein Litowitz), Cohen Milstein Sellers & Toll PLLC (CohenMilstein), Kessler Topaz Meltzer & Check LLP (Kessler Topaz), and Labaton Sucharow LLP (Labaton) effective December 1, 2017. Each of the agreements have a term of two years, with automatic renewals for up to four additional one-year terms unless terminated by written

notice by either VRS or the law firm. All four firms have been renewed for a one-year term ending November 30, 2022.

The Office of the Attorney General (OAG) recently appointed eight firms to provide domestic securities litigation services to VRS for a period beginning December 1, 2020 and running through November 30, 2022. Bernstein Litowitz, CohenMilstein, Kessler Topaz and Labaton are included in the list of firms appointed by OAG.

The firms work closely with VRS' custodians – Bank of New York Mellon, Goldman Sachs, and State Street Bank & Trust to monitor the VRS investment portfolio to:

- Inform VRS about newly filed securities class actions and whether and to what extent VRS has sustained a loss with respect to the affected securities;
- Inform VRS about settled or adjudicated securities class actions; and
- Provide legal advice and representation about prosecution of securities claims.

VRS has not been the lead plaintiff in any U.S. securities litigation matters other than Escala in 2006 and MF Global in 2012, but VRS continues to participate monetarily in the settlement of U.S. class action litigation by filing proofs of claim, monitoring payments, etc.

Bank of New York Mellon reported that VRS received class action proceeds totaling \$3,171,235 during FY2021 on behalf of the defined benefit plan. These proceeds were related to separate accounts where Bank of New York Mellon serves as the custodian. Investments in long-only equity comingled funds involving other custodial relationships resulted in \$24,908 of proceeds. Our long/short equity accounts that use Goldman Sachs as a prime broker received class action proceeds totaling \$47,049 on behalf of the defined benefit plan. BlackRock reported as a unit holder of various BlackRock collective trust funds, the VRS defined contribution accounts pro-rata share of class action proceeds totaled \$59,109.

Since the Supreme Court case of *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), investors such as VRS have not had the protection of the U.S. securities laws if the securities were purchased on a foreign exchange. Given the new realities of global securities litigation after *Morrison*, VRS has adapted and continues to adapt to the new and varying challenges of monitoring its portfolio to ensure that non-U.S. opportunities to recover assets based on securities fraud are not lost. For example, with the assistance of outside counsel, VRS takes a conservative approach by participating in cases in select foreign jurisdictions where such participation is similar to the claims filing process in domestic actions. Also, VRS only participates in foreign securities litigation in those jurisdictions that either do not involve a risk that VRS would be liable for expenses if the litigation is unsuccessful (i.e., no “loser pays” rule) or where the litigation funder fully indemnifies VRS for any potential “loser pays” costs. In such jurisdictions, VRS assumes a passive role in its participation in the case after an initial filing of transactional data supporting the VRS claim.

VRS joined 5 non-U.S. cases and received approximately \$1.2 million in proceeds from non-U.S. cases during FY2021, and we are participating passively in 15 other non-U.S. cases for which the recovery amounts have not yet been determined.

### Investor Organizations

VRS continues to be a non-voting member of the Council of Institutional Investors (CII) and staff continues to view the organization as a cost-effective resource for research on corporate governance issues. CII members consist of representatives from public and private pension plans, foundations, endowments, mutual funds, insurance companies, and international institutional investors with member assets over three trillion dollars. The organization is well respected among regulatory bodies and government leaders. The diversity of its membership affords thought provoking debate on corporate governance issues. Because of the depth of its membership, quality of data, and timely dissemination of information, staff still believes that participation in other corporate governance organizations is not necessary at this time.



**BOARD OF TRUSTEES’  
PROXY VOTING AND LITIGATION POLICY**

GUIDING PRINCIPLE

The guiding principle for the Virginia Retirement System’s (“VRS”) proxy voting and litigation activity is fiduciary responsibility, only taking actions that are in the best interest of the plan's participants and beneficiaries.

***I. POLICY STATEMENT***

***A. PROXY VOTING***

It is the policy of VRS to review all proxy issues carefully and to vote them in the best interest of the participants and beneficiaries of the fund. The Board should review a report on VRS proxy voting from time to time, which includes an evaluation of any outside Proxy Voting Service Provider.

***B. VRS AS LONG-TERM INVESTOR***

VRS should act like an owner of companies in which it invests by encouraging long-term value creation. However, the costs of becoming an active investor must be considered. VRS should always seek cost-effective means for acting as an owner. VRS can share the costs of any shareholder activism by joining organizations made up of other similar institutional investors who are also concerned about creating and improving economic value for shareholders.

***C. LITIGATION***

Other than cases brought under the Virginia Administrative Process Act,<sup>1</sup> the most common type of litigation that affects VRS directly is securities litigation class actions for investments in which VRS has incurred a loss. From time to time other types of litigation will arise, including cases where VRS is a defendant and cases brought under the Virginia Fraud Against Taxpayers Act (§ 8.01-216.1, et seq., of the *Code of Virginia*). While VRS acknowledges that there are situations that may give rise to a fiduciary duty to pursue legal action on its own to recover on a claim, VRS also places significant weight on the fact that

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<sup>1</sup> Article V, section A (2) of the Board Governance Policy delegates authority to the Director to issue final case decisions regarding applications for disability retirement and other matters that have been appealed pursuant to the Administrative Process Act.

most (if not all) of these domestic claims will be prosecuted by class action attorneys on behalf of a multitude of institutional investors, whether or not VRS undertakes an active role. Consequently, the default position for VRS in connection with domestic securities litigation is to simply file claims in connection with the settlement of securities litigation class action matters based on VRS holdings in the affected securities.

VRS will consider an active role in securities litigation typically in those cases where (i) VRS has experienced a significant loss related to illegal conduct, fraud, or willful wrongdoing, (ii) active involvement could provide added value to VRS (e.g., in the form of a higher recovery than if VRS was not involved), either in the specific case or on a longer-term, portfolio-wide basis, or (iii) in the case of foreign litigation where active involvement is the only avenue for recovery. For the purposes of this policy and as a general guideline, a loss is significant when it exceeds three basis points of the total fund value (“Loss Threshold”). The decision to take an active role in any securities litigation requires a balancing of the costs and benefits involved.

In considering whether to take an active role in securities litigation, VRS should also assess the long-term consequences of litigation as well as the impact of litigation on staff productivity. VRS will appoint outside counsel with expertise in securities litigation to assist in determining whether fraud or willful wrongdoing has occurred in connection with the acquisition or ownership of its investments. Outside counsel will identify significant cases that should be brought to the Board’s attention and, if the Board decides to take an active role in the case, to help evaluate an appropriate litigation strategy.<sup>2</sup>

The landscape of United States securities laws drastically changed with the Supreme Court decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010). Under *Morrison*, investors no longer have the protection of the U.S. securities laws if the securities were purchased on a foreign exchange. After the *Morrison* decision, it is no longer possible to pursue a recovery in securities litigation in a foreign jurisdiction as a “free rider” as part of a class action, and an affirmative decision to participate in the class is typically required. Generally, in cases pending in foreign jurisdictions, VRS will only consider recovery methods that do not involve a risk that VRS would be liable for any expenses if the litigation were unsuccessful. For example, in most cases, VRS would not consider pursuing recovery in a foreign jurisdiction where the losing party in litigation pays the prevailing party’s fees and costs. However, VRS might consider such foreign litigation if there was insurance in place to cover the potential “loser pays” liability.

On relatively rare occasions, other types of litigation affect VRS that are not related to securities litigation for investments in which VRS has incurred a loss. For example, VRS may be a defendant in litigation, and the outcome of the litigation could affect the assets in the trust fund. While these types of cases are relatively rare and arise under unique facts

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<sup>2</sup> See “Selection of Counsel” in section II (C) (2).

and circumstances, the same guiding principle applies to the strategic decisions that may be involved in their resolution.

## **II. GUIDELINES**

### **A. PROXY VOTING**

VRS should contract out the development of proxy voting positions to a Proxy Voting Service Provider. The decision by VRS staff to hire an outside Proxy Voting Service Provider should be based on a thorough review of the provider's proxy voting policies. These proxy voting policies must be based on sound economic analysis and research of proxy issues and driven solely by the objective of enhancing and protecting shareholder returns. VRS staff should review and evaluate the Proxy Voting Service Provider used by VRS from time to time.

Generally, VRS policy mandates that the Proxy Voting Service Provider vote all proxies. Exceptions to this policy include commingled or mutual funds where proxy policies are part of the fund documentation and certain separate accounts where proxy voting is part of the firm's investment strategy. VRS staff should review the proxy voting policies of such managers for overall reasonableness and should use the results of this review as a manager evaluation criterion.

VRS staff should provide to the Board from time to time a review and evaluation of the VRS Proxy Voting Service Provider.

### **B. VRS AS LONG-TERM INVESTOR**

It is expected that VRS will align itself with certain oversight organizations with an eye toward creating and improving economic value for shareholders. This will provide VRS with access to multiple, cost-effective tools for promoting good corporate governance at portfolio companies and for monitoring regulatory organizations such as the Securities and Exchange Commission. Moreover, membership will provide information and analysis about corporate governance issues, best practices and solutions going forward.

### **C. LITIGATION**

#### **1. Filing Proofs of Claim**

The VRS custodial bank is responsible for filing all proofs of claim, including the necessary supporting documents and information, in every securities class action pending in the U.S. in which VRS has an interest (the "Claims Filing"). To memorialize the custodian's Claims Filing responsibilities, the Chief Investment Officer ("CIO") shall prepare and revise, as appropriate, a statement of work to be included with the custodial

agreement setting out formal Claims Filing procedures for the custodial bank to follow. These procedures shall include:

- i. Identifying and reviewing all class action recoveries (whether by settlement or trial)
- ii. Providing timely notice of each settlement recovery, with sufficient time to allow VRS to opt out
- iii. Filing complete and accurate proof of claim forms in a timely fashion on behalf of VRS
- iv. Providing quarterly reports regarding these efforts
- v. Providing quarterly reports identifying all securities litigation proceeds recovered by VRS directly or on its behalf

Alternatively, the VRS Board may elect to use a third-party vendor to be responsible for the Claims Filing activities.

## **2. Selection of Counsel**

VRS has undertaken an open procurement process to select a number of outside counsel firms to provide legal advice related to investments, and has entered into contractual agreements with each of the firms. Pursuant to this policy, VRS staff is authorized to select which of these firms should assist with a specific action depending on the facts and circumstances of each case. Criteria may include the firm's expertise in a particular area of law, the firm's analysis of a specific case, or the firm's recommended strategy.

## **3. Class Actions – Securities Listed on a Domestic Exchange**

The Board desires to create an evaluation policy that provides guidance regarding when and how VRS will become actively involved in domestic securities litigation, including seeking lead plaintiff status. The VRS Board adopts this policy to place itself, the CIO and the Director, with the advice of counsel, in the best position to identify, protect, and serve the best interests of VRS.

The following is an outline of the procedures to assist in decisions regarding domestic securities litigation issues.

### **i. Monitoring and Evaluation Procedures**

VRS may retain a vendor specializing in identifying and analyzing potential and existing securities cases to perform this function, and to report its findings on a timely basis. VRS also retains law firms as outside counsel to monitor and advise VRS of recently-filed

class actions that appear to have merit and for which VRS has sustained a loss that (i) exceeds its Loss Threshold or (ii) is substantial and involves unique factors justifying the involvement of VRS regardless of the Loss Threshold.

When a case meets the Loss Threshold for active management, VRS staff, in consultation with the office of the Attorney General (“OAG”) and outside counsel, shall evaluate whether the class action is meritorious and deserves closer examination. The evaluation shall include a review of available information regarding the lawsuit before considering whether to seek lead plaintiff status or embark on some other active claim management strategy (e.g., opting out of the class and pursuing a separate claim).

ii. Decision-making Process

Absent a loss exceeding the Loss Threshold or unusual and compelling circumstances, the VRS Board will not consider pursuing any active claim management strategy for any given case without the concurrence of the Office of the Attorney General (“OAG”). VRS staff should work with outside counsel to evaluate securities litigation options available to VRS on a case-by-case basis. VRS may also engage other vendors to monitor and identify potential securities litigation cases. These outside entities should forward material pertaining to such cases to VRS for further review and evaluation under the guidance contained in this policy.

The VRS Board will only consider taking an active role in litigation in accordance with the “Monitoring and Evaluation Procedures” described above.

If these initial criteria are met, VRS staff should coordinate its analysis with outside counsel to ensure that the situation meets the VRS criteria. If so, VRS staff and outside counsel should forward relevant information and a recommended course of legal action to VRS investment staff for review and evaluation consistent with the guidance contained in this policy. Following this review and evaluation, VRS staff should only forward a recommendation to pursue legal action to the VRS Board for those cases that are considered appropriate under this policy.

In most cases, decisions regarding a given case must be submitted, in advance, to the VRS Board at a regular meeting or, where immediate action is necessary, at a special meeting. However, where it is determined that immediate action is required in order to preserve the rights or interests of VRS by such involvement, and the matter cannot be timely presented at a regular or special meeting, or where a quorum cannot be reached at such meeting, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair’s designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting. This procedure may also be used for other

time-sensitive decisions related to securities litigation where it is deemed in the best interests of the plan to do so, to the extent such decisions are in conformance with this policy.

If the VRS Board (or its designees under this policy) approves a recommendation to pursue an active role in a given case, VRS will work with outside counsel to pursue an agreed-upon litigation or active claim management strategy.

The VRS Board should receive an annual report on the total asset recoveries from securities litigation received during the year, including a status report on any litigation in which VRS is the lead plaintiff.

iii. Settlement or Other Disposition/Resolution

In most cases, decisions to settle a case or to pursue other disposition or resolution in a given case will be submitted, in advance, to the VRS Board at a regular meeting or, where immediate action is necessary, at a special meeting. However, where it is determined that immediate action is required in order to preserve the rights or interests of VRS by such involvement, and the matter cannot be timely presented at a regular or special meeting, or where a quorum cannot be reached at such meeting, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair's designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting.

**3. Class Actions – Securities Listed on a Foreign Exchange**

Given the new realities of global securities litigation after *Morrison*, VRS must adapt to the new challenges of monitoring its portfolio to ensure that opportunities to recover assets based on securities fraud are not lost. This includes the analysis of whether to participate in an action in a foreign jurisdiction or to bring a state law action.

i. Participation in a Foreign Action

Unlike the class action process in the United States where investors can remain absent, receive notice of a settlement, and then decide to file a proof of claim or opt-out of the class case, foreign actions generally require investors to join as named plaintiffs or “opt-in” at the commencement of the case. This “opt-in” process will require affirmative decisions by VRS early in the process to join the case (and sometimes prior to the case being filed) to recover anything on its losses.

There are select foreign jurisdictions such as Australia, Japan and possibly other emerging jurisdictions where participation is very similar to the claims filing process in

domestic actions. For example, participation does not involve a risk that VRS would be liable for expenses if the litigation is unsuccessful (i.e., no “loser pays” rule or the risk is assumed by a third party), and VRS could assume a passive role in its participation in the case after an initial filing of transactional data supporting the VRS claim. Under those circumstances, the Loss Threshold does not come into play as the only way for VRS to participate in a foreign case to maximize its potential recovery on actionable losses is to take affirmative action.

In the case of jurisdictions (such as Australia and Japan) where participation in a foreign action does not involve a risk that VRS would be liable for expenses if the litigation is unsuccessful, VRS staff should obtain assurances and recommendations from its outside counsel and the OAG in the review and evaluation of foreign actions in those jurisdictions. In cases where there is no risk that VRS will be liable for expenses in the event of a loss, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair’s designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision to participate in a foreign action. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting. Consistent with the *Code of Virginia*, VRS staff will coordinate its efforts with OAG or the Governor’s Office as appropriate under the circumstances.

ii. Participation in State Law Action

Another option that is sometimes available with a foreign loss is to bring an action under state law in the United States. Because there are numerous issues that must be considered beforehand, the VRS Board should consider an action under state law only under very rare circumstances and after extensive consultation with staff, OAG, and outside counsel. In most cases, decisions regarding bringing a state law action related to a given foreign case will be submitted, in advance, to the VRS Board at a regular meeting or, where immediate action is necessary, at a special meeting. However, where it is determined that immediate action is required in order to preserve the rights or interests of VRS by such involvement, and the matter cannot be timely presented at a regular or special meeting, or where a quorum cannot be reached at such meeting, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair’s designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting.

iii. Settlement or Other Disposition/Resolution

In most cases, decisions to settle a case or to pursue other disposition or resolution in a given case will be submitted, in advance, to the VRS Board at a regular meeting or, where immediate action is necessary, at a special meeting. However, where it is determined

that immediate action is required in order to preserve the rights or interests of VRS by such settlement or other disposition, and the matter cannot be timely presented at a regular or special meeting, or where a quorum cannot be reached at such meeting, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair's designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting.

iv. Monitoring Procedures

VRS recognizes the importance of developing a protocol to stay informed and make prudent decisions relating to its involvement in foreign actions. VRS will use outside counsel and other entities to assist in monitoring foreign actions. This will ensure that VRS has the greatest possible visibility into applicable deadlines so VRS can make a timely and informed decision on whether to participate in a given foreign action and in what manner such participation will occur.

The VRS Board should receive an annual report on the total asset recoveries from foreign securities litigation received during the year.

**4. Other Litigation**

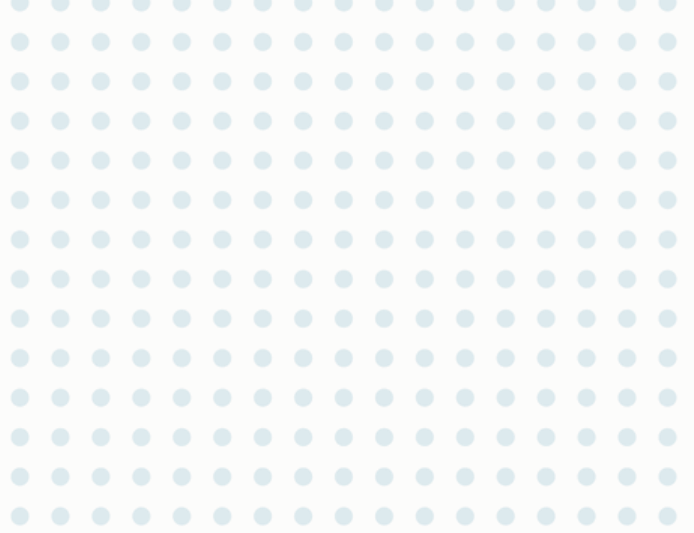
In all other types of litigation, with the exception of cases under the Administrative Process Act, such as those cases where VRS is a defendant and settlement negotiations may be ongoing, VRS staff will submit recommendations for actions (e.g., approval of a settlement), in advance, to the VRS Board at a regular meeting or, where immediate action is necessary, at a special meeting. However, where it is determined that immediate action is required in order to preserve the rights or interests of VRS, and the matter cannot be timely presented at a regular or special meeting, or where a quorum cannot be reached at such meeting, the Chair of the VRS Board (or if the Chair is not available, the Vice Chair or the Chair's designee), after consultation with the Director and CIO, and with the advice of counsel, is authorized to make the decision. The VRS Board shall be notified as soon as practicable upon the exercise of such authority, and the VRS Board shall receive a summary of the action at its next regular meeting. Consistent with the *Code of Virginia*, VRS staff will coordinate its efforts with OAG or the Governor's Office as appropriate under the circumstances.

**5. Interpretation**

The Board of Trustees intends that this Policy should be construed broadly to provide the flexibility necessary for VRS to take immediate action where it is required to protect the best interests of the Fund's members, retirees and beneficiaries. In all cases, any



such action must be reported to the Board at the earliest practicable opportunity and summarized at the next regular meeting of the Board.

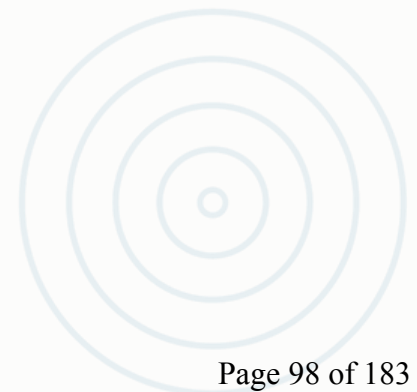


# UNITED STATES

## Proxy Voting Guidelines Benchmark Policy Recommendations

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Effective for Meetings on or after February 1, 2021  
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## Coverage

The U.S. research team provides proxy analyses and voting recommendations for common shareholder meetings of publicly - traded U.S. - incorporated companies that are held in our institutional investor clients' portfolios and includes all S&P 1500 and Russell 3000 companies that are considered U.S. Domestic Issuers by the SEC. Coverage generally includes corporate actions for common equity holders, such as written consents and bankruptcies. ISS' U.S. coverage includes investment companies (including open-end funds, closed-end funds, exchange-traded funds, and unit investment trusts), limited partnerships ("LPs"), master limited partnerships ("MLPs"), limited liability companies ("LLCs"), and business development companies. ISS reviews its universe of coverage on an annual basis, and the coverage is subject to change based on client need and industry trends.

The U.S. research team also produces, for subscribing clients, research and recommendations for fixed income meetings, and meetings of certain preferred securities, including Auction Rate Preferred Securities ("ARPS") and Variable Rate Municipal Term Preferred securities ("VMTPs").

### Foreign-incorporated companies

In addition to U.S. - incorporated companies, U.S. policies are applied to certain foreign-incorporated company analyses. Like the SEC, ISS distinguishes two types of companies that list but are not incorporated in the U.S.:

- U.S. Domestic Issuers – which have a majority of outstanding shares held in the U.S. and meet other criteria, as determined by the SEC, and are subject to the same disclosure and listing standards as U.S. incorporated companies – are generally covered under standard U.S. policy guidelines.
- Foreign Private Issuers (FPIs) – which do not meet the Domestic Issuer criteria and are exempt from most disclosure requirements (e.g., they do not file DEF14A reports) and listing standards (e.g., for required levels of board and committee independence) – are covered under a combination of policy guidelines:
  - FPI Guidelines (see the [Americas Regional Proxy Voting Guidelines](#)), which apply certain minimum independence and disclosure standards in the evaluation of key proxy ballot items, such as the election of directors and approval of financial reports; and
  - For other issues, guidelines for the market that is responsible for, or most relevant to, the item on the ballot.

In all cases – including with respect to other companies with cross-market features that may lead to ballot items related to multiple markets – items that are on the ballot solely due to the requirements of another market (listing, incorporation, or national code) may be evaluated under the policy of the relevant market, regardless of the "assigned" market coverage.



## 1. Board of Directors

### Voting on Director Nominees in Uncontested Elections


Four fundamental principles apply when determining votes on director nominees:

**Independence:** Boards should be sufficiently independent from management (and significant shareholders) to ensure that they are able and motivated to effectively supervise management's performance for the benefit of all shareholders, including in setting and monitoring the execution of corporate strategy, with appropriate use of shareholder capital, and in setting and monitoring executive compensation programs that support that strategy. The chair of the board should ideally be an independent director, and all boards should have an independent leadership position or a similar role in order to help provide appropriate counterbalance to executive management, as well as having sufficiently independent committees that focus on key governance concerns such as audit, compensation, and nomination of directors.

**Composition:** Companies should ensure that directors add value to the board through their specific skills and expertise and by having sufficient time and commitment to serve effectively. Boards should be of a size appropriate to accommodate diversity, expertise, and independence, while ensuring active and collaborative participation by all members. Boards should be sufficiently diverse to ensure consideration of a wide range of perspectives.

**Responsiveness:** Directors should respond to investor input, such as that expressed through significant opposition to management proposals, significant support for shareholder proposals (whether binding or non-binding), and tender offers where a majority of shares are tendered.

**Accountability:** Boards should be sufficiently accountable to shareholders, including through transparency of the company's governance practices and regular board elections, by the provision of sufficient information for shareholders to be able to assess directors and board composition, and through the ability of shareholders to remove directors.

 **General Recommendation:** Generally vote for director nominees, except under the following circumstances (with new nominees<sup>1</sup> considered on case-by-case basis):

#### Independence

Vote against<sup>2</sup> or withhold from non-independent directors (Executive Directors and Non-Independent Non-Executive Directors per [ISS' Classification of Directors](#)) when:

- Independent directors comprise 50 percent or less of the board;
- The non-independent director serves on the audit, compensation, or nominating committee;
- The company lacks an audit, compensation, or nominating committee so that the full board functions as that committee; or
- The company lacks a formal nominating committee, even if the board attests that the independent directors fulfill the functions of such a committee.

<sup>1</sup> A "new nominee" is a director who is being presented for election by shareholders for the first time. Recommendations on new nominees who have served for less than one year are made on a case-by-case basis depending on the timing of their appointment and the problematic governance issue in question.

<sup>2</sup> In general, companies with a plurality vote standard use "Withhold" as the contrary vote option in director elections; companies with a majority vote standard use "Against". However, it will vary by company and the proxy must be checked to determine the valid contrary vote option for the particular company.

## ISS Classification of Directors – U.S.

1. **Executive Director**
  - 1.1. Current officer<sup>1</sup> of the company or one of its affiliates<sup>2</sup>.
2. **Non-Independent Non-Executive Director**
  - Board Identification
    - 2.1. Director identified as not independent by the board.
  - Controlling/Significant Shareholder
    - 2.2. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a group).
  - Current Employment at Company or Related Company
    - 2.3. Non-officer employee of the firm (including employee representatives).
    - 2.4. Officer<sup>1</sup>, former officer, or general or limited partner of a joint venture or partnership with the company.
  - Former Employment
    - 2.5. Former CEO of the company.<sup>3,4</sup>
    - 2.6. Former non-CEO officer<sup>1</sup> of the company or an affiliate<sup>2</sup> within the past five years.
    - 2.7. Former officer<sup>1</sup> of an acquired company within the past five years.<sup>4</sup>
    - 2.8. Officer<sup>1</sup> of a former parent or predecessor firm at the time the company was sold or split off within the past five years.
    - 2.9. Former interim officer if the service was longer than 18 months. If the service was between 12 and 18 months an assessment of the interim officer's employment agreement will be made.<sup>5</sup>
  - Family Members
    - 2.10. Immediate family member<sup>6</sup> of a current or former officer<sup>1</sup> of the company or its affiliates<sup>2</sup> within the last five years.
    - 2.11. Immediate family member<sup>6</sup> of a current employee of company or its affiliates<sup>2</sup> where additional factors raise concern (which may include, but are not limited to, the following: a director related to numerous employees; the company or its affiliates employ relatives of numerous board members; or a non-Section 16 officer in a key strategic role).
  - Professional, Transactional, and Charitable Relationships
    - 2.12. Director who (or whose immediate family member<sup>6</sup>) currently provides professional services<sup>7</sup> in excess of \$10,000 per year to: the company, an affiliate<sup>2</sup>, or an individual officer of the company or an affiliate; or who is (or whose immediate family member<sup>6</sup> is) a partner, employee, or controlling shareholder of an organization which provides the services.
    - 2.13. Director who (or whose immediate family member<sup>6</sup>) currently has any material transactional relationship<sup>8</sup> with the company or its affiliates<sup>2</sup>; or who is (or whose immediate family member<sup>6</sup> is) a partner in, or a controlling shareholder or an executive officer of, an organization which has the material transactional relationship<sup>8</sup> (excluding investments in the company through a private placement).
    - 2.14. Director who (or whose immediate family member<sup>6</sup>) is a trustee, director, or employee of a charitable or non-profit organization that receives material grants or endowments<sup>8</sup> from the company or its affiliates<sup>2</sup>.
  - Other Relationships
    - 2.15. Party to a voting agreement<sup>9</sup> to vote in line with management on proposals being brought to shareholder vote.
    - 2.16. Has (or an immediate family member<sup>6</sup> has) an interlocking relationship as defined by the SEC involving members of the board of directors or its Compensation Committee.<sup>10</sup>
    - 2.17. Founder<sup>11</sup> of the company but not currently an employee.
    - 2.18. Director with pay comparable to Named Executive Officers.
    - 2.19. Any material<sup>12</sup> relationship with the company.
3. **Independent Director**
  - 3.1. No material<sup>12</sup> connection to the company other than a board seat.

**Footnotes:**

1. The definition of officer will generally follow that of a “Section 16 officer” (officers subject to Section 16 of the Securities and Exchange Act of 1934) and includes the chief executive, operating, financial, legal, technology, and accounting officers of a company (including the president, treasurer, secretary, controller, or any vice president in charge of a principal business unit, division, or policy function). Current interim officers are included in this category. For private companies, the equivalent positions are applicable. A non-employee director serving as an officer due to statutory requirements (e.g. corporate secretary) will generally be classified as a Non-Independent Non-Executive Director under “Any material relationship with the company.” However, if the company provides explicit disclosure that the director is not receiving additional compensation exceeding \$10,000 per year for serving in that capacity, then the director will be classified as an Independent Director.
2. “Affiliate” includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation. The manager/advisor of an externally managed issuer (EMI) is considered an affiliate.
3. Includes any former CEO of the company prior to the company’s initial public offering (IPO).
4. When there is a former CEO of a special purpose acquisition company (SPAC) serving on the board of an acquired company, ISS will generally classify such directors as independent unless determined otherwise taking into account the following factors: the applicable listing standards determination of such director’s independence; any operating ties to the firm; and the existence of any other conflicting relationships or related party transactions.
5. ISS will look at the terms of the interim officer’s employment contract to determine if it contains severance pay, long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was under way for a full-time officer at the time.
6. “Immediate family member” follows the SEC’s definition of such and covers spouses, parents, children, step-parents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.
7. Professional services can be characterized as advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically have a commission- or fee-based payment structure. Professional services generally include but are not limited to the following: investment banking/financial advisory services, commercial banking (beyond deposit services), investment services, insurance services, accounting/audit services, consulting services, marketing services, legal services, property management services, realtor services, lobbying services, executive search services, and IT consulting services. The following would generally be considered transactional relationships and not professional services: deposit services, IT tech support services, educational services, and construction services. The case of participation in a banking syndicate by a non-lead bank should be considered a transactional (and hence subject to the associated materiality test) rather than a professional relationship. “Of Counsel” relationships are only considered immaterial if the individual does not receive any form of compensation (in excess of \$10,000 per year) from, or is a retired partner of, the firm providing the professional service. The case of a company providing a professional service to one of its directors or to an entity with which one of its directors is affiliated, will be considered a transactional rather than a professional relationship. Insurance services and marketing services are assumed to be professional services unless the company explains why such services are not advisory.
8. A material transactional relationship, including grants to non-profit organizations, exists if the company makes annual payments to, or receives annual payments from, another entity, exceeding the greater of: \$200,000 or 5 percent of the recipient’s gross revenues, for a company that follows NASDAQ listing standards; or the greater of \$1,000,000 or 2 percent of the recipient’s gross revenues, for a company that follows NYSE listing standards. For a company that follows neither of the preceding standards, ISS will apply the NASDAQ-based materiality test. (The recipient is the party receiving the financial proceeds from the transaction).
9. Dissident directors who are parties to a voting agreement pursuant to a settlement or similar arrangement may be classified as Independent Directors if an analysis of the following factors indicates that the voting agreement does not compromise their alignment with all shareholders’ interests: the terms of the agreement; the duration of the standstill provision in the agreement; the limitations and requirements of actions that are agreed upon; if the dissident director nominee(s) is subject to the standstill; and if there any conflicting relationships or related party transactions.
10. Interlocks include: executive officers serving as directors on each other’s compensation or similar committees (or, in the absence of such a committee, on the board); or executive officers sitting on each other’s boards and at least one serves on the other’s compensation or similar committees (or, in the absence of such a committee, on the board).

11. The operating involvement of the founder with the company will be considered; if the founder was never employed by the company, ISS may deem him or her an Independent Director.

12. For purposes of ISS's 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.

## Composition

**Attendance at Board and Committee Meetings:** Generally vote against or withhold from directors (except nominees who served only part of the fiscal year<sup>3</sup>) who attend less than 75 percent of the aggregate of their board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed in the proxy or another SEC filing. Acceptable reasons for director absences are generally limited to the following:

- Medical issues/illness;
- Family emergencies; and
- Missing only one meeting (when the total of all meetings is three or fewer).

In cases of chronic poor attendance without reasonable justification, in addition to voting against the director(s) with poor attendance, generally vote against or withhold from appropriate members of the nominating/governance committees or the full board.

If the proxy disclosure is unclear and insufficient to determine whether a director attended at least 75 percent of the aggregate of his/her board and committee meetings during his/her period of service, vote against or withhold from the director(s) in question.

**Overboarded Directors:** Generally vote against or withhold from individual directors who:

- Sit on more than five public company boards; or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own— withhold only at their outside boards<sup>4</sup>.

**Gender Diversity:** For companies in the Russell 3000 or S&P 1500 indices, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company's board. An exception will be made if there was a woman on the board at the

<sup>3</sup> Nominees who served for only part of the fiscal year are generally exempted from the attendance policy.

<sup>4</sup> Although all of a CEO's subsidiary boards with publicly-traded common stock will be counted as separate boards, ISS will not recommend a withhold vote for the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships.

preceding annual meeting and the board makes a firm commitment to return to a gender-diverse status within a year.

**Racial and/or Ethnic Diversity:** For companies in the Russell 3000 or S&P 1500 indices, highlight boards with no apparent racial and/or ethnic diversity<sup>5</sup>.

For companies in the Russell 3000 or S&P 1500 indices, effective for meetings on or after Feb. 1, 2022, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent racially or ethnically diverse members. An exception will be made if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racial and/or ethnic diverse member within a year.

### Responsiveness

Vote case-by-case on individual directors, committee members, or the entire board of directors as appropriate if:

- The board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year or failed to act on a management proposal seeking to ratify an existing charter/bylaw provision that received opposition of a majority of the shares cast in the previous year. Factors that will be considered are:
  - Disclosed outreach efforts by the board to shareholders in the wake of the vote;
  - Rationale provided in the proxy statement for the level of implementation;
  - The subject matter of the proposal;
  - The level of support for and opposition to the resolution in past meetings;
  - Actions taken by the board in response to the majority vote and its engagement with shareholders;
  - The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
  - Other factors as appropriate.
- The board failed to act on takeover offers where the majority of shares are tendered;
- At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote.

Vote case-by-case on Compensation Committee members (or, in exceptional cases, the full board) and the Say on Pay proposal if:

- The company's previous say-on-pay received the support of less than 70 percent of votes cast. Factors that will be considered are:
  - The company's response, including:
    - Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);
    - Disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;
    - Disclosure of specific and meaningful actions taken to address shareholders' concerns;
  - Other recent compensation actions taken by the company;
  - Whether the issues raised are recurring or isolated;
  - The company's ownership structure; and

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<sup>5</sup> Aggregate diversity statistics provided by the board will only be considered if specific to racial and/or ethnic diversity.

- Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.
- The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the plurality of votes cast.

## Accountability

### *Problematic Takeover Defenses/Governance Structure*

**Poison Pills:** Vote against or withhold from all nominees (except new nominees<sup>1</sup>, who should be considered case-by-case) if:

- The company has a poison pill that was not approved by shareholders<sup>6</sup>. However, vote case-by-case on nominees if the board adopts an initial pill with a term of one year or less, depending on the disclosed rationale for the adoption, and other factors as relevant (such as a commitment to put any renewal to a shareholder vote);
- The board makes a material adverse modification to an existing pill, including, but not limited to, extension, renewal, or lowering the trigger, without shareholder approval; or
- The pill, whether short-term<sup>7</sup> or long-term, has a deadhand or slowhand feature.

**Classified Board Structure:** The board is classified, and a continuing director responsible for a problematic governance issue at the board/committee level that would warrant a withhold/against vote recommendation is not up for election. All appropriate nominees (except new) may be held accountable.

**Removal of Shareholder Discretion on Classified Boards:** The company has opted into, or failed to opt out of, state laws requiring a classified board structure.

**Director Performance Evaluation:** The board lacks mechanisms to promote accountability and oversight, coupled with sustained poor performance relative to peers. Sustained poor performance is measured by one-, three-, and five-year total shareholder returns in the bottom half of a company's four-digit GICS industry group (Russell 3000 companies only). Take into consideration the company's operational metrics and other factors as warranted. Problematic provisions include but are not limited to:

- A classified board structure;
- A supermajority vote requirement;
- Either a plurality vote standard in uncontested director elections, or a majority vote standard in contested elections;
- The inability of shareholders to call special meetings;
- The inability of shareholders to act by written consent;
- A multi-class capital structure; and/or
- A non-shareholder-approved poison pill.

**Unilateral Bylaw/Charter Amendments and Problematic Capital Structures:** Generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees<sup>1</sup>, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors:

<sup>6</sup> Public shareholders only, approval prior to a company's becoming public is insufficient.

<sup>7</sup> If the short-term pill with a deadhand or slowhand feature is enacted but expires before the next shareholder vote, ISS will generally still recommend withhold/against nominees at the next shareholder meeting following its adoption.

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

Unless the adverse amendment is reversed or submitted to a binding shareholder vote, in subsequent years vote case-by-case on director nominees. Generally vote against (except new nominees<sup>1</sup>, who should be considered case-by-case) if the directors:

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

**Problematic Capital Structure - Newly Public Companies:** For newly public companies<sup>8</sup>, generally vote against or withhold from the entire board (except new nominees<sup>1</sup>, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting the multi-class capital structure to a reasonable time-based sunset. In assessing the reasonableness of a time-based sunset provision, consideration will be given to the company's lifespan, its post-IPO ownership structure and the board's disclosed rationale for the sunset period selected. No sunset period of more than seven years from the date of the IPO will be considered to be reasonable.

Continue to vote against or withhold from incumbent directors in subsequent years, unless the problematic capital structure is reversed or removed.

**Problematic Governance Structure - Newly Public Companies:** For newly public companies<sup>8</sup>, generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees<sup>1</sup>, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopted the following bylaw or charter provisions that are considered to be materially adverse to shareholder rights:

- Supermajority vote requirements to amend the bylaws or charter;
- A classified board structure; or
- Other egregious provisions.

A reasonable sunset provision will be considered a mitigating factor.

Unless the adverse provision is reversed or removed, vote case-by-case on director nominees in subsequent years.

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<sup>8</sup> Newly-public companies generally include companies that emerge from bankruptcy, spin-offs, direct listings, and those who complete a traditional initial public offering.

**Management Proposals to Ratify Existing Charter or Bylaw Provisions:** Vote against/withhold from individual directors, members of the governance committee, or the full board, where boards ask shareholders to ratify existing charter or bylaw provisions considering the following factors:

- The presence of a shareholder proposal addressing the same issue on the same ballot;
- The board's rationale for seeking ratification;
- Disclosure of actions to be taken by the board should the ratification proposal fail;
- Disclosure of shareholder engagement regarding the board's ratification request;
- The level of impairment to shareholders' rights caused by the existing provision;
- The history of management and shareholder proposals on the provision at the company's past meetings;
- Whether the current provision was adopted in response to the shareholder proposal;
- The company's ownership structure; and
- Previous use of ratification proposals to exclude shareholder proposals.

### ***Restrictions on Shareholders' Rights***

**Restricting Binding Shareholder Proposals:** Generally vote against or withhold from the members of the governance committee if:

- The company's governing documents impose undue restrictions on shareholders' ability to amend the bylaws. Such restrictions include but are not limited to: outright prohibition on the submission of binding shareholder proposals or share ownership requirements, subject matter restrictions, or time holding requirements in excess of SEC Rule 14a-8. Vote against or withhold on an ongoing basis.

Submission of management proposals to approve or ratify requirements in excess of SEC Rule 14a-8 for the submission of binding bylaw amendments will generally be viewed as an insufficient restoration of shareholders' rights. Generally continue to vote against or withhold on an ongoing basis until shareholders are provided with an unfettered ability to amend the bylaws or a proposal providing for such unfettered right is submitted for shareholder approval.

### ***Problematic Audit-Related Practices***

Generally vote against or withhold from the members of the Audit Committee if:

- The non-audit fees paid to the auditor are [excessive](#);
- The company receives an adverse opinion on the company's financial statements from its auditor; or
- There is persuasive evidence that the Audit Committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

Vote case-by-case on members of the Audit Committee and potentially the full board if:

- Poor accounting practices are identified that rise to a level of serious concern, such as: fraud; misapplication of GAAP; and material weaknesses identified in Section 404 disclosures. Examine the severity, breadth, chronological sequence, and duration, as well as the company's efforts at remediation or corrective actions, in determining whether withhold/against votes are warranted.

### ***Problematic Compensation Practices***

In the absence of an Advisory Vote on Executive Compensation (Say on Pay) ballot item or in egregious situations, vote against or withhold from the members of the Compensation Committee and potentially the full board if:

- There is an unmitigated misalignment between CEO pay and company performance ([pay for performance](#));
- The company maintains significant [problematic pay practices](#); or
- The board exhibits a significant level of [poor communication and responsiveness](#) to shareholders.



Generally vote against or withhold from the Compensation Committee chair, other committee members, or potentially the full board if:

- The company fails to include a Say on Pay ballot item when required under SEC provisions, or under the company's declared frequency of say on pay; or
- The company fails to include a Frequency of Say on Pay ballot item when required under SEC provisions.

Generally vote against members of the board committee responsible for approving/setting non-employee director compensation if there is a pattern (i.e. two or more years) of awarding excessive non-employee director compensation without disclosing a compelling rationale or other mitigating factors.

### ***Problematic Pledging of Company Stock:***

Vote against the members of the committee that oversees risks related to pledging, or the full board, where a significant level of pledged company stock by executives or directors raises concerns. The following factors will be considered:

- The presence of an anti-pledging policy, disclosed in the proxy statement, that prohibits future pledging activity;
- The magnitude of aggregate pledged shares in terms of total common shares outstanding, market value, and trading volume;
- Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
- Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- Any other relevant factors.

### ***Governance Failures***

Under extraordinary circumstances, vote against or withhold from directors individually, committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight<sup>9</sup>, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

## Voting on Director Nominees in Contested Elections

### **Vote-No Campaigns**



**General Recommendation:** In cases where companies are targeted in connection with public "vote-no" campaigns, evaluate director nominees under the existing governance policies for voting on director nominees in uncontested elections. Take into consideration the arguments submitted by shareholders and other publicly available information.

<sup>9</sup> Examples of failure of risk oversight include but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; demonstrably poor risk oversight of environmental and social issues, including climate change; significant adverse legal judgments or settlement; or hedging of company stock.

### Proxy Contests/Proxy Access

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

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

In the case of candidates nominated pursuant to proxy access, vote case-by-case considering any applicable factors listed above or additional factors which may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether there are more candidates than board seats).

## Other Board-Related Proposals

### Adopt Anti-Hedging/Pledging/Speculative Investments Policy

➤ **General Recommendation:** Generally vote for proposals seeking a policy that prohibits named executive officers from engaging in derivative or speculative transactions involving company stock, including hedging, holding stock in a margin account, or pledging stock as collateral for a loan. However, the company's existing policies regarding responsible use of company stock will be considered.

### Board Refreshment

Board refreshment is best implemented through an ongoing program of individual director evaluations, conducted annually, to ensure the evolving needs of the board are met and to bring in fresh perspectives, skills, and diversity as needed.

### **Term/Tenure Limits**

➤ **General Recommendation:** Vote case-by-case on management proposals regarding director term/tenure limits, considering:

- The rationale provided for adoption of the term/tenure limit;
- The robustness of the company's board evaluation process;
- Whether the limit is of sufficient length to allow for a broad range of director tenures;
- Whether the limit would disadvantage independent directors compared to non-independent directors; and
- Whether the board will impose the limit evenly, and not have the ability to waive it in a discriminatory manner.

Vote case-by-case on shareholder proposals asking for the company to adopt director term/tenure limits, considering:

- The scope of the shareholder proposal; and
- Evidence of problematic issues at the company combined with, or exacerbated by, a lack of board refreshment.

### **Age Limits**

➤ **General Recommendation:** Generally vote against management and shareholder proposals to limit the tenure of independent directors through mandatory retirement ages. Vote for proposals to remove mandatory age limits.

### Board Size

- ▷ **General Recommendation:** Vote for proposals seeking to fix the board size or designate a range for the board size.

Vote against proposals that give management the ability to alter the size of the board outside of a specified range without shareholder approval.

### Classification/Declassification of the Board

- ▷ **General Recommendation:** Vote against proposals to classify (stagger) the board.

Vote for proposals to repeal classified boards and to elect all directors annually.

### CEO Succession Planning

- ▷ **General Recommendation:** Generally vote for proposals seeking disclosure on a CEO succession planning policy, considering, at a minimum, the following factors:

- The reasonableness/scope of the request; and
- The company's existing disclosure on its current CEO succession planning process.

### Cumulative Voting

- ▷ **General Recommendation:** Generally vote against management proposals to eliminate cumulate voting, and for shareholder proposals to restore or provide for cumulative voting, unless:

- The company has proxy access<sup>10</sup>, thereby allowing shareholders to nominate directors to the company's ballot; and
- The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.

Vote for proposals for cumulative voting at controlled companies (insider voting power > 50%).

### Director and Officer Indemnification and Liability Protection

- ▷ **General Recommendation:** Vote case-by-case on proposals on director and officer indemnification and liability protection.

Vote against proposals that would:

- Eliminate entirely directors' and officers' liability for monetary damages for violating the duty of care.
- Expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness.
- Expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts that previously the company was permitted to provide indemnification for, at the discretion of the company's board (*i.e.*, "permissive indemnification"), but that previously the company was not required to indemnify.

Vote for only those proposals providing such expanded coverage in cases when a director's or officer's legal defense was unsuccessful if both of the following apply:

- If the director was found to have acted in good faith and in a manner that s/he reasonably believed was in the best interests of the company; and

<sup>10</sup> A proxy access right that meets the [recommended guidelines](#).

- If only the director's legal expenses would be covered.

### **Establish/Amend Nominee Qualifications**

- ▷ **General Recommendation:** Vote case-by-case on proposals that establish or amend director qualifications. Votes should be based on the reasonableness of the criteria and the degree to which they may preclude dissident nominees from joining the board.

Vote case-by-case on shareholder resolutions seeking a director nominee who possesses a particular subject matter expertise, considering:

- The company's board committee structure, existing subject matter expertise, and board nomination provisions relative to that of its peers;
- The company's existing board and management oversight mechanisms regarding the issue for which board oversight is sought;
- The company's disclosure and performance relating to the issue for which board oversight is sought and any significant related controversies; and
- The scope and structure of the proposal.

### **Establish Other Board Committee Proposals**

- ▷ **General Recommendation:** Generally vote against shareholder proposals to establish a new board committee, as such proposals seek a specific oversight mechanism/structure that potentially limits a company's flexibility to determine an appropriate oversight mechanism for itself. However, the following factors will be considered:

- Existing oversight mechanisms (including current committee structure) regarding the issue for which board oversight is sought;
- Level of disclosure regarding the issue for which board oversight is sought;
- Company performance related to the issue for which board oversight is sought;
- Board committee structure compared to that of other companies in its industry sector; and
- The scope and structure of the proposal.

### **Filling Vacancies/Removal of Directors**

- ▷ **General Recommendation:** Vote against proposals that provide that directors may be removed only for cause.

Vote for proposals to restore shareholders' ability to remove directors with or without cause.

Vote against proposals that provide that only continuing directors may elect replacements to fill board vacancies.

Vote for proposals that permit shareholders to elect directors to fill board vacancies.

### **Independent Board Chair**

- ▷ **General Recommendation:** Generally vote for shareholder proposals requiring that the board chair position be filled by an independent director, taking into consideration the following:

- The scope and rationale of the proposal;
- The company's current board leadership structure;
- The company's governance structure and practices;
- Company performance; and
- Any other relevant factors that may be applicable.

The following factors will increase the likelihood of a "for" recommendation:

- A majority non-independent board and/or the presence of non-independent directors on key board committees;

- A weak or poorly-defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role;
- The presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair, and/or departure from a structure with an independent chair;
- Evidence that the board has failed to oversee and address material risks facing the company;
- A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights; or
- Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

### **Majority of Independent Directors/Establishment of Independent Committees**

- **General Recommendation:** Vote for shareholder proposals asking that a majority or more of directors be independent unless the board composition already meets the proposed threshold by ISS' definition of Independent Director (See [ISS' Classification of Directors](#).)

Vote for shareholder proposals asking that board audit, compensation, and/or nominating committees be composed exclusively of independent directors unless they currently meet that standard.

### **Majority Vote Standard for the Election of Directors**

- **General Recommendation:** Generally vote for management proposals to adopt a majority of votes cast standard for directors in uncontested elections. Vote against if no carve-out for a plurality vote standard in contested elections is included.

Generally vote for precatory and binding shareholder resolutions requesting that the board change the company's bylaws to stipulate that directors need to be elected with an affirmative majority of votes cast, provided it does not conflict with the state law where the company is incorporated. Binding resolutions need to allow for a carve-out for a plurality vote standard when there are more nominees than board seats.

Companies are strongly encouraged to also adopt a post-election policy (also known as a director resignation policy) that will provide guidelines so that the company will promptly address the situation of a holdover director.

### **Proxy Access**

- **General Recommendation:** Generally vote for management and shareholder proposals for proxy access with the following provisions:
- **Ownership threshold:** maximum requirement not more than three percent (3%) of the voting power;
  - **Ownership duration:** maximum requirement not longer than three (3) years of continuous ownership for each member of the nominating group;
  - **Aggregation:** minimal or no limits on the number of shareholders permitted to form a nominating group;
  - **Cap:** cap on nominees of generally twenty-five percent (25%) of the board.

Review for reasonableness any other restrictions on the right of proxy access.  
Generally vote against proposals that are more restrictive than these guidelines.

### **Require More Nominees than Open Seats**

- **General Recommendation:** Vote against shareholder proposals that would require a company to nominate more candidates than the number of open board seats.

### **Shareholder Engagement Policy (Shareholder Advisory Committee)**

➤ **General Recommendation:** Generally vote for shareholder proposals requesting that the board establish an internal mechanism/process, which may include a committee, in order to improve communications between directors and shareholders, unless the company has the following features, as appropriate:

- Established a communication structure that goes beyond the exchange requirements to facilitate the exchange of information between shareholders and members of the board;
- Effectively disclosed information with respect to this structure to its shareholders;
- Company has not ignored majority-supported shareholder proposals or a majority withhold vote on a director nominee; and
- The company has an independent chair or a lead director, according to [ISS' definition](#). This individual must be made available for periodic consultation and direct communication with major shareholders.

## 2. Audit-Related

### Auditor Indemnification and Limitation of Liability

➤ **General Recommendation:** Vote case-by-case on the issue of auditor indemnification and limitation of liability. Factors to be assessed include, but are not limited to:

- The terms of the auditor agreement—the degree to which these agreements impact shareholders' rights;
- The motivation and rationale for establishing the agreements;
- The quality of the company's disclosure; and
- The company's historical practices in the audit area.

Vote against or withhold from members of an audit committee in situations where there is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

### Auditor Ratification

➤ **General Recommendation:** Vote for proposals to ratify auditors unless any of the following apply:

- An auditor has a financial interest in or association with the company, and is therefore not independent;
- There is reason to believe that the independent auditor has rendered an opinion that is neither accurate nor indicative of the company's financial position;
- Poor accounting practices are identified that rise to a serious level of concern, such as fraud or misapplication of GAAP; or
- Fees for non-audit services ("Other" fees) are excessive.

Non-audit fees are excessive if:

- Non-audit ("other") fees > audit fees + audit-related fees + tax compliance/preparation fees

Tax compliance and preparation include 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 added to "Other" fees. If the breakout of tax fees cannot be determined, add all tax fees to "Other" fees.

In circumstances where "Other" fees include fees related to significant one-time capital structure events (such as initial public offerings, bankruptcy emergence, and spin-offs) 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 Proposals Limiting Non-Audit Services

➤ **General Recommendation:** Vote case-by-case on shareholder proposals asking companies to prohibit or limit their auditors from engaging in non-audit services.

### Shareholder Proposals on Audit Firm Rotation

➤ **General Recommendation:** Vote case-by-case on shareholder proposals asking for audit firm rotation, taking into account:

- The tenure of the audit firm;

- 
- The length of rotation specified in the proposal;
  - Any significant audit-related issues at the company;
  - The number of Audit Committee meetings held each year;
  - The number of financial experts serving on the committee; and
  - Whether the company has a periodic renewal process where the auditor is evaluated for both audit quality and competitive price.



### 3. Shareholder Rights & Defenses

#### Advance Notice Requirements for Shareholder Proposals/Nominations

- **General Recommendation:** Vote case-by-case on advance notice proposals, giving support to those proposals which allow shareholders to submit proposals/nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review.

To be reasonable, the company's deadline for shareholder notice of a proposal/nominations must be no earlier than 120 days prior to the anniversary of the previous year's meeting and have a submittal window of no shorter than 30 days from the beginning of the notice period (also known as a 90-120 day window). The submittal window is the period under which shareholders must file their proposals/nominations prior to the deadline.

In general, support additional efforts by companies to ensure full disclosure in regard to a proponent's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review such proposals.

#### Amend Bylaws without Shareholder Consent

- **General Recommendation:** Vote against proposals giving the board exclusive authority to amend the bylaws.

Vote case-by-case on proposals giving the board the ability to amend the bylaws in addition to shareholders, taking into account the following:

- Any impediments to shareholders' ability to amend the bylaws (i.e. supermajority voting requirements);
- The company's ownership structure and historical voting turnout;
- Whether the board could amend bylaws adopted by shareholders; and
- Whether shareholders would retain the ability to ratify any board-initiated amendments.

#### Control Share Acquisition Provisions

- **General Recommendation:** Vote for proposals to opt out of control share acquisition statutes unless doing so would enable the completion of a takeover that would be detrimental to shareholders.

Vote against proposals to amend the charter to include control share acquisition provisions.

Vote for proposals to restore voting rights to the control shares.

Control share acquisition statutes function by denying shares their voting rights when they contribute to ownership in excess of certain thresholds. Voting rights for those shares exceeding ownership limits may only be restored by approval of either a majority or supermajority of disinterested shares. Thus, control share acquisition statutes effectively require a hostile bidder to put its offer to a shareholder vote or risk voting disenfranchisement if the bidder continues buying up a large block of shares.

#### Control Share Cash-Out Provisions

- **General Recommendation:** Vote for proposals to opt out of control share cash-out statutes.

Control share cash-out statutes give dissident shareholders the right to "cash-out" of their position in a company at the expense of the shareholder who has taken a control position. In other words, when an investor crosses a

preset threshold level, remaining shareholders are given the right to sell their shares to the acquirer, who must buy them at the highest acquiring price.

### Disgorgement Provisions

- ▷ **General Recommendation:** Vote for proposals to opt out of state disgorgement provisions.

Disgorgement provisions require an acquirer or potential acquirer of more than a certain percentage of a company's stock to disgorge, or pay back, to the company any profits realized from the sale of that company's stock purchased 24 months before achieving control status. All sales of company stock by the acquirer occurring within a certain period of time (between 18 months and 24 months) prior to the investor's gaining control status are subject to these recapture-of-profits provisions.

### Fair Price Provisions

- ▷ **General Recommendation:** Vote case-by-case on proposals to adopt fair price provisions (provisions that stipulate that an acquirer must pay the same price to acquire all shares as it paid to acquire the control shares), evaluating factors such as the vote required to approve the proposed acquisition, the vote required to repeal the fair price provision, and the mechanism for determining the fair price.

Generally vote against fair price provisions with shareholder vote requirements greater than a majority of disinterested shares.

### Freeze-Out Provisions

- ▷ **General Recommendation:** Vote for proposals to opt out of state freeze-out provisions. Freeze-out provisions force an investor who surpasses a certain ownership threshold in a company to wait a specified period of time before gaining control of the company.

### Greenmail

- ▷ **General Recommendation:** Vote for proposals to adopt anti-greenmail charter or bylaw amendments or otherwise restrict a company's ability to make greenmail payments.

Vote case-by-case on anti-greenmail proposals when they are bundled with other charter or bylaw amendments.

Greenmail payments are targeted share repurchases by management of company stock from individuals or groups seeking control of the company. Since only the hostile party receives payment, usually at a substantial premium over the market value of its shares, the practice discriminates against all other shareholders.

### Shareholder Litigation Rights

#### **Federal Forum Selection Provisions**

Federal forum selection provisions require that U.S. federal courts be the sole forum for shareholders to litigate claims arising under federal securities law.

- ▷ **General Recommendation:** Generally vote for federal forum selection provisions in the charter or bylaws that specify "the district courts of the United States" as the exclusive forum for federal securities law matters, in the absence of serious concerns about corporate governance or board responsiveness to shareholders.

Vote against provisions that restrict the forum to a particular federal district court; unilateral adoption (without a shareholder vote) of such a provision will generally be considered a one-time failure under the [Unilateral Bylaw/Charter Amendments](#) policy.

## Exclusive Forum Provisions for State Law Matters

Exclusive forum provisions in the charter or bylaws restrict shareholders' ability to bring derivative lawsuits against the company, for claims arising out of state corporate law, to the courts of a particular state (generally the state of incorporation).

- **General Recommendation:** Generally vote for charter or bylaw provisions that specify courts located within the state of Delaware as the exclusive forum for corporate law matters for Delaware corporations, in the absence of serious concerns about corporate governance or board responsiveness to shareholders.

For states other than Delaware, vote case-by-case on exclusive forum provisions, taking into consideration:

- The company's stated rationale for adopting such a provision;
- Disclosure of past harm from duplicative shareholder lawsuits in more than one forum;
- The breadth of application of the charter or bylaw provision, including the types of lawsuits to which it would apply and the definition of key terms; and
- Governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the charter or bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections.

Generally vote against provisions that specify a state other than the state of incorporation as the exclusive forum for corporate law matters, or that specify a particular local court within the state; unilateral adoption of such a provision will generally be considered a one-time failure under the [Unilateral Bylaw/Charter Amendments](#) policy.

## Fee shifting

Fee-shifting provisions in the charter or bylaws require that a shareholder who sues a company unsuccessfully pay all litigation expenses of the defendant corporation and its directors and officers.

- **General Recommendation:** Generally vote against provisions that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., including cases where the plaintiffs are partially successful).

Unilateral adoption of a fee-shifting provision will generally be considered an ongoing failure under the [Unilateral Bylaw/Charter Amendments](#) policy.

## Net Operating Loss (NOL) Protective Amendments

- **General Recommendation:** Vote against proposals to adopt a protective amendment for the stated purpose of protecting a company's net operating losses (NOL) if the effective term of the protective amendment would exceed the shorter of three years and the exhaustion of the NOL.

Vote case-by-case, considering the following factors, for management proposals to adopt an NOL protective amendment that would remain in effect for the shorter of three years (or less) and the exhaustion of the NOL:

- The ownership threshold (NOL protective amendments generally prohibit stock ownership transfers that would result in a new 5-percent holder or increase the stock ownership percentage of an existing 5-percent holder);
- The value of the NOLs;

- Shareholder protection mechanisms (sunset provision or commitment to cause expiration of the protective amendment upon exhaustion or expiration of the NOL);
- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

## Poison Pills (Shareholder Rights Plans)

### Shareholder Proposals to Put Pill to a Vote and/or Adopt a Pill Policy

➤ **General Recommendation:** Vote for shareholder proposals requesting that the company submit its poison pill to a shareholder vote or redeem it unless the company has: (1) A shareholder-approved poison pill in place; or (2) The company has adopted a policy concerning the adoption of a pill in the future specifying that the board will only adopt a shareholder rights plan if either:

- Shareholders have approved the adoption of the plan; or
- The board, in its exercise of its fiduciary responsibilities, determines that it is in the best interest of shareholders under the circumstances to adopt a pill without the delay in adoption that would result from seeking stockholder approval (i.e., the “fiduciary out” provision). A poison pill adopted under this fiduciary out will be put to a shareholder ratification vote within 12 months of adoption or expire. If the pill is not approved by a majority of the votes cast on this issue, the plan will immediately terminate.

If the shareholder proposal calls for a time period of less than 12 months for shareholder ratification after adoption, vote for the proposal, but add the caveat that a vote within 12 months would be considered sufficient implementation.

### Management Proposals to Ratify a Poison Pill

➤ **General Recommendation:** Vote case-by-case on management proposals on poison pill ratification, focusing on the features of the shareholder rights plan. Rights plans should contain the following attributes:

- No lower than a 20 percent trigger, flip-in or flip-over;
- A term of no more than three years;
- No deadhand, slowhand, no-hand, or similar feature that limits the ability of a future board to redeem the pill;
- Shareholder redemption feature (qualifying offer clause); if the board refuses to redeem the pill 90 days after a qualifying offer is announced, 10 percent of the shares may call a special meeting or seek a written consent to vote on rescinding the pill.

In addition, the rationale for adopting the pill should be thoroughly explained by the company. In examining the request for the pill, take into consideration the company's existing governance structure, including: board independence, existing takeover defenses, and any problematic governance concerns.

### Management Proposals to Ratify a Pill to Preserve Net Operating Losses (NOLs)

➤ **General Recommendation:** Vote against proposals to adopt a poison pill for the stated purpose of protecting a company's net operating losses (NOL) if the term of the pill would exceed the shorter of three years and the exhaustion of the NOL.

Vote case-by-case on management proposals for poison pill ratification, considering the following factors, if the term of the pill would be the shorter of three years (or less) and the exhaustion of the NOL:

- The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);
- The value of the NOLs;
- Shareholder protection mechanisms (sunset provision, or commitment to cause expiration of the pill upon exhaustion or expiration of NOLs);

- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

### Proxy Voting Disclosure, Confidentiality, and Tabulation

- **General Recommendation:** Vote case-by-case on proposals regarding proxy voting mechanics, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder rights. Specific issues covered under the policy include, but are not limited to, confidential voting of individual proxies and ballots, confidentiality of running vote tallies, and the treatment of abstentions and/or broker non-votes in the company's vote-counting methodology.

While a variety of factors may be considered in each analysis, the guiding principles are: transparency, consistency, and fairness in the proxy voting process. The factors considered, as applicable to the proposal, may include:

- The scope and structure of the proposal;
- The company's stated confidential voting policy (or other relevant policies) and whether it ensures a "level playing field" by providing shareholder proponents with equal access to vote information prior to the annual meeting;
- The company's vote standard for management and shareholder proposals and whether it ensures consistency and fairness in the proxy voting process and maintains the integrity of vote results;
- Whether the company's disclosure regarding its vote counting method and other relevant voting policies with respect to management and shareholder proposals are consistent and clear;
- Any recent controversies or concerns related to the company's proxy voting mechanics;
- Any unintended consequences resulting from implementation of the proposal; and
- Any other factors that may be relevant.

### Ratification Proposals: Management Proposals to Ratify Existing Charter or Bylaw Provisions

- **General Recommendation:** Generally vote against management proposals to ratify provisions of the company's existing charter or bylaws, unless these governance provisions align with best practice.

In addition, voting against/withhold from individual directors, members of the governance committee, or the full board may be warranted, considering:

- The presence of a shareholder proposal addressing the same issue on the same ballot;
- The board's rationale for seeking ratification;
- Disclosure of actions to be taken by the board should the ratification proposal fail;
- Disclosure of shareholder engagement regarding the board's ratification request;
- The level of impairment to shareholders' rights caused by the existing provision;
- The history of management and shareholder proposals on the provision at the company's past meetings;
- Whether the current provision was adopted in response to the shareholder proposal;
- The company's ownership structure; and
- Previous use of ratification proposals to exclude shareholder proposals.

### Reimbursing Proxy Solicitation Expenses

- **General Recommendation:** Vote case-by-case on proposals to reimburse proxy solicitation expenses.

When voting in conjunction with support of a dissident slate, vote for the reimbursement of all appropriate proxy solicitation expenses associated with the election.

Generally vote for shareholder proposals calling for the reimbursement of reasonable costs incurred in connection with nominating one or more candidates in a contested election where the following apply:

- The election of fewer than 50 percent of the directors to be elected is contested in the election;
- One or more of the dissident's candidates is elected;
- Shareholders are not permitted to cumulate their votes for directors; and
- The election occurred, and the expenses were incurred, after the adoption of this bylaw.

### Reincorporation Proposals

➤ **General Recommendation:** Management or shareholder proposals to change a company's state of incorporation should be evaluated case-by-case, giving consideration to both financial and corporate governance concerns including the following:

- Reasons for reincorporation;
- Comparison of company's governance practices and provisions prior to and following the reincorporation; and
- Comparison of corporation laws of original state and destination state.

Vote for reincorporation when the economic factors outweigh any neutral or negative governance changes.

### Shareholder Ability to Act by Written Consent

➤ **General Recommendation:** Generally vote against management and shareholder proposals to restrict or prohibit shareholders' ability to act by written consent.

Generally vote for management and shareholder proposals that provide shareholders with the ability to act by written consent, taking into account the following factors:

- Shareholders' current right to act by written consent;
- The consent threshold;
- The inclusion of exclusionary or prohibitive language;
- Investor ownership structure; and
- Shareholder support of, and management's response to, previous shareholder proposals.

Vote case-by-case on shareholder proposals if, in addition to the considerations above, the company has the following governance and antitakeover provisions:

- An unfettered<sup>11</sup> right for shareholders to call special meetings at a 10 percent threshold;
- A majority vote standard in uncontested director elections;
- No non-shareholder-approved pill; and
- An annually elected board.

### Shareholder Ability to Call Special Meetings

➤ **General Recommendation:** Vote against management or shareholder proposals to restrict or prohibit shareholders' ability to call special meetings.

Generally vote for management or shareholder proposals that provide shareholders with the ability to call special meetings taking into account the following factors:

- Shareholders' current right to call special meetings;
- Minimum ownership threshold necessary to call special meetings (10 percent preferred);
- The inclusion of exclusionary or prohibitive language;

<sup>11</sup> "Unfettered" means no restrictions on agenda items, no restrictions on the number of shareholders who can group together to reach the 10 percent threshold, and only reasonable limits on when a meeting can be called: no greater than 30 days after the last annual meeting and no greater than 90 prior to the next annual meeting.

- Investor ownership structure; and
- Shareholder support of, and management's response to, previous shareholder proposals.

### Stakeholder Provisions

- ▷ **General Recommendation:** Vote against proposals that ask the board to consider non-shareholder constituencies or other non-financial effects when evaluating a merger or business combination.

### State Antitakeover Statutes

- ▷ **General Recommendation:** Vote case-by-case on proposals to opt in or out of state takeover statutes (including fair price provisions, stakeholder laws, poison pill endorsements, severance pay and labor contract provisions, and anti-greenmail provisions).

### Supermajority Vote Requirements

- ▷ **General Recommendation:** Vote against proposals to require a supermajority shareholder vote.
- Vote for management or shareholder proposals to reduce supermajority vote requirements. However, for companies with shareholder(s) who have significant ownership levels, vote case-by-case, taking into account:
  - Ownership structure;
  - Quorum requirements; and
  - Vote requirements.

### Virtual Shareholder Meetings

- ▷ **General Recommendation:** Generally vote for management proposals allowing for the convening of shareholder meetings by electronic means, so long as they do not preclude in-person meetings. Companies are encouraged to disclose the circumstances under which virtual-only<sup>12</sup> meetings would be held, and to allow for comparable rights and opportunities for shareholders to participate electronically as they would have during an in-person meeting.

Vote case-by-case on shareholder proposals concerning virtual-only meetings, considering:

- Scope and rationale of the proposal; and
- Concerns identified with the company's prior meeting practices.

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<sup>12</sup> Virtual-only shareholder meeting" refers to a meeting of shareholders that is held exclusively using technology without a corresponding in-person meeting.

## 4. Capital/Restructuring

### Capital

#### Adjustments to Par Value of Common Stock

- **General Recommendation:** Vote for management proposals to reduce the par value of common stock unless the action is being taken to facilitate an anti-takeover device or some other negative corporate governance action.

Vote for management proposals to eliminate par value.

#### Common Stock Authorization

- **General Recommendation:** Vote for proposals to increase the number of authorized common shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class of common stock to increase the number of authorized shares of the class of common stock that has superior voting rights.

Vote against proposals to increase the number of authorized common shares if a vote for a reverse stock split on the same ballot is warranted despite the fact that the authorized shares would not be reduced proportionally.

Vote case-by-case on all other proposals to increase the number of shares of common stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized shares during the last three years;
- The Current Request:
  - Disclosure in the proxy statement of the specific purposes of the proposed increase;
  - Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request; and
  - The dilutive impact of the request as determined relative to an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns.

ISS will apply the relevant allowable increase below to requests to increase common stock that are for general corporate purposes (or to the general corporate purposes portion of a request that also includes a specific need):

- A. Most companies: **100 percent** of existing authorized shares.
- B. Companies with less than 50 percent of existing authorized shares either outstanding or reserved for issuance: **50 percent** of existing authorized shares.
- C. Companies with one- and three-year total shareholder returns (TSRs) in the bottom 10 percent of the U.S. market as of the end of the calendar quarter that is closest to their most recent fiscal year end: **50 percent** of existing authorized shares.
- D. Companies at which both conditions (B and C) above are both present: **25 percent** of existing authorized shares.

If there is an acquisition, private placement, or similar transaction on the ballot (not including equity incentive plans) that ISS is recommending FOR, the allowable increase will be the greater of (i) twice the amount needed to support the transactions on the ballot, and (ii) the allowable increase as calculated above.



### Dual Class Structure

➤ **General Recommendation:** Generally vote against proposals to create a new class of common stock unless:

- The company discloses a compelling rationale for the dual-class capital structure, such as:
- The company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or
- The new class of shares will be transitory;
- The new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and
- The new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

### Issue Stock for Use with Rights Plan

➤ **General Recommendation:** Vote against proposals that increase authorized common stock for the explicit purpose of implementing a non-shareholder-approved shareholder rights plan (poison pill).

### Preemptive Rights

➤ **General Recommendation:** Vote case-by-case on shareholder proposals that seek preemptive rights, taking into consideration:

- The size of the company;
- The shareholder base; and
- The liquidity of the stock.

### Preferred Stock Authorization

➤ **General Recommendation:** Vote for proposals to increase the number of authorized preferred shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote against proposals at companies with more than one class or series of preferred stock to increase the number of authorized shares of the class or series of preferred stock that has superior voting rights.

Vote case-by-case on all other proposals to increase the number of shares of preferred stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:


- Past Board Performance:
  - The company's use of authorized preferred shares during the last three years;
- The Current Request:
  - Disclosure in the proxy statement of the specific purposes for the proposed increase;
  - Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request;
  - In cases where the company has existing authorized preferred stock, the dilutive impact of the request as determined by an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns; and
  - Whether the shares requested are blank check preferred shares that can be used for antitakeover purposes.

### Recapitalization Plans

➤ **General Recommendation:** Vote case-by-case on recapitalizations (reclassifications of securities), taking into account the following:

- More simplified capital structure;
- Enhanced liquidity;
- Fairness of conversion terms;
- Impact on voting power and dividends;
- Reasons for the reclassification;
- Conflicts of interest; and
- Other alternatives considered.

### Reverse Stock Splits


 **General Recommendation:** Vote for management proposals to implement a reverse stock split if:

- The number of authorized shares will be proportionately reduced; or
- The effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

Vote case-by-case on proposals that do not meet either of the above conditions, taking into consideration the following factors:

- Stock exchange notification to the company of a potential delisting;
- Disclosure of substantial doubt about the company's ability to continue as a going concern without additional financing;
- The company's rationale; or
- Other factors as applicable.


### Share Repurchase Programs

 **General Recommendation:** For U.S.-incorporated companies, and foreign-incorporated U.S. Domestic Issuers that are traded solely on U.S. exchanges, vote for management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms, or to grant the board authority to conduct open-market repurchases, in the absence of company-specific concerns regarding:


- Greenmail,
- The use of buybacks to inappropriately manipulate incentive compensation metrics,
- Threats to the company's long-term viability, or
- Other company-specific factors as warranted.

Vote case-by-case on proposals to repurchase shares directly from specified shareholders, balancing the stated rationale against the possibility for the repurchase authority to be misused, such as to repurchase shares from insiders at a premium to market price.

### Share Repurchase Programs Shareholder Proposals

 **General Recommendation:** Generally vote against shareholder proposals prohibiting executives from selling shares of company stock during periods in which the company has announced that it may or will be repurchasing shares of its stock. Vote for the proposal when there is a pattern of abuse by executives exercising options or selling shares during periods of share buybacks.

### Stock Distributions: Splits and Dividends

 **General Recommendation:** Generally vote for management proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase in authorized shares is equal to or is less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

### Tracking Stock

▷ **General Recommendation:** Vote case-by-case on the creation of tracking stock, weighing the strategic value of the transaction against such factors as:

- Adverse governance changes;
- Excessive increases in authorized capital stock;
- Unfair method of distribution;
- Diminution of voting rights;
- Adverse conversion features;
- Negative impact on stock option plans; and
- Alternatives such as spin-off.

## Restructuring

### Appraisal Rights

▷ **General Recommendation:** Vote for proposals to restore or provide shareholders with rights of appraisal.

### Asset Purchases

▷ **General Recommendation:** Vote case-by-case on asset purchase proposals, considering the following factors:

- Purchase price;
- Fairness opinion;
- Financial and strategic benefits;
- How the deal was negotiated;
- Conflicts of interest;
- Other alternatives for the business;
- Non-completion risk.

### Asset Sales

▷ **General Recommendation:** Vote case-by-case on asset sales, considering the following factors:

- Impact on the balance sheet/working capital;
- Potential elimination of diseconomies;
- Anticipated financial and operating benefits;
- Anticipated use of funds;
- Value received for the asset;
- Fairness opinion;
- How the deal was negotiated;
- Conflicts of interest.

### Bundled Proposals

▷ **General Recommendation:** Vote case-by-case on bundled or “conditional” proxy proposals. In the case of items that are conditioned upon each other, examine the benefits and costs of the packaged items. In instances when the joint effect of the conditioned items is not in shareholders’ best interests, vote against the proposals. If the combined effect is positive, support such proposals.

### Conversion of Securities

- ▷ **General Recommendation:** Vote case-by-case on proposals regarding conversion of securities. When evaluating these proposals, the investor should review the dilution to existing shareholders, the conversion price relative to market value, financial issues, control issues, termination penalties, and conflicts of interest.

Vote for the conversion if it is expected that the company will be subject to onerous penalties or will be forced to file for bankruptcy if the transaction is not approved.

### Corporate Reorganization/Debt Restructuring/Prepackaged Bankruptcy Plans/Reverse Leveraged Buyouts/Wrap Plans

- ▷ **General Recommendation:** Vote case-by-case on proposals to increase common and/or preferred shares and to issue shares as part of a debt restructuring plan, after evaluating:

- Dilution to existing shareholders' positions;
- Terms of the offer - discount/premium in purchase price to investor, including any fairness opinion; termination penalties; exit strategy;
- Financial issues - company's financial situation; degree of need for capital; use of proceeds; effect of the financing on the company's cost of capital;
- Management's efforts to pursue other alternatives;
- Control issues - change in management; change in control, guaranteed board and committee seats; standstill provisions; voting agreements; veto power over certain corporate actions; and
- Conflict of interest - arm's length transaction, managerial incentives.

Vote for the debt restructuring if it is expected that the company will file for bankruptcy if the transaction is not approved.

### Formation of Holding Company

- ▷ **General Recommendation:** Vote case-by-case on proposals regarding the formation of a holding company, taking into consideration the following:

- The reasons for the change;
- Any financial or tax benefits;
- Regulatory benefits;
- Increases in capital structure; and
- Changes to the articles of incorporation or bylaws of the company.

Absent compelling financial reasons to recommend for the transaction, vote against the formation of a holding company if the transaction would include either of the following:

- Increases in common or preferred stock in excess of the allowable maximum (see discussion under "Capital"); or
- Adverse changes in shareholder rights.

### Going Private and Going Dark Transactions (LBOs and Minority Squeeze-outs)

- ▷ **General Recommendation:** Vote case-by-case on going private transactions, taking into account the following:


- Offer price/premium;
- Fairness opinion;
- How the deal was negotiated;

- Conflicts of interest;
- Other alternatives/offers considered; and
- Non-completion risk.

Vote case-by-case on going dark transactions, determining whether the transaction enhances shareholder value by taking into consideration:


- Whether the company has attained benefits from being publicly-traded (examination of trading volume, liquidity, and market research of the stock);
- Balanced interests of continuing vs. cashed-out shareholders, taking into account the following:
- Are all shareholders able to participate in the transaction?
- Will there be a liquid market for remaining shareholders following the transaction?
- Does the company have strong corporate governance?
- Will insiders reap the gains of control following the proposed transaction?
- Does the state of incorporation have laws requiring continued reporting that may benefit shareholders?

### Joint Ventures

 **General Recommendation:** Vote case-by-case on proposals to form joint ventures, taking into account the following:

- 
- Percentage of assets/business contributed;
- Percentage ownership;
- Financial and strategic benefits;
- Governance structure;
- Conflicts of interest;
- Other alternatives; and
- Non-completion risk.


### Liquidations

 **General Recommendation:** Vote case-by-case on liquidations, taking into account the following:

- Management's efforts to pursue other alternatives;
- Appraisal value of assets; and
- The compensation plan for executives managing the liquidation.

Vote for the liquidation if the company will file for bankruptcy if the proposal is not approved.

### 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., full auction, partial auction, no auction) 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. The CIC figure presented in the "ISS Transaction Summary" section of this report is an aggregate figure that can in certain cases be a misleading indicator of the true value transfer from shareholders to insiders. Where such figure appears to be excessive, analyze the underlying assumptions to determine whether a potential conflict exists.
- *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.

### Private Placements/Warrants/Convertible Debentures



**General Recommendation:** Vote case-by-case on proposals regarding private placements, warrants, and convertible debentures taking into consideration:

- Dilution to existing shareholders' position: The amount and timing of shareholder ownership dilution should be weighed against the needs and proposed shareholder benefits of the capital infusion. Although newly issued common stock, absent preemptive rights, is typically dilutive to existing shareholders, share price appreciation is often the necessary event to trigger the exercise of "out of the money" warrants and convertible debt. In these instances from a value standpoint, the negative impact of dilution is mitigated by the increase in the company's stock price that must occur to trigger the dilutive event.
- Terms of the offer (discount/premium in purchase price to investor, including any fairness opinion, conversion features, termination penalties, exit strategy):
  - The terms of the offer should be weighed against the alternatives of the company and in light of company's financial condition. Ideally, the conversion price for convertible debt and the exercise price for warrants should be at a premium to the then prevailing stock price at the time of private placement.
  - When evaluating the magnitude of a private placement discount or premium, consider factors that influence the discount or premium, such as, liquidity, due diligence costs, control and monitoring costs, capital scarcity, information asymmetry, and anticipation of future performance.
- Financial issues:
  - The company's financial condition;
  - Degree of need for capital;
  - Use of proceeds;
  - Effect of the financing on the company's cost of capital;
  - Current and proposed cash burn rate;
  - Going concern viability and the state of the capital and credit markets.
- Management's efforts to pursue alternatives and whether the company engaged in a process to evaluate alternatives: A fair, unconstrained process helps to ensure the best price for shareholders. Financing alternatives can include joint ventures, partnership, merger, or sale of part or all of the company.
- Control issues:

- Change in management;
  - Change in control;
  - Guaranteed board and committee seats;
  - Standstill provisions;
  - Voting agreements;
  - Veto power over certain corporate actions; and
  - Minority versus majority ownership and corresponding minority discount or majority control premium.
- Conflicts of interest:
    - Conflicts of interest should be viewed from the perspective of the company and the investor.
    - Were the terms of the transaction negotiated at arm's length? Are managerial incentives aligned with shareholder interests?
  - Market reaction:
    - The market's response to the proposed deal. A negative market reaction is a cause for concern. Market reaction may be addressed by analyzing the one-day impact on the unaffected stock price.

Vote for the private placement, or for the issuance of warrants and/or convertible debentures in a private placement, if it is expected that the company will file for bankruptcy if the transaction is not approved.

### Reorganization/Restructuring Plan (Bankruptcy)



**General Recommendation:** Vote case-by-case on proposals to common shareholders on bankruptcy plans of reorganization, considering the following factors including, but not limited to:

- Estimated value and financial prospects of the reorganized company;
- Percentage ownership of current shareholders in the reorganized company;
- Whether shareholders are adequately represented in the reorganization process (particularly through the existence of an Official Equity Committee);
- The cause(s) of the bankruptcy filing, and the extent to which the plan of reorganization addresses the cause(s);
- Existence of a superior alternative to the plan of reorganization; and
- Governance of the reorganized company.

### Special Purpose Acquisition Corporations (SPACs)



**General Recommendation:** Vote case-by-case on SPAC mergers and acquisitions taking into account the following:

- *Valuation* - Is the value being paid by the SPAC reasonable? SPACs generally lack an independent fairness opinion and the financials on the target may be limited. Compare the conversion price with the intrinsic value of the target company provided in the fairness opinion. Also, evaluate the proportionate value of the combined entity attributable to the SPAC IPO shareholders versus the pre-merger value of SPAC. Additionally, a private company discount may be applied to the target, if it is a private entity.
- *Market reaction* - How has the market responded to the proposed deal? A negative market reaction may be a cause for concern. Market reaction may be addressed by analyzing the one-day impact on the unaffected stock price.
- *Deal timing* - A main driver for most transactions is that the SPAC charter typically requires the deal to be complete within 18 to 24 months, or the SPAC is to be liquidated. Evaluate the valuation, market reaction, and potential conflicts of interest for deals that are announced close to the liquidation date.
- *Negotiations and process* - What was the process undertaken to identify potential target companies within specified industry or location specified in charter? Consider the background of the sponsors.
- *Conflicts of interest* - How are sponsors benefiting from the transaction compared to IPO shareholders? Potential conflicts could arise if a fairness opinion is issued by the insiders to qualify the deal rather than a

third party or if management is encouraged to pay a higher price for the target because of an 80 percent rule (the charter requires that the fair market value of the target is at least equal to 80 percent of net assets of the SPAC). Also, there may be sense of urgency by the management team of the SPAC to close the deal since its charter typically requires a transaction to be completed within the 18-24 month timeframe.

- *Voting agreements* - Are the sponsors entering into any voting agreements/tender offers with shareholders who are likely to vote against the proposed merger or exercise conversion rights?
- *Governance* - What is the impact of having the SPAC CEO or founder on key committees following the proposed merger?

### Special Purpose Acquisition Corporations (SPACs) - Proposals for Extensions

➤ **General Recommendation:** Vote case-by-case on SPAC extension proposals taking into account the length of the requested extension, the status of any pending transaction(s) or progression of the acquisition process, any added incentive for non-redeeming shareholders, and any prior extension requests.

- *Length of request:* Typically, extension requests range from two to six months, depending on the progression of the SPAC's acquisition process.
- *Pending transaction(s) or progression of the acquisition process:* Sometimes an initial business combination was already put to a shareholder vote, but, for varying reasons, the transaction could not be consummated by the termination date and the SPAC is requesting an extension. Other times, the SPAC has entered into a definitive transaction agreement, but needs additional time to consummate or hold the shareholder meeting.
- *Added incentive for non-redeeming shareholders:* Sometimes the SPAC sponsor (or other insiders) will contribute, typically as a loan to the company, additional funds that will be added to the redemption value of each public share as long as such shares are not redeemed in connection with the extension request. The purpose of the "equity kicker" is to incentivize shareholders to hold their shares through the end of the requested extension or until the time the transaction is put to a shareholder vote, rather than electing redemption at the extension proposal meeting.
- *Prior extension requests:* Some SPACs request additional time beyond the extension period sought in prior extension requests.

### Spin-offs

➤ **General Recommendation:** Vote case-by-case on spin-offs, considering:

- Tax and regulatory advantages;
- Planned use of the sale proceeds;
- Valuation of spinoff;
- Fairness opinion;
- Benefits to the parent company;
- Conflicts of interest;
- Managerial incentives;
- Corporate governance changes;
- Changes in the capital structure.

### Value Maximization Shareholder Proposals

➤ **General Recommendation:** Vote case-by-case on shareholder proposals seeking to maximize shareholder value by:

- Hiring a financial advisor to explore strategic alternatives;
- Selling the company; or
- Liquidating the company and distributing the proceeds to shareholders.

These proposals should be evaluated based on the following factors:

- Prolonged poor performance with no turnaround in sight;
- Signs of entrenched board and management (such as the adoption of takeover defenses);



- 
- Strategic plan in place for improving value;
  - Likelihood of receiving reasonable value in a sale or dissolution; and
  - The company actively exploring its strategic options, including retaining a financial advisor.


## 5. Compensation

### Executive Pay Evaluation

Underlying all evaluations are five global principles that most investors expect corporations to adhere to in designing and administering executive and director compensation programs:

1. 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 plan costs;
2. Avoid arrangements that risk “pay for failure”: This principle addresses the appropriateness of long or indefinite contracts, excessive severance packages, and guaranteed compensation;
3. 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 compensation decision-making (e.g., including access to independent expertise and advice when needed);
4. Provide shareholders with clear, comprehensive compensation disclosures: This principle underscores the importance of informative and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly;
5. Avoid inappropriate pay to non-executive directors: This principle recognizes the interests of shareholders in ensuring that compensation to outside directors is reasonable and does not compromise their independence and ability to make appropriate judgments in overseeing managers’ pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

#### Advisory Votes on Executive Compensation—Management Proposals (Say-on-Pay)

 **General Recommendation:** Vote case-by-case on ballot items related to executive pay and practices, as well as certain aspects of outside director compensation.

Vote against Advisory Votes on Executive Compensation (Say-on-Pay or “SOP”) if:

- There is an unmitigated misalignment between CEO pay and company performance (pay for performance);
- The company maintains significant problematic pay practices;
- The board exhibits a significant level of [poor communication and responsiveness](#) to shareholders.

Vote against or withhold from the members of the Compensation Committee and potentially the full board if:

- There is no SOP on the ballot, and an against vote on an SOP would otherwise be warranted due to pay-for-performance misalignment, problematic pay practices, or the lack of adequate responsiveness on compensation issues raised previously, or a combination thereof;
- The board fails to respond adequately to a previous SOP proposal that received less than 70 percent support of votes cast;
- The company has recently practiced or approved problematic pay practices, such as option repricing or option backdating; or
- The situation is egregious.

## Primary Evaluation Factors for Executive Pay

### Pay-for-Performance Evaluation

ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the S&P1500, Russell 3000, or Russell 3000E Indices<sup>13</sup>, this analysis considers the following:

1. Peer Group<sup>14</sup> Alignment:
  - The degree of alignment between the company's annualized TSR rank and the CEO's annualized total pay rank within a peer group, each measured over a three-year period.
  - The rankings of CEO total pay and company financial performance within a peer group, each measured over a three-year period.
  - The multiple of the CEO's total pay relative to the peer group median in the most recent fiscal year.
2. Absolute Alignment<sup>15</sup> – the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – i.e., the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

If the above analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment or, in the case of companies outside the Russell indices, a misalignment between pay and performance is otherwise suggested, our analysis may include any of the following qualitative factors, as relevant to an evaluation of how various pay elements may work to encourage or to undermine long-term value creation and alignment with shareholder interests:

- The ratio of performance- to time-based incentive awards;
- The overall ratio of performance-based compensation to fixed or discretionary pay;
- The rigor of performance goals;
- The complexity and risks around pay program design;
- The transparency and clarity of disclosure;
- The company's peer group benchmarking practices;
- Financial/operational results, both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior FY or anomalous equity grant practices (e.g., bi-annual awards);
- Realizable pay<sup>16</sup> compared to grant pay; and
- Any other factors deemed relevant.

### Problematic Pay Practices

The focus is on executive compensation practices that contravene the global pay principles, including:

- Problematic practices related to non-performance-based compensation elements;

<sup>13</sup> The [Russell 3000E](#) Index includes approximately 4,000 of the largest U.S. equity securities.

<sup>14</sup> The revised peer group is generally comprised of 14-24 companies that are selected using market cap, revenue (or assets for certain financial firms), GICS industry group, and company's selected peers' GICS industry group, with size constraints, via a process designed to select peers that are comparable to the subject company in terms of revenue/assets and industry, and also within a market-cap bucket that is reflective of the company's. For Oil, Gas & Consumable Fuels companies, market cap is the only size determinant.

<sup>15</sup> Only Russell 3000 Index companies are subject to the Absolute Alignment analysis.

<sup>16</sup> ISS research reports include realizable pay for S&P1500 companies.

- Incentives that may motivate excessive risk-taking or present a windfall risk; and
- Pay decisions that circumvent pay-for-performance, such as options backdating or waiving performance requirements.

#### **Problematic Pay Practices related to Non-Performance-Based Compensation Elements**

Pay elements that are not directly based on performance are generally evaluated case-by-case considering the context of a company's overall pay program and demonstrated pay-for-performance philosophy. Please refer to ISS' [U.S. Compensation Policies FAQ](#) document for detail on specific pay practices that have been identified as potentially problematic and may lead to negative recommendations if they are deemed to be inappropriate or unjustified relative to executive pay best practices. The list below highlights the problematic practices that carry significant weight in this overall consideration and may result in adverse vote recommendations:

- Repricing or replacing of underwater stock options/SARs without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- Extraordinary perquisites or tax gross-ups;
- New or materially amended agreements that provide for:
  - Excessive termination or CIC severance payments (generally exceeding 3 times base salary and average/target/most recent bonus);
  - CIC severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers) or in connection with a problematic Good Reason definition;
  - CIC excise tax gross-up entitlements (including "modified" gross-ups);
  - Multi-year guaranteed awards that are not at risk due to rigorous performance conditions;
- Liberal CIC definition combined with any single-trigger CIC benefits;
- Insufficient executive compensation disclosure by externally-managed issuers (EMIs) such that a reasonable assessment of pay programs and practices applicable to the EMI's executives is not possible;
- Any other provision or practice deemed to be egregious and present a significant risk to investors.

#### **Options Backdating**

The following factors should be examined case-by-case to allow for distinctions to be made between "sloppy" plan administration versus deliberate action or fraud:

- Reason and motive for the options backdating issue, such as inadvertent vs. deliberate grant date changes;
- Duration of options backdating;
- Size of restatement due to options backdating;
- Corrective actions taken by the board or compensation committee, such as canceling or re-pricing backdated options, the recouping of option gains on backdated grants; and
- Adoption of a grant policy that prohibits backdating and creates a fixed grant schedule or window period for equity grants in the future.

#### **Compensation Committee Communications and Responsiveness**

Consider the following factors case-by-case when evaluating ballot items related to executive pay on the board's responsiveness to investor input and engagement on compensation issues:

- Failure to respond to majority-supported shareholder proposals on executive pay topics; or
- Failure to adequately respond to the company's previous say-on-pay proposal that received the support of less than 70 percent of votes cast, taking into account:
  - Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);

- Disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;
- Disclosure of specific and meaningful actions taken to address shareholders' concerns;
- Other recent compensation actions taken by the company;
- Whether the issues raised are recurring or isolated;
- The company's ownership structure; and
- Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.

### Frequency of Advisory Vote on Executive Compensation ("Say When on Pay")

- **General Recommendation:** Vote for annual advisory votes on compensation, which provide the most consistent and clear communication channel for shareholder concerns about companies' executive pay programs.

### Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale

- **General Recommendation:** Vote case-by-case on say on Golden Parachute proposals, including consideration of existing change-in-control arrangements maintained with named executive officers but also considering new or extended arrangements.

Features that may result in an "against" recommendation include one or more of the following, depending on the number, magnitude, and/or timing of issue(s):

- Single- or modified-single-trigger cash severance;
- Single-trigger acceleration of unvested equity awards;
- Full acceleration of equity awards granted shortly before the change in control;
- Acceleration of performance awards above the target level of performance without compelling rationale;
- Excessive cash severance (generally >3x base salary and bonus);
- Excise tax gross-ups triggered and payable;
- Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value); or
- Recent amendments that incorporate any problematic features (such as those above) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; or
- The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote.

Recent amendment(s) that incorporate problematic features will tend to carry more weight on the overall analysis. However, the presence of multiple legacy problematic features will also be closely scrutinized.

In cases where the golden parachute vote is incorporated into a company's advisory vote on compensation (management say-on-pay), ISS will evaluate the say-on-pay proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

## Equity-Based and Other Incentive Plans

Please refer to ISS' [U.S. Equity Compensation Plans FAQ](#) document for additional details on the Equity Plan Scorecard policy.

▶ **General Recommendation:** Vote case-by-case on certain equity-based compensation plans<sup>17</sup> depending on a combination of certain plan features and equity grant practices, where positive factors may counterbalance negative factors, and vice versa, as evaluated using an "Equity Plan Scorecard" (EPSC) approach with three pillars:

- **Plan Cost:** The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
  - SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
  - SVT based only on new shares requested plus shares remaining for future grants.
- **Plan Features:**
  - Quality of disclosure around vesting upon a change in control (CIC);
  - Discretionary vesting authority;
  - Liberal share recycling on various award types;
  - Lack of minimum vesting period for grants made under the plan;
  - Dividends payable prior to award vesting.
- **Grant Practices:**
  - The company's three-year burn rate relative to its industry/market cap peers;
  - Vesting requirements in CEO's recent equity grants (3-year look-back);
  - The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years);
  - The proportion of the CEO's most recent equity grants/awards subject to performance conditions;
  - Whether the company maintains a sufficient claw-back policy;
  - Whether the company maintains sufficient post-exercise/vesting share-holding requirements.

Generally vote against the plan proposal if the combination of above factors indicates that the plan is not, overall, in shareholders' interests, or if any of the following egregious factors ("overriding factors") apply:

- Awards may vest in connection with a liberal change-of-control definition;
- The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it – for NYSE and Nasdaq listed companies – or by not prohibiting it when the company has a history of repricing – for non-listed companies);
- The plan is a vehicle for problematic pay practices or a significant pay-for-performance disconnect under certain circumstances;
- The plan is excessively dilutive to shareholders' holdings;
- The plan contains an evergreen (automatic share replenishment) feature; or
- Any other plan features are determined to have a significant negative impact on shareholder interests.

#### Further Information on certain EPSC Factors:

##### Shareholder Value Transfer (SVT)

The cost of the equity plans is expressed as Shareholder Value Transfer (SVT), which is measured using a binomial option pricing model that assesses the amount of shareholders' equity flowing out of the company to employees and directors. SVT is expressed as both a dollar amount and as a percentage of market value, and includes the new

<sup>17</sup> Proposals evaluated under the EPSC policy generally include those to approve or amend (1) stock option plans for employees and/or employees and directors, (2) restricted stock plans for employees and/or employees and directors, and (3) omnibus stock incentive plans for employees and/or employees and directors; amended plans will be further evaluated case-by-case.

shares proposed, shares available under existing plans, and shares granted but unexercised (using two measures, in the case of plans subject to the Equity Plan Scorecard evaluation, as noted above). All award types are valued. For omnibus plans, unless limitations are placed on the most expensive types of awards (for example, full-value awards), the assumption is made that all awards to be granted will be the most expensive types.

For proposals that are not subject to the Equity Plan Scorecard evaluation, Shareholder Value Transfer is reasonable if it falls below a company-specific benchmark. The benchmark is determined as follows: The top quartile performers in each industry group (using the Global Industry Classification Standard: GICS) are identified. Benchmark SVT levels for each industry are established based on these top performers' historic SVT. Regression analyses are run on each industry group to identify the variables most strongly correlated to SVT. The benchmark industry SVT level is then adjusted upwards or downwards for the specific company by plugging the company-specific performance measures, size and cash compensation into the industry cap equations to arrive at the company's benchmark.<sup>18</sup>

### Three-Year Burn Rate

Burn-rate benchmarks (utilized in Equity Plan Scorecard evaluations) are calculated as the greater of: (1) the mean ( $\mu$ ) plus one standard deviation ( $\sigma$ ) of the company's GICS group segmented by S&P 500, Russell 3000 index (less the S&P500), and non-Russell 3000 index; and (2) two percent of weighted common shares outstanding. In addition, year-over-year burn-rate benchmark changes will be limited to a maximum of two (2) percentage points plus or minus the prior year's burn-rate benchmark. See the [U.S. Equity Compensation Plans FAQ](#) for the benchmarks.

### Egregious Factors

#### Liberal Change in Control Definition

Generally vote against equity plans if the plan has a liberal definition of change in control and the equity awards could vest upon such liberal definition of change in control, even though an actual change in control may not occur. Examples of such a definition include, but are not limited to, announcement or commencement of a tender offer, provisions for acceleration upon a "potential" takeover, shareholder approval of a merger or other transactions, or similar language.

#### Repricing Provisions

Vote against plans that expressly permit the repricing or exchange of underwater stock options/stock appreciate rights (SARs) without prior shareholder approval. "Repricing" typically includes the ability to do any of the following:

- Amend the terms of outstanding options or SARs to reduce the exercise price of such outstanding options or SARs;
- Cancel outstanding options or SARs in exchange for options or SARs with an exercise price that is less than the exercise price of the original options or SARs;
- Cancel underwater options in exchange for stock awards; or
- Provide cash buyouts of underwater options.

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<sup>18</sup> For plans evaluated under the Equity Plan Scorecard policy, the company's SVT benchmark is considered along with other factors.

While the above cover most types of repricing, ISS may view other provisions as akin to repricing depending on the facts and circumstances.

Also, vote against or withhold from members of the Compensation Committee who approved repricing (as defined above or otherwise determined by ISS), without prior shareholder approval, even if such repricings are allowed in their equity plan.

Vote against plans that do not expressly prohibit repricing or cash buyout of underwater options without shareholder approval if the company has a history of repricing/buyouts without shareholder approval, and the applicable listing standards would not preclude them from doing so.

### **Problematic Pay Practices or Significant Pay-for-Performance Disconnect**

If the equity plan on the ballot is a vehicle for [problematic pay practices](#), vote against the plan.

ISS may recommend a vote against the equity plan if the plan is determined to be a vehicle for pay-for-performance misalignment. Considerations in voting against the equity plan may include, but are not limited to:

- Severity of the pay-for-performance misalignment;
- Whether problematic equity grant practices are driving the misalignment; and/or
- Whether equity plan awards have been heavily concentrated to the CEO and/or the other NEOs.

### **Amending Cash and Equity Plans (including Approval for Tax Deductibility (162(m)))**



**General Recommendation:** Vote case-by-case on amendments to cash and equity incentive plans.

Generally vote for proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- Addresses administrative features only; or
- Seeks approval for Section 162(m) purposes only, and the plan administering committee consists entirely of independent directors, per [ISS' Classification of Directors](#). Note that if the company is presenting the plan to shareholders for the first time for any reason (including after the company's initial public offering), or if the proposal is bundled with other material plan amendments, then the recommendation will be case-by-case (see below).

Vote against proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal:

- Seeks approval for Section 162(m) purposes only, and the plan administering committee does not consist entirely of independent directors, per [ISS' Classification of Directors](#).

Vote case-by-case on all other proposals to amend cash incentive plans. This includes plans presented to shareholders for the first time after the company's IPO and/or proposals that bundle material amendment(s) other than those for Section 162(m) purposes.

Vote case-by-case on all other proposals to amend equity incentive plans, considering the following:

- If the proposal requests additional shares and/or the amendments include a term extension or addition of full value awards as an award type, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of the amendments.
- If the plan is being presented to shareholders for the first time (including after the company's IPO), whether or not additional shares are being requested, the recommendation will be based on the Equity Plan Scorecard evaluation as well as an analysis of the overall impact of any amendments.



- If there is no request for additional shares and the amendments do not include a term extension or addition of full value awards as an award type, then the recommendation will be based entirely on an analysis of the overall impact of the amendments, and the EPSC evaluation will be shown only for informational purposes.

In the first two case-by-case evaluation scenarios, the EPSC evaluation/score is the more heavily weighted consideration.

### Specific Treatment of Certain Award Types in Equity Plan Evaluations

#### **Dividend Equivalent Rights**

Options that have Dividend Equivalent Rights (DERs) associated with them will have a higher calculated award value than those without DERs under the binomial model, based on the value of these dividend streams. The higher value will be applied to new shares, shares available under existing plans, and shares awarded but not exercised per the plan specifications. DERS transfer more shareholder equity to employees and non-employee directors and this cost should be captured.

#### **Operating Partnership (OP) Units in Equity Plan Analysis of Real Estate Investment Trusts (REITs)**

For Real Estate Investment Trusts (REITs), include the common shares issuable upon conversion of outstanding Operating Partnership (OP) units in the share count for the purposes of determining: (1) market capitalization in the Shareholder Value Transfer (SVT) analysis and (2) shares outstanding in the burn rate analysis.

## Other Compensation Plans

### 401(k) Employee Benefit Plans

▷ **General Recommendation:** Vote for proposals to implement a 401(k) savings plan for employees.

### Employee Stock Ownership Plans (ESOPs)

▷ **General Recommendation:** Vote for proposals to implement an ESOP or increase authorized shares for existing ESOPs, unless the number of shares allocated to the ESOP is excessive (more than five percent of outstanding shares).

### Employee Stock Purchase Plans—Qualified Plans

▷ **General Recommendation:** Vote case-by-case on qualified employee stock purchase plans. Vote for employee stock purchase plans where all of the following apply:

- Purchase price is at least 85 percent of fair market value;
- Offering period is 27 months or less; and
- The number of shares allocated to the plan is 10 percent or less of the outstanding shares.

Vote against qualified employee stock purchase plans where when the plan features do not meet all of the above criteria.

### Employee Stock Purchase Plans—Non-Qualified Plans


▷ **General Recommendation:** Vote case-by-case on nonqualified employee stock purchase plans. Vote for nonqualified employee stock purchase plans with all the following features:

- Broad-based participation;
- Limits on employee contribution, which may be a fixed dollar amount or expressed as a percent of base salary;
- Company matching contribution up to 25 percent of employee's contribution, which is effectively a discount of 20 percent from market value; and

- No discount on the stock price on the date of purchase when there is a company matching contribution.

Vote against nonqualified employee stock purchase plans when the plan features do not meet all of the above criteria. If the matching contribution or effective discount exceeds the above, ISS may evaluate the SVT cost of the plan as part of the assessment.

### Option Exchange Programs/Repricing Options

 **General Recommendation:** Vote case-by-case on management proposals seeking approval to exchange/reprice options taking into consideration:


- Historic trading patterns--the stock price should not be so volatile that the options are likely to be back “in-the-money” over the near term;
- Rationale for the re-pricing--was the stock price decline beyond management's control?;
- Is this a value-for-value exchange?;
- Are surrendered stock options added back to the plan reserve?;
- Timing--repricing should occur at least one year out from any precipitous drop in company's stock price;
- Option vesting--does the new option vest immediately or is there a black-out period?;
- Term of the option--the term should remain the same as that of the replaced option;
- Exercise price--should be set at fair market or a premium to market;
- Participants--executive officers and directors must be excluded.

If the surrendered options are added back to the equity plans for re-issuance, then also take into consideration the company's total cost of equity plans and its three-year average burn rate.

In addition to the above considerations, evaluate the intent, rationale, and timing of the repricing proposal. The proposal should clearly articulate why the board is choosing to conduct an exchange program at this point in time. Repricing underwater options after a recent precipitous drop in the company's stock price demonstrates poor timing and warrants additional scrutiny. Also, consider the terms of the surrendered options, such as the grant date, exercise price and vesting schedule. Grant dates of surrendered options should be far enough back (two to three years) so as not to suggest that repricings are being done to take advantage of short-term downward price movements. Similarly, the exercise price of surrendered options should be above the 52-week high for the stock price.

Vote for shareholder proposals to put option repricings to a shareholder vote.


### Stock Plans in Lieu of Cash

 **General Recommendation:** Vote case-by-case on plans that provide participants with the option of taking all or a portion of their cash compensation in the form of stock.

Vote for non-employee director-only equity plans that provide a dollar-for-dollar cash-for-stock exchange.

Vote case-by-case on plans which do not provide a dollar-for-dollar cash for stock exchange. In cases where the exchange is not dollar-for-dollar, the request for new or additional shares for such equity program will be considered using the binomial option pricing model. In an effort to capture the total cost of total compensation, ISS will not make any adjustments to carve out the in-lieu-of cash compensation.

### Transfer Stock Option (TSO) Programs

 **General Recommendation:** One-time Transfers: Vote against or withhold from compensation committee members if they fail to submit one-time transfers to shareholders for approval.

Vote case-by-case on one-time transfers. Vote for if:

- Executive officers and non-employee directors are excluded from participating;
- Stock options are purchased by third-party financial institutions at a discount to their fair value using option pricing models such as Black-Scholes or a Binomial Option Valuation or other appropriate financial models; and
- There is a two-year minimum holding period for sale proceeds (cash or stock) for all participants.

Additionally, management should provide a clear explanation of why options are being transferred to a third-party institution and whether the events leading up to a decline in stock price were beyond management's control. A review of the company's historic stock price volatility should indicate if the options are likely to be back "in-the-money" over the near term.


Ongoing TSO program: Vote against equity plan proposals if the details of ongoing TSO programs are not provided to shareholders. Since TSOs will be one of the award types under a stock plan, the ongoing TSO program, structure and mechanics must be disclosed to shareholders. The specific criteria to be considered in evaluating these proposals include, but not limited to, the following:

- Eligibility;
- Vesting;
- Bid-price;
- Term of options;
- Cost of the program and impact of the TSOs on company's total option expense; and
- Option repricing policy.

Amendments to existing plans that allow for introduction of transferability of stock options should make clear that only options granted post-amendment shall be transferable.

## Director Compensation

### Shareholder Ratification of Director Pay Programs

 **General Recommendation:** Vote case-by-case on management proposals seeking ratification of non-employee director compensation, based on the following factors:

- If the equity plan under which non-employee director grants are made is on the ballot, whether or not it warrants support; and
- An assessment of the following qualitative factors:
  - The relative magnitude of director compensation as compared to companies of a similar profile;
  - The presence of problematic pay practices relating to director compensation;
  - Director stock ownership guidelines and holding requirements;
  - Equity award vesting schedules;
  - The mix of cash and equity-based compensation;
  - Meaningful limits on director compensation;
  - The availability of retirement benefits or perquisites; and
  - The quality of disclosure surrounding director compensation.

### Equity Plans for Non-Employee Directors

 **General Recommendation:** Vote case-by-case on compensation plans for non-employee directors, based on:


- The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants;
- The company's three-year burn rate relative to its industry/market cap peers (in certain circumstances); and

- The presence of any egregious plan features (such as an option repricing provision or liberal CIC vesting risk).

On occasion, non-employee director stock plans will exceed the plan cost or burn-rate benchmarks when combined with employee or executive stock plans. In such cases, vote case-by-case on the plan taking into consideration the following qualitative factors:


- The relative magnitude of director compensation as compared to companies of a similar profile;
- The presence of problematic pay practices relating to director compensation;
- Director stock ownership guidelines and holding requirements;
- Equity award vesting schedules;
- The mix of cash and equity-based compensation;
- Meaningful limits on director compensation;
- The availability of retirement benefits or perquisites; and
- The quality of disclosure surrounding director compensation.

### Non-Employee Director Retirement Plans


-  **General Recommendation:** Vote against retirement plans for non-employee directors. Vote for shareholder proposals to eliminate retirement plans for non-employee directors.

## Shareholder Proposals on Compensation


### Bonus Banking/Bonus Banking “Plus”

-  **General Recommendation:** Vote case-by-case on proposals seeking deferral of a portion of annual bonus pay, with ultimate payout linked to sustained results for the performance metrics on which the bonus was earned (whether for the named executive officers or a wider group of employees), taking into account the following factors:
- The company’s past practices regarding equity and cash compensation;
  - Whether the company has a holding period or stock ownership requirements in place, such as a meaningful retention ratio (at least 50 percent for full tenure); and
  - Whether the company has a rigorous claw-back policy in place.

### Compensation Consultants—Disclosure of Board or Company’s Utilization

-  **General Recommendation:** Generally vote for shareholder proposals seeking disclosure regarding the company, board, or compensation committee’s use of compensation consultants, such as company name, business relationship(s), and fees paid.

### Disclosure/Setting Levels or Types of Compensation for Executives and Directors

-  **General Recommendation:** Generally vote for shareholder proposals seeking additional disclosure of executive and director pay information, provided the information requested is relevant to shareholders' needs, would not put the company at a competitive disadvantage relative to its industry, and is not unduly burdensome to the company.

Generally vote against shareholder proposals seeking to set absolute levels on compensation or otherwise dictate the amount or form of compensation (such as types of compensation elements or specific metrics) to be used for executive or directors.

Generally vote against shareholder proposals that mandate a minimum amount of stock that directors must own in order to qualify as a director or to remain on the board.

Vote case-by-case on all other shareholder proposals regarding executive and director pay, taking into account relevant factors, including but not limited to: company performance, pay level and design versus peers, history of compensation concerns or pay-for-performance disconnect, and/or the scope and prescriptive nature of the proposal.

### Golden Coffins/Executive Death Benefits

- **General Recommendation:** Generally vote for proposals calling for companies to adopt a policy of obtaining shareholder approval for any future agreements and corporate policies that could oblige the company to make payments or awards following the death of a senior executive in the form of unearned salary or bonuses, accelerated vesting or the continuation in force of unvested equity grants, perquisites and other payments or awards made in lieu of compensation. This would not apply to any benefit programs or equity plan proposals for which the broad-based employee population is eligible.

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

- **General Recommendation:** Vote case-by-case on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain a portion of net shares acquired through compensation plans. The following factors will be taken into account:
- The percentage/ratio of net shares required to be retained;
  - The time period required to retain the shares;
  - Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
  - Whether the company has any other policies aimed at mitigating risk taking by executives;
  - Executives' actual stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's existing requirements; and
  - Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.

### Pay Disparity

- **General Recommendation:** Vote case-by-case on proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The following factors will be considered:
- The company's current level of disclosure of its executive compensation setting process, including how the company considers pay disparity;
  - If any problematic pay practices or pay-for-performance concerns have been identified at the company; and
  - The level of shareholder support for the company's pay programs.

Generally vote against proposals calling for the company to use the pay disparity analysis or pay ratio in a specific way to set or limit executive pay.


### Pay for Performance/Performance-Based Awards

- **General Recommendation:** Vote case-by-case on shareholder proposals requesting that a significant amount of future long-term incentive compensation awarded to senior executives shall be performance-based and requesting that the board adopt and disclose challenging performance metrics to shareholders, based on the following analytical steps:
- First, vote for shareholder proposals advocating the use of performance-based equity awards, such as performance contingent options or restricted stock, indexed options or premium-priced options, unless the proposal is overly restrictive or if the company has demonstrated that it is using a "substantial" portion of performance-based awards for its top executives. Standard stock options and performance-accelerated awards do not meet the criteria to be considered as performance-based awards. Further, premium-priced options should have a meaningful premium to be considered performance-based awards.

- Second, assess the rigor of the company's performance-based equity program. If the bar set for the performance-based program is too low based on the company's historical or peer group comparison, generally vote for the proposal. Furthermore, if target performance results in an above target payout, vote for the shareholder proposal due to program's poor design. If the company does not disclose the performance metric of the performance-based equity program, vote for the shareholder proposal regardless of the outcome of the first step to the test.

In general, vote for the shareholder proposal if the company does not meet both of the above two steps.

### Pay for Superior Performance


 **General Recommendation:** Vote case-by-case on shareholder proposals that request the board establish a pay-for-superior performance standard in the company's executive compensation plan for senior executives. These proposals generally include the following principles:

- Set compensation targets for the plan's annual and long-term incentive pay components at or below the peer group median;
- Deliver a majority of the plan's target long-term compensation through performance-vested, not simply time-vested, equity awards;
- Provide the strategic rationale and relative weightings of the financial and non-financial performance metrics or criteria used in the annual and performance-vested long-term incentive components of the plan;
- Establish performance targets for each plan financial metric relative to the performance of the company's peer companies;
- Limit payment under the annual and performance-vested long-term incentive components of the plan to when the company's performance on its selected financial performance metrics exceeds peer group median performance.

Consider the following factors in evaluating this proposal:


- What aspects of the company's annual and long-term equity incentive programs are performance driven?
- If the annual and long-term equity incentive programs are performance driven, are the performance criteria and hurdle rates disclosed to shareholders or are they benchmarked against a disclosed peer group?
- Can shareholders assess the correlation between pay and performance based on the current disclosure?
- What type of industry and stage of business cycle does the company belong to?

### Pre-Arranged Trading Plans (10b5-1 Plans)

 **General Recommendation:** Generally vote for shareholder proposals calling for certain principles regarding the use of prearranged trading plans (10b5-1 plans) for executives. These principles include:

- Adoption, amendment, or termination of a 10b5-1 Plan must be disclosed within two business days in a Form 8-K;
- Amendment or early termination of a 10b5-1 Plan is allowed only under extraordinary circumstances, as determined by the board;
- Ninety days must elapse between adoption or amendment of a 10b5-1 Plan and initial trading under the plan;
- Reports on Form 4 must identify transactions made pursuant to a 10b5-1 Plan;
- An executive may not trade in company stock outside the 10b5-1 Plan;
- Trades under a 10b5-1 Plan must be handled by a broker who does not handle other securities transactions for the executive.

### Prohibit Outside CEOs from Serving on Compensation Committees

 **General Recommendation:** Generally vote against proposals seeking a policy to prohibit any outside CEO from serving on a company's compensation committee, unless the company has demonstrated problematic pay practices that raise concerns about the performance and composition of the committee.

### Recoupment of Incentive or Stock Compensation in Specified Circumstances

- ▷ **General Recommendation:** : Vote case-by-case on proposals to recoup incentive cash or stock compensation made to senior executives if it is later determined that the figures upon which incentive compensation is earned turn out to have been in error, or if the senior executive has breached company policy or has engaged in misconduct that may be significantly detrimental to the company's financial position or reputation, or if the senior executive failed to manage or monitor risks that subsequently led to significant financial or reputational harm to the company. Many companies have adopted policies that permit recoupment in cases where an executive's fraud, misconduct, or negligence significantly contributed to a restatement of financial results that led to the awarding of unearned incentive compensation. However, such policies may be narrow given that not all misconduct or negligence may result in significant financial restatements. Misconduct, negligence or lack of sufficient oversight by senior executives may lead to significant financial loss or reputational damage that may have long-lasting impact.

In considering whether to support such shareholder proposals, ISS will take into consideration the following factors:

- If the company has adopted a formal recoupment policy;
- The rigor of the recoupment policy focusing on how and under what circumstances the company may recoup incentive or stock compensation;
- Whether the company has chronic restatement history or material financial problems;
- Whether the company's policy substantially addresses the concerns raised by the proponent;
- Disclosure of recoupment of incentive or stock compensation from senior executives or lack thereof; or
- Any other relevant factors.

### Severance Agreements for Executives/Golden Parachutes

- ▷ **General Recommendation:** Vote for shareholder proposals requiring that golden parachutes or executive severance agreements be submitted for shareholder ratification, unless the proposal requires shareholder approval *prior* to entering into employment contracts.

Vote case-by-case on proposals to ratify or cancel golden parachutes. An acceptable parachute should include, but is not limited to, the following:

- The triggering mechanism should be beyond the control of management;
- The amount should not exceed three times base amount (defined as the average annual taxable W-2 compensation during the five years prior to the year in which the change of control occurs);
- Change-in-control payments should be double-triggered, i.e., (1) after a change in control has taken place, and (2) termination of the executive as a result of the change in control. Change in control is defined as a change in the company ownership structure.

### Share Buyback Impact on Incentive Program Metrics

- ▷ **General Recommendation:** Vote case-by-case on proposals requesting the company exclude the impact of share buybacks from the calculation of incentive program metrics, considering the following factors:

- The frequency and timing of the company's share buybacks;
- The use of per-share metrics in incentive plans;
- The effect of recent buybacks on incentive metric results and payouts; and
- Whether there is any indication of metric result manipulation.

### Supplemental Executive Retirement Plans (SERPs)

- ▷ **General Recommendation:** Generally vote for shareholder proposals requesting to put extraordinary benefits contained in SERP agreements to a shareholder vote unless the company's executive pension plans do not contain excessive benefits beyond what is offered under employee-wide plans.

Generally vote for shareholder proposals requesting to limit the executive benefits provided under the company's supplemental executive retirement plan (SERP) by limiting covered compensation to a senior executive's annual salary or those pay elements covered for the general employee population.

### Tax Gross-Up Proposals

- **General Recommendation:** Generally vote for proposals calling for companies to adopt a policy of not providing tax gross-up payments to executives, except in situations where gross-ups are provided pursuant to a plan, policy, or arrangement applicable to management employees of the company, such as a relocation or expatriate tax equalization policy.

### Termination of Employment Prior to Severance Payment/Eliminating Accelerated Vesting of Unvested Equity

- **General Recommendation:** Vote case-by-case on shareholder proposals seeking a policy requiring termination of employment prior to severance payment and/or eliminating accelerated vesting of unvested equity.

The following factors will be considered:

- The company's current treatment of equity upon employment termination and/or in change-in-control situations (i.e., vesting is double triggered and/or pro rata, does it allow for the assumption of equity by acquiring company, the treatment of performance shares, etc.);
- Current employment agreements, including potential poor pay practices such as gross-ups embedded in those agreements.

Generally vote for proposals seeking a policy that prohibits automatic acceleration of the vesting of equity awards to senior executives upon a voluntary termination of employment or in the event of a change in control (except for pro rata vesting considering the time elapsed and attainment of any related performance goals between the award date and the change in control).



## 6. Routine/Miscellaneous

### Adjourn Meeting

- ▶ **General Recommendation:** Generally vote against proposals to provide management with the authority to adjourn an annual or special meeting absent compelling reasons to support the proposal.

Vote for proposals that relate specifically to soliciting votes for a merger or transaction if supporting that merger or transaction. Vote against proposals if the wording is too vague or if the proposal includes "other business."

### Amend Quorum Requirements

- ▶ **General Recommendation:** Vote against proposals to reduce quorum requirements for shareholder meetings below a majority of the shares outstanding unless there are compelling reasons to support the proposal.

### Amend Minor Bylaws

- ▶ **General Recommendation:** Vote for bylaw or charter changes that are of a housekeeping nature (updates or corrections).

### Change Company Name

- ▶ **General Recommendation:** Vote for proposals to change the corporate name unless there is compelling evidence that the change would adversely impact shareholder value.

### Change Date, Time, or Location of Annual Meeting

- ▶ **General Recommendation:** Vote for management proposals to change the date, time, or location of the annual meeting unless the proposed change is unreasonable.

Vote against shareholder proposals to change the date, time, or location of the annual meeting unless the current scheduling or location is unreasonable.

### Other Business

- ▶ **General Recommendation:** Vote against proposals to approve other business when it appears as a voting item.

## 7. Social and Environmental Issues

### Global Approach

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

- **General Recommendation:** Generally vote case-by-case, examining primarily whether implementation of the proposal is likely to enhance or protect shareholder value. The following factors will be considered:
- If the issues presented in the proposal are 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 or timeframe) or overly prescriptive;
  - The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
  - Whether there are significant controversies, fines, penalties, or litigation associated with the company's environmental or social practices;
  - If the proposal requests increased disclosure or greater transparency, whether reasonable and sufficient information is currently available to shareholders from the company or from other publicly available sources; and
  - If the proposal requests increased disclosure or greater transparency, whether implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.

### Endorsement of Principles

- **General Recommendation:** Generally vote against proposals seeking a company's endorsement of principles that support a particular public policy position. Endorsing a set of principles may require a company to take a stand on an issue that is beyond its own control and may limit its flexibility with respect to future developments. Management and the board should be afforded the flexibility to make decisions on specific public policy positions based on their own assessment of the most beneficial strategies for the company.

### Animal Welfare

#### Animal Welfare Policies

- **General Recommendation:** Generally vote for proposals seeking a report on a company's animal welfare standards, or animal welfare-related risks, unless:
- The company has already published a set of animal welfare standards and monitors compliance;
  - The company's standards are comparable to industry peers; and
  - There are no recent significant fines, litigation, or controversies related to the company's and/or its suppliers' treatment of animals.

### Animal Testing

➤ **General Recommendation:** Generally vote against proposals to phase out the use of animals in product testing, unless:

- The company is conducting animal testing programs that are unnecessary or not required by regulation;
- The company is conducting animal testing when suitable alternatives are commonly accepted and used by industry peers; or
- There are recent, significant fines or litigation related to the company's treatment of animals.

### Animal Slaughter

➤ **General Recommendation:** Generally vote against proposals requesting the implementation of Controlled Atmosphere Killing (CAK) methods at company and/or supplier operations unless such methods are required by legislation or generally accepted as the industry standard.

Vote case-by-case on proposals requesting a report on the feasibility of implementing CAK methods at company and/or supplier operations considering the availability of existing research conducted by the company or industry groups on this topic and any fines or litigation related to current animal processing procedures at the company.

## Consumer Issues

### Genetically Modified Ingredients

➤ **General Recommendation:** Generally vote against proposals requesting that a company voluntarily label genetically engineered (GE) ingredients in its products. The labeling of products with GE ingredients is best left to the appropriate regulatory authorities.

Vote case-by-case on proposals asking for a report on the feasibility of labeling products containing GE ingredients, taking into account:

- The potential impact of such labeling on the company's business;
- The quality of the company's disclosure on GE product labeling, related voluntary initiatives, and how this disclosure compares with industry peer disclosure; and
- Company's current disclosure on the feasibility of GE product labeling.

Generally vote against proposals seeking a report on the social, health, and environmental effects of genetically modified organisms (GMOs). Studies of this sort are better undertaken by regulators and the scientific community.

Generally vote against proposals to eliminate GE ingredients from the company's products, or proposals asking for reports outlining the steps necessary to eliminate GE ingredients from the company's products. Such decisions are more appropriately made by management with consideration of current regulations.

### Reports on Potentially Controversial Business/Financial Practices

➤ **General Recommendation:** Vote case-by-case on requests for reports on a company's potentially controversial business or financial practices or products, taking into account:

- Whether the company has adequately disclosed mechanisms in place to prevent abuses;
- Whether the company has adequately disclosed the financial risks of the products/practices in question;
- Whether the company has been subject to violations of related laws or serious controversies; and
- Peer companies' policies/practices in this area.

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

- **General Recommendation:** Generally vote against proposals requesting that companies implement specific price restraints on pharmaceutical products unless the company fails to adhere to legislative guidelines or industry norms in its product pricing practices.

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

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

Generally vote for proposals requesting that a company report on the financial and legal impact of its prescription drug reimportation policies unless such information is already publicly disclosed.

Generally vote against proposals requesting that companies adopt specific policies to encourage or constrain prescription drug reimportation. Such matters are more appropriately the province of legislative activity and may place the company at a competitive disadvantage relative to its peers.

### Product Safety and Toxic/Hazardous Materials

- **General Recommendation:** Generally vote for proposals requesting that a company report on its policies, initiatives/procedures, and oversight mechanisms related to toxic/hazardous materials or product safety in its supply chain, unless:

- The company already discloses similar information through existing reports such as a supplier code of conduct and/or a sustainability report;
- The company has formally committed to the implementation of a toxic/hazardous materials and/or product safety and supply chain reporting and monitoring program based on industry norms or similar standards within a specified time frame; and
- The company has not been recently involved in relevant significant controversies, fines, or litigation.

Vote case-by-case on resolutions requesting that companies develop a feasibility assessment to phase-out of certain toxic/hazardous materials, or evaluate and disclose the potential financial and legal risks associated with utilizing certain materials, considering:

- The company's current level of disclosure regarding its product safety policies, initiatives, and oversight mechanisms;
- Current regulations in the markets in which the company operates; and
- Recent significant controversies, litigation, or fines stemming from toxic/hazardous materials at the company.

Generally vote against resolutions requiring that a company reformulate its products.

### Tobacco-Related Proposals

- **General Recommendation:** Vote case-by-case on resolutions regarding the advertisement of tobacco products, considering:

- Recent related fines, controversies, or significant litigation;
- Whether the company complies with relevant laws and regulations on the marketing of tobacco;

- Whether the company's advertising restrictions deviate from those of industry peers;
- Whether the company entered into the Master Settlement Agreement, which restricts marketing of tobacco to youth; and
- Whether restrictions on marketing to youth extend to foreign countries.

Vote case-by-case on proposals regarding second-hand smoke, considering;


- Whether the company complies with all laws and regulations;
- The degree that voluntary restrictions beyond those mandated by law might hurt the company's competitiveness; and
- The risk of any health-related liabilities.

Generally vote against resolutions to cease production of tobacco-related products, to avoid selling products to tobacco companies, to spin-off tobacco-related businesses, or prohibit investment in tobacco equities. Such business decisions are better left to company management or portfolio managers.

Generally vote against proposals regarding tobacco product warnings. Such decisions are better left to public health authorities.

## Climate Change

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

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

- Whether the company already provides current, publicly-available information on the impact that climate change may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
- The company's level of disclosure compared to industry peers; and
- Whether there are significant controversies, fines, penalties, or litigation associated with the company's climate change-related performance.

Generally vote for proposals requesting a report on greenhouse gas (GHG) emissions from company operations and/or products and operations, unless:

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

Vote case-by-case on proposals that call for the adoption of GHG reduction goals from products and operations, taking into account:

- Whether the company provides disclosure of year-over-year GHG emissions performance data;
- Whether company disclosure lags behind industry peers;
- The company's actual GHG emissions performance;
- The company's current GHG emission policies, oversight mechanisms, and related initiatives; and

- Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to GHG emissions.

### Energy Efficiency

▷ **General Recommendation:** Generally vote for proposals requesting that a company report on its energy efficiency policies, unless:

- The company complies with applicable energy efficiency regulations and laws, and discloses its participation in energy efficiency policies and programs, including disclosure of benchmark data, targets, and performance measures; or
- The proponent requests adoption of specific energy efficiency goals within specific timelines.

### Renewable Energy

▷ **General Recommendation:** Generally vote for requests for reports on the feasibility of developing renewable energy resources unless the report would be duplicative of existing disclosure or irrelevant to the company's line of business.

Generally vote against proposals requesting that the company invest in renewable energy resources. Such decisions are best left to management's evaluation of the feasibility and financial impact that such programs may have on the company.

Generally vote against proposals that call for the adoption of renewable energy goals, taking into account:

- The scope and structure of the proposal;
- The company's current level of disclosure on renewable energy use and GHG emissions; and
- The company's disclosure of policies, practices, and oversight implemented to manage GHG emissions and mitigate climate change risks.

## Diversity

### Board Diversity

▷ **General Recommendation:** Generally vote for requests for reports on a company's efforts to diversify the board, unless:

- The gender and racial minority representation of the company's board is reasonably inclusive in relation to companies of similar size and business; and
- The board already reports on its nominating procedures and gender and racial minority initiatives on the board and within the company.

Vote case-by-case on proposals asking a company to increase the gender and racial minority representation on its board, taking into account:

- The degree of existing gender and racial minority diversity on the company's board and among its executive officers;
- The level of gender and racial minority representation that exists at the company's industry peers;
- The company's established process for addressing gender and racial minority board representation;
- Whether the proposal includes an overly prescriptive request to amend nominating committee charter language;
- The independence of the company's nominating committee;
- Whether the company uses an outside search firm to identify potential director nominees; and
- Whether the company has had recent controversies, fines, or litigation regarding equal employment practices.

### Equality of Opportunity

▷ **General Recommendation:** Generally vote for proposals requesting a company disclose its diversity policies or initiatives, or proposals requesting disclosure of a company's comprehensive workforce diversity data, including requests for EEO-1 data, unless:

- The company publicly discloses equal opportunity policies and initiatives in a comprehensive manner;
- The company already publicly discloses comprehensive workforce diversity data; and
- The company has no recent significant EEO-related violations or litigation.

Generally vote against proposals seeking information on the diversity efforts of suppliers and service providers. Such requests may pose a significant burden on the company.

### Gender Identity, Sexual Orientation, and Domestic Partner Benefits

▷ **General Recommendation:** Generally vote for proposals seeking to amend a company's EEO statement or diversity policies to prohibit discrimination based on sexual orientation and/or gender identity, unless the change would be unduly burdensome.

Generally vote against proposals to extend company benefits to, or eliminate benefits from, domestic partners. Decisions regarding benefits should be left to the discretion of the company.

### Gender, Race/Ethnicity Pay Gap

▷ **General Recommendation:** Vote case-by-case on requests for reports on a company's pay data by gender or race/ethnicity, or a report on a company's policies and goals to reduce any gender or race/ethnicity pay gaps, taking into account:

- The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy on fair and equitable compensation practices;
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender, race, or ethnicity pay gap issues;
- The company's disclosure regarding gender, race, or ethnicity pay gap policies or initiatives compared to its industry peers; and
- Local laws regarding categorization of race and/or ethnicity and definitions of ethnic and/or racial minorities.

## Environment and Sustainability

### Facility and Workplace Safety

▷ **General Recommendation:** Vote case-by-case on requests for workplace safety reports, including reports on accident risk reduction efforts, taking into account:

- The company's current level of disclosure of its workplace health and safety performance data, health and safety management policies, initiatives, and oversight mechanisms;
- The nature of the company's business, specifically regarding company and employee exposure to health and safety risks;
- Recent significant controversies, fines, or violations related to workplace health and safety; and
- The company's workplace health and safety performance relative to industry peers.

Vote case-by-case on resolutions requesting that a company report on safety and/or security risks associated with its operations and/or facilities, considering:

- The company's compliance with applicable regulations and guidelines;

- The company's current level of disclosure regarding its security and safety policies, procedures, and compliance monitoring; and
- The existence of recent, significant violations, fines, or controversy regarding the safety and security of the company's operations and/or facilities.

### General Environmental Proposals and Community Impact Assessments

➤ **General Recommendation:** Vote case-by-case on requests for reports on policies and/or the potential (community) social and/or environmental impact of company operations, considering:

- Current disclosure of applicable policies and risk assessment report(s) and risk management procedures;
- The impact of regulatory non-compliance, litigation, remediation, or reputational loss that may be associated with failure to manage the company's operations in question, including the management of relevant community and stakeholder relations;
- The nature, purpose, and scope of the company's operations in the specific region(s);
- The degree to which company policies and procedures are consistent with industry norms; and
- The scope of the resolution.

### Hydraulic Fracturing

➤ **General Recommendation:** Generally vote for proposals requesting greater disclosure of a company's (natural gas) hydraulic fracturing operations, including measures the company has taken to manage and mitigate the potential community and environmental impacts of those operations, considering:

- The company's current level of disclosure of relevant policies and oversight mechanisms;
- The company's current level of such disclosure relative to its industry peers;
- Potential relevant local, state, or national regulatory developments; and
- Controversies, fines, or litigation related to the company's hydraulic fracturing operations.

### Operations in Protected Areas

➤ **General Recommendation:** Generally vote for requests for reports on potential environmental damage as a result of company operations in protected regions, unless:

- Operations in the specified regions are not permitted by current laws or regulations;
- The company does not currently have operations or plans to develop operations in these protected regions; or
- The company's disclosure of its operations and environmental policies in these regions is comparable to industry peers.

### Recycling

➤ **General Recommendation:** Vote case-by-case on proposals to report on an existing recycling program, or adopt a new recycling program, taking into account:

- The nature of the company's business;
- The current level of disclosure of the company's existing related programs;
- The timetable and methods of program implementation prescribed by the proposal;
- The company's ability to address the issues raised in the proposal; and
- How the company's recycling programs compare to similar programs of its industry peers.

### Sustainability Reporting

➤ **General Recommendation:** Generally vote for proposals requesting that a company report on its policies, initiatives, and oversight mechanisms related to social, economic, and environmental sustainability, unless:



- The company already discloses similar information through existing reports or policies such as an environment, health, and safety (EHS) report; a comprehensive code of corporate conduct; and/or a diversity report; or
- The company has formally committed to the implementation of a reporting program based on Global Reporting Initiative (GRI) guidelines or a similar standard within a specified time frame.

### Water Issues

➤ **General Recommendation:** Vote case-by-case on proposals requesting a company report on, or adopt a new policy on, water-related risks and concerns, taking into account:

- The company's current disclosure of relevant policies, initiatives, oversight mechanisms, and water usage metrics;
- Whether or not the company's existing water-related policies and practices are consistent with relevant internationally recognized standards and national/local regulations;
- The potential financial impact or risk to the company associated with water-related concerns or issues; and
- Recent, significant company controversies, fines, or litigation regarding water use by the company and its suppliers.

## General Corporate Issues

### Charitable Contributions

➤ **General Recommendation:** Vote against proposals restricting a company from making charitable contributions. Charitable contributions are generally useful for assisting worthwhile causes and for creating goodwill in the community. In the absence of bad faith, self-dealing, or gross negligence, management should determine which, and if, contributions are in the best interests of the company.

### Data Security, Privacy, and Internet Issues

➤ **General Recommendation:** Vote case-by-case on proposals requesting the disclosure or implementation of data security, privacy, or information access and management policies and procedures, considering:

- The level of disclosure of company policies and procedures relating to data security, privacy, freedom of speech, information access and management, and Internet censorship;
- Engagement in dialogue with governments or relevant groups with respect to data security, privacy, or the free flow of information on the Internet;
- The scope of business involvement and of investment in countries whose governments censor or monitor the Internet and other telecommunications;
- Applicable market-specific laws or regulations that may be imposed on the company; and
- Controversies, fines, or litigation related to data security, privacy, freedom of speech, or Internet censorship.

### Environmental, Social, and Governance (ESG) Compensation-Related Proposals

➤ **General Recommendation:** Vote case-by-case on proposals to link, or report on linking, executive compensation to sustainability (environmental and social) criteria, considering:

- The scope and prescriptive nature of the proposal;
- Whether the company has significant and/or persistent controversies or regulatory violations regarding social and/or environmental issues;
- Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- The company's current level of disclosure regarding its environmental and social performance.

## Human Rights, Human Capital Management, and International Operations

### Human Rights Proposals

- ▷ **General Recommendation:** Generally vote for proposals requesting a report on company or company supplier labor and/or human rights standards and policies unless such information is already publicly disclosed.

Vote case-by-case on proposals to implement company or company supplier labor and/or human rights standards and policies, considering:

- The degree to which existing relevant policies and practices are disclosed;
- Whether or not existing relevant policies are consistent with internationally recognized standards;
- Whether company facilities and those of its suppliers are monitored and how;
- Company participation in fair labor organizations or other internationally recognized human rights initiatives;
- Scope and nature of business conducted in markets known to have higher risk of workplace labor/human rights abuse;
- Recent, significant company controversies, fines, or litigation regarding human rights at the company or its suppliers;
- The scope of the request; and
- Deviation from industry sector peer company standards and practices.

Vote case-by-case on proposals requesting that a company conduct an assessment of the human rights risks in its operations or in its supply chain, or report on its human rights risk assessment process, considering:

- The degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms;
- The company's industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
- Recent significant controversies, fines, or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and
- Whether the proposal is unduly burdensome or overly prescriptive.

### Mandatory Arbitration

- ▷ **General Recommendation:** Vote case-by-case on requests for a report on a company's use of mandatory arbitration on employment-related claims, taking into account:

- The company's current policies and practices related to the use of mandatory arbitration agreements on workplace claims;
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to the use of mandatory arbitration agreements on workplace claims; and
- The company's disclosure of its policies and practices related to the use of mandatory arbitration agreements compared to its peers.

### Operations in High Risk Markets

- ▷ **General Recommendation:** Vote case-by-case on requests for a report on a company's potential financial and reputational risks associated with operations in "high-risk" markets, such as a terrorism-sponsoring state or politically/socially unstable region, taking into account:

- The nature, purpose, and scope of the operations and business involved that could be affected by social or political disruption;

- Current disclosure of applicable risk assessment(s) and risk management procedures;
- Compliance with U.S. sanctions and laws;
- Consideration of other international policies, standards, and laws; and
- Whether the company has been recently involved in recent, significant controversies, fines, or litigation related to its operations in "high-risk" markets.

### Outsourcing/Offshoring

➤ **General Recommendation:** Vote case-by-case on proposals calling for companies to report on the risks associated with outsourcing/plant closures, considering:

- Controversies surrounding operations in the relevant market(s);
- The value of the requested report to shareholders;
- The company's current level of disclosure of relevant information on outsourcing and plant closure procedures; and
- The company's existing human rights standards relative to industry peers.

### Sexual Harassment

➤ **General Recommendation:** Vote case-by-case on requests for a report on company actions taken to strengthen policies and oversight to prevent workplace sexual harassment, or a report on risks posed by a company's failure to prevent workplace sexual harassment, taking into account:

- The company's current policies, practices, oversight mechanisms related to preventing workplace sexual harassment;
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to workplace sexual harassment issues; and
- The company's disclosure regarding workplace sexual harassment policies or initiatives compared to its industry peers.

### Weapons and Military Sales

➤ **General Recommendation:** Vote against reports on foreign military sales or offsets. Such disclosures may involve sensitive and confidential information. Moreover, companies must comply with government controls and reporting on foreign military sales.

Generally vote against proposals asking a company to cease production or report on the risks associated with the use of depleted uranium munitions or nuclear weapons components and delivery systems, including disengaging from current and proposed contracts. Such contracts are monitored by government agencies, serve multiple military and non-military uses, and withdrawal from these contracts could have a negative impact on the company's business.

## Political Activities

### Lobbying

➤ **General Recommendation:** Vote case-by-case on proposals requesting information on a company's lobbying (including direct, indirect, and grassroots lobbying) activities, policies, or procedures, considering:

- The company's current disclosure of relevant lobbying policies, and management and board oversight;
- The company's disclosure regarding trade associations or other groups that it supports, or is a member of, that engage in lobbying activities; and
- Recent significant controversies, fines, or litigation regarding the company's lobbying-related activities.

### Political Contributions

► **General Recommendation:** Generally vote for proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities, considering:

- The company's policies, and management and board oversight related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes;
- The company's disclosure regarding its support of, and participation in, trade associations or other groups that may make political contributions; and
- Recent significant controversies, fines, or litigation related to the company's political contributions or political activities.

Vote against proposals barring a company from making political contributions. Businesses are affected by legislation at the federal, state, and local level; barring political contributions can put the company at a competitive disadvantage.

Vote against proposals to publish in newspapers and other media a company's political contributions. Such publications could present significant cost to the company without providing commensurate value to shareholders.

### Political Ties

► **General Recommendation:** Generally vote against proposals asking a company to affirm political nonpartisanship in the workplace, so long as:

- There are no recent, significant controversies, fines, or litigation regarding the company's political contributions or trade association spending; and
- The company has procedures in place to ensure that employee contributions to company-sponsored political action committees (PACs) are strictly voluntary and prohibit coercion.

Vote against proposals asking for a list of company executives, directors, consultants, legal counsels, lobbyists, or investment bankers that have prior government service and whether such service had a bearing on the business of the company. Such a list would be burdensome to prepare without providing any meaningful information to shareholders.

## 8. Mutual Fund Proxies

### Election of Directors

- **General Recommendation:** Vote case-by-case on the election of directors and trustees, following the same guidelines for uncontested directors for public company shareholder meetings. However, mutual fund boards do not usually have compensation committees, so do not withhold for the lack of this committee.

### Closed End Funds- Unilateral Opt-In to Control Share Acquisition Statutes

- **General Recommendation:** For closed-end management investment companies (CEFs), vote against or withhold from nominating/governance committee members (or other directors on a case-by-case basis) at CEFs that have not provided a compelling rationale for opting-in to a Control Share Acquisition statute, nor submitted a by-law amendment to a shareholder vote.

### Converting Closed-end Fund to Open-end Fund

- **General Recommendation:** Vote case-by-case on conversion proposals, considering the following factors:
- Past performance as a closed-end fund;
  - Market in which the fund invests;
  - Measures taken by the board to address the discount; and
  - Past shareholder activism, board activity, and votes on related proposals.

### Proxy Contests

- **General Recommendation:** Vote case-by-case on proxy contests, considering the following factors:
- Past performance relative to its peers;
  - Market in which the fund invests;
  - Measures taken by the board to address the issues;
  - Past shareholder activism, board activity, and votes on related proposals;
  - Strategy of the incumbents versus the dissidents;
  - Independence of directors;
  - Experience and skills of director candidates;
  - Governance profile of the company;
  - Evidence of management entrenchment.

### Investment Advisory Agreements

- **General Recommendation:** Vote case-by-case on investment advisory agreements, considering the following factors:
- Proposed and current fee schedules;
  - Fund category/investment objective;
  - Performance benchmarks;
  - Share price performance as compared with peers;
  - Resulting fees relative to peers;
  - Assignments (where the advisor undergoes a change of control).

### Approving New Classes or Series of Shares

- **General Recommendation:** Vote for the establishment of new classes or series of shares.

### Preferred Stock Proposals

- **General Recommendation:** Vote case-by-case on the authorization for or increase in preferred shares, considering the following factors:

- Stated specific financing purpose;
- Possible dilution for common shares;
- Whether the shares can be used for antitakeover purposes.

### 1940 Act Policies

➤ **General Recommendation:** Vote case-by-case on policies under the Investment Advisor Act of 1940, considering the following factors:

- Potential competitiveness;
- Regulatory developments;
- Current and potential returns; and
- Current and potential risk.

Generally vote for these amendments as long as the proposed changes do not fundamentally alter the investment focus of the fund and do comply with the current SEC interpretation.

### Changing a Fundamental Restriction to a Nonfundamental Restriction

➤ **General Recommendation:** Vote case-by-case on proposals to change a fundamental restriction to a non-fundamental restriction, considering the following factors:

- The fund's target investments;
- The reasons given by the fund for the change; and
- The projected impact of the change on the portfolio.

### Change Fundamental Investment Objective to Nonfundamental

➤ **General Recommendation:** Vote against proposals to change a fund's fundamental investment objective to non-fundamental.

### Name Change Proposals

➤ **General Recommendation:** Vote case-by-case on name change proposals, considering the following factors:

- Political/economic changes in the target market;
- Consolidation in the target market; and
- Current asset composition.

### Change in Fund's Subclassification

➤ **General Recommendation:** Vote case-by-case on changes in a fund's sub-classification, considering the following factors:

- Potential competitiveness;
- Current and potential returns;
- Risk of concentration;
- Consolidation in target industry.

### Business Development Companies—Authorization to Sell Shares of Common Stock at a Price below Net Asset Value

➤ **General Recommendation:** Vote for proposals authorizing the board to issue shares below Net Asset Value (NAV) if:

- The proposal to allow share issuances below NAV has an expiration date no more than one year from the date shareholders approve the underlying proposal, as required under the Investment Company Act of 1940;
- The sale is deemed to be in the best interests of shareholders by (1) a majority of the company's independent directors and (2) a majority of the company's directors who have no financial interest in the issuance; and

- The company has demonstrated responsible past use of share issuances by either:
- Outperforming peers in its 8-digit GICS group as measured by one- and three-year median TSRs; or
- Providing disclosure that its past share issuances were priced at levels that resulted in only small or moderate discounts to NAV and economic dilution to existing non-participating shareholders.

#### Disposition of Assets/Termination/Liquidation

▷ **General Recommendation:** Vote case-by-case on proposals to dispose of assets, to terminate or liquidate, considering the following factors:

- Strategies employed to salvage the company;
- The fund's past performance;
- The terms of the liquidation.

#### Changes to the Charter Document

▷ **General Recommendation:** Vote case-by-case on changes to the charter document, considering the following factors:

- The degree of change implied by the proposal;
- The efficiencies that could result;
- The state of incorporation;
- Regulatory standards and implications.

Vote against any of the following changes:

- Removal of shareholder approval requirement to reorganize or terminate the trust or any of its series;
- Removal of shareholder approval requirement for amendments to the new declaration of trust;
- Removal of shareholder approval requirement to amend the fund's management contract, allowing the contract to be modified by the investment manager and the trust management, as permitted by the 1940 Act;
- Allow the trustees to impose other fees in addition to sales charges on investment in a fund, such as deferred sales charges and redemption fees that may be imposed upon redemption of a fund's shares;
- Removal of shareholder approval requirement to engage in and terminate subadvisory arrangements;
- Removal of shareholder approval requirement to change the domicile of the fund.

#### Changing the Domicile of a Fund

▷ **General Recommendation:** Vote case-by-case on re-incorporations, considering the following factors:

- Regulations of both states;
- Required fundamental policies of both states;
- The increased flexibility available.

#### Authorizing the Board to Hire and Terminate Subadvisers Without Shareholder Approval

▷ **General Recommendation:** Vote against proposals authorizing the board to hire or terminate subadvisers without shareholder approval if the investment adviser currently employs only one subadviser.

#### Distribution Agreements

▷ **General Recommendation:** Vote case-by-case on distribution agreement proposals, considering the following factors:

- Fees charged to comparably sized funds with similar objectives;
- The proposed distributor's reputation and past performance;
- The competitiveness of the fund in the industry;
- The terms of the agreement.

### Master-Feeder Structure

- ▶ **General Recommendation:** Vote for the establishment of a master-feeder structure.

### Mergers

- ▶ **General Recommendation:** Vote case-by-case on merger proposals, considering the following factors:

- Resulting fee structure;
- Performance of both funds;
- Continuity of management personnel;
- Changes in corporate governance and their impact on shareholder rights.

## Shareholder Proposals for Mutual Funds

### Establish Director Ownership Requirement

- ▶ **General Recommendation:** Generally vote against shareholder proposals that mandate a specific minimum amount of stock that directors must own in order to qualify as a director or to remain on the board.

### Reimburse Shareholder for Expenses Incurred

- ▶ **General Recommendation:** Vote case-by-case on shareholder proposals to reimburse proxy solicitation expenses. When supporting the dissidents, vote for the reimbursement of the proxy solicitation expenses.

### Terminate the Investment Advisor

- ▶ **General Recommendation:** Vote case-by-case on proposals to terminate the investment advisor, considering the following factors:

- Performance of the fund's Net Asset Value (NAV);
- The fund's history of shareholder relations;
- The performance of other funds under the advisor's management.



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### EXHIBIT 3

#### **Managers Not Using ISS Proxy Voting Services – FY 2021**

##### Defined Benefit Managers

Arrowstreet 130/30

Baillie Gifford Global

Baillie Gifford Emerging Markets

Jackson Square

Lansdowne Global Long Only

All hedge funds except for Advent

##### Defined Contribution Managers

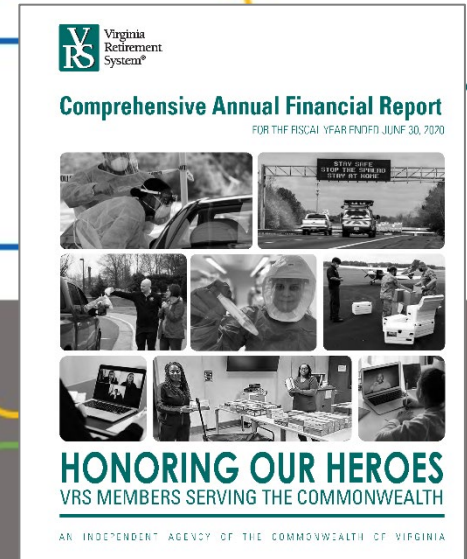
All

##### Optional Retirement Plan for Higher Education Managers

All

# Producing the VRS Annual Reports

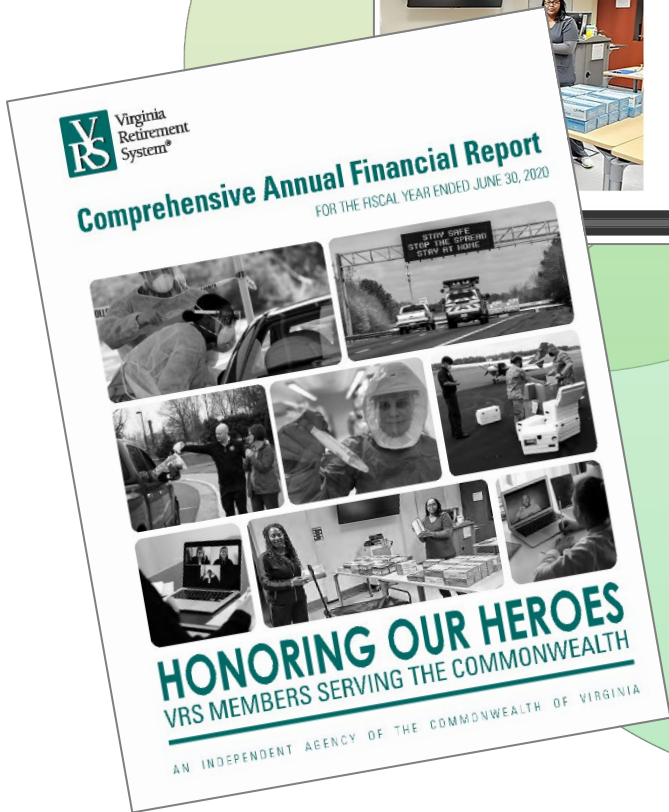
VRS Board of Trustees Meeting  
November 16, 2021



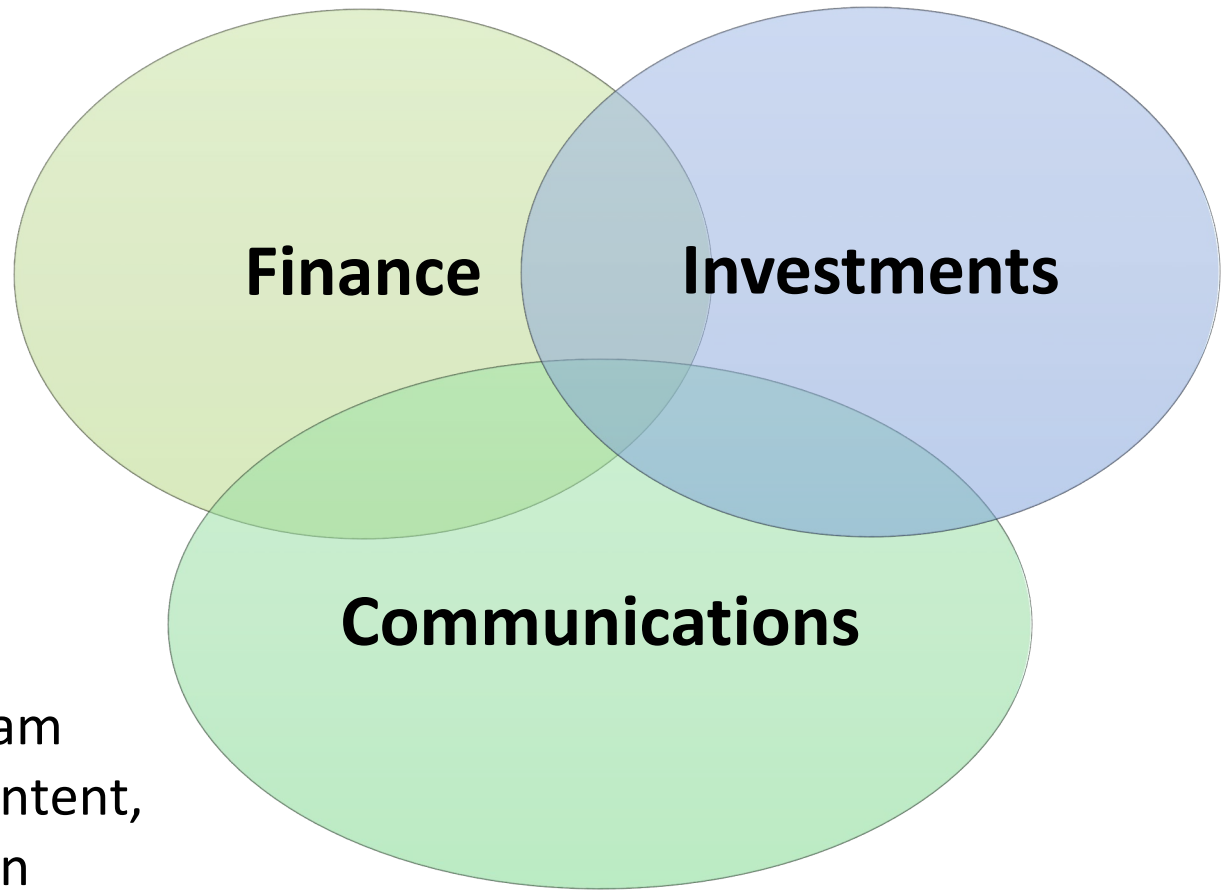
# The Final Products



## HONORING OUR HEROES

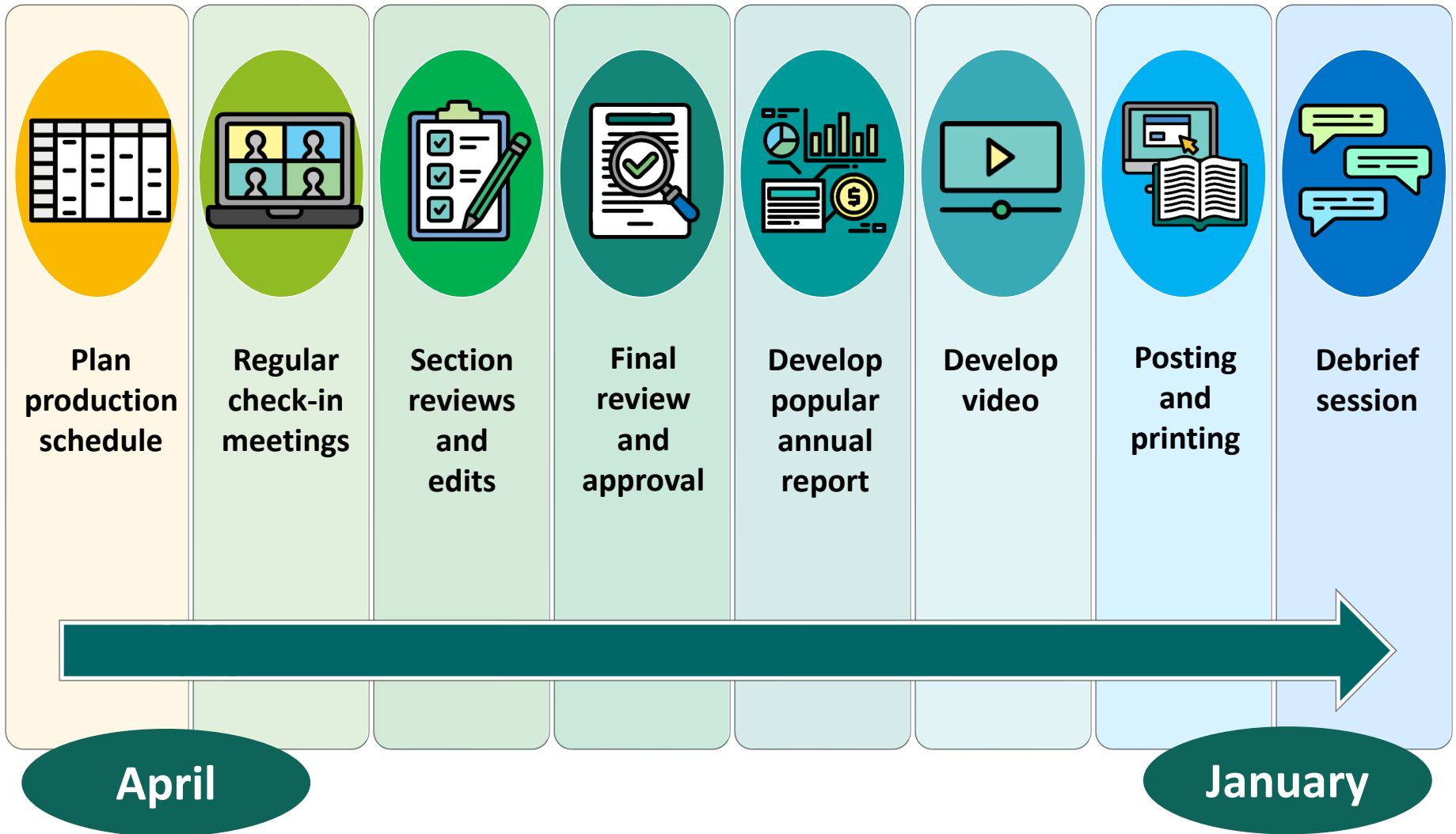


## Annual Report Core Team:



We also appreciate the involvement of many others at VRS who assist the core team with Annual Report content, reviews and production

# Schedule and Production



# Design and Key Messages



How do we tell this year's VRS story?

What have we accomplished?



What are the key messages?

What images or designs help us tell the story?



Include key messages in major content items



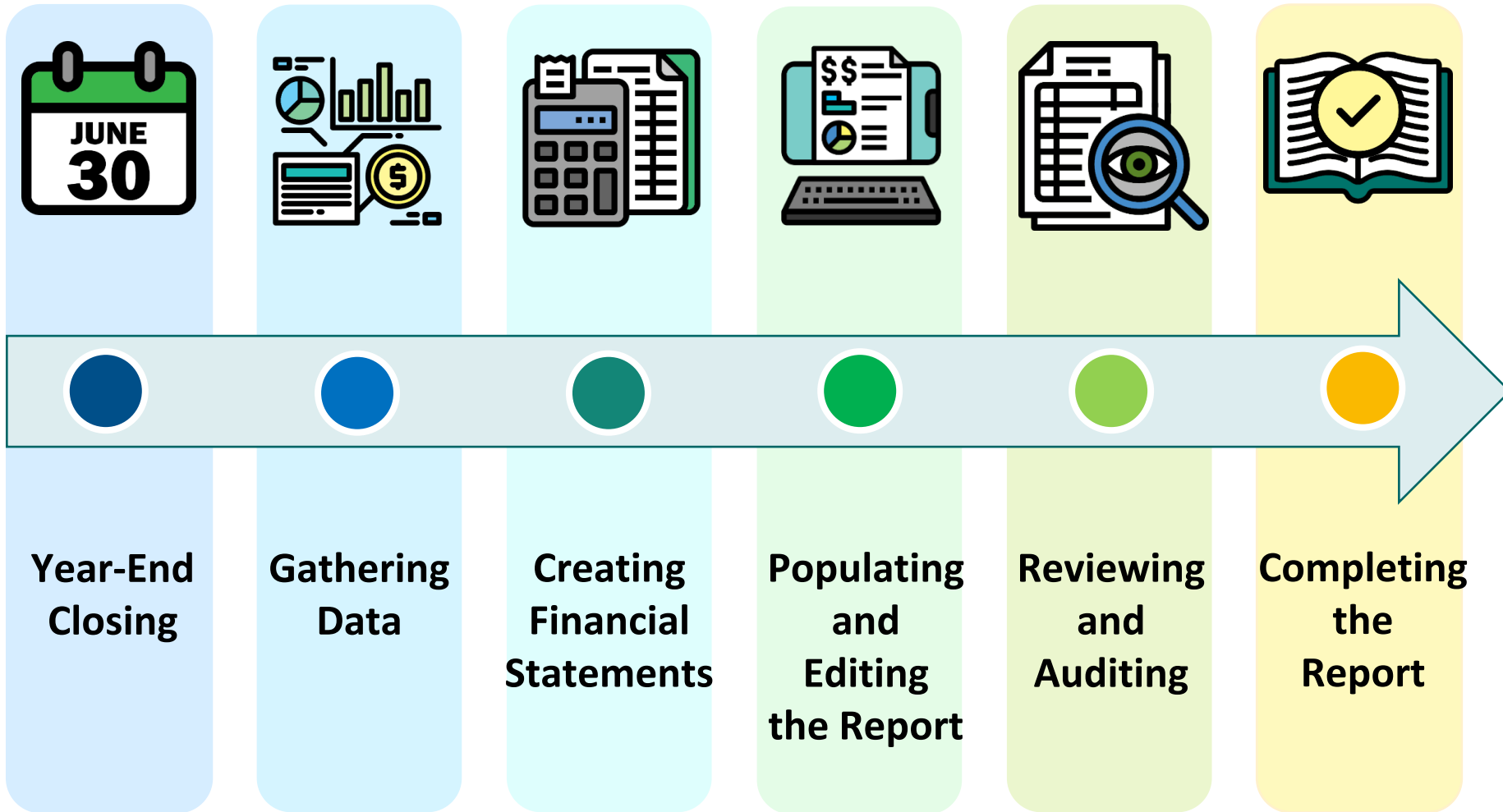
Develop a design proposal for the cover and dividers

# Wdesk: Where It All Comes Together





# Interactions Within VRS



# Interactions Beyond VRS



## **Auditor of Public Accounts (APA)**

APA audits the Financial, Investment, Actuarial and Statistical Sections and issues an opinion



## **Government Finance Officers Association (GFOA)**

GFOA provides criteria for the annual report and recognizes outstanding work with awards



## **Department of Accounts (DOA)**

VRS provides information for the Commonwealth's annual report, published by DOA

# Traditions of Excellence



Government Finance Officers Association

## Certificate of Achievement for Excellence in Financial Reporting

Presented to

**Virginia Retirement System**

For its Comprehensive Annual Financial Report  
For the Fiscal Year Ended

June 30, 2020

*Christopher P. Morill*

Executive Director/CEO

**39 consecutive years**



Government Finance Officers Association

## Award for Outstanding Achievement in Popular Annual Financial Reporting

Presented to

**Virginia Retirement System**

For its Annual Financial Report  
for the Fiscal Year Ended

June 30, 2020

*Christopher P. Morill*

Executive Director/CEO

**5 consecutive years**

**Thank you!**

Coverage Elected	Details
Tax-Deferred Purchase of Prior Service	- City of Norfolk Effective January 1, 2022



## VRS Project Portfolio FISCAL YEAR 2022 October 2021 - Monthly Status

**Status Indicator**

- Proceeding as planned
- ▲ Off plan, mitigation in place
- ◆ Off plan, mitigation needed
- ★ Completed
- Project timeline
- N/S Not started

		2021						2022							
		Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun		
<b>Agency Performance Objectives (APOs)</b>	<b>Status</b>														
Cloud Migration	▲														
ERM Implementation	●														
Records Management Program - Phase 1 Implementation	●														
Cardinal HCM Implementation - The Plan (Track 1), Agency (Track 2) and Retiree (Track 3)	●														
<b>IT Initiatives<sup>1</sup></b>	<b>Status</b>														
Upgrade Angular JS Framework to Angular	●														
IT Security - Fraud Prevention Initiatives	N/S														
Security Maturity Assessment	●														
Sagitec Framework Upgrade	●														
SharePoint Online	●														
<b>Other Projects<sup>2</sup></b>	<b>Status</b>														
Employee Engagement Initiative Implementation	●														
Implement Performance Management Evaluation Process	●														
Develop FY 22-26 Strategic Plan Operational Initiatives	●														
VSDP and VLDP Long Term Care Plans RFP	●														
Implement Enterprise Electronic Signature Solution	N/S														
Develop and Implement Strategy to switch 'Retiree News' letter from Print to Electronic	N/S														
LODA Annual Report	●														
Develop Strategy and Begin CCC Customer Experience Survey	N/S														
Develop Strategy for Handling Undelivered Mail Received by VRS and TPAs	N/S														
Death Match Services RFP (current services end September 30)	●														
Convert Paper Personnel Files to Electronic	N/S														
Employees Job Descriptions Update - Phase 1 <sup>3</sup>	●														
Post Pandemic Return to the Office	●														
<b>Operational/Ongoing Activities</b>	<b>Status</b>														
COLA 2021	★														
FYE 2021	★														
Retirement Wave 2021	★														
Teacher Contracts	★														
MBPs	★														
Annual Code of Ethics Training	N/S														
Annual Security Awareness Training	●														
FOIA Training	N/S														
ACFR	●														
PAFR	●														
GASB 67	●														
GASB 68	N/S														
GASB 74	●														
GASB 75	N/S														
Actuarial Valuations	●														
myVRS Annual Updates	N/S														
1099/W2	N/S														

Operational/Ongoing Activities	Status	2021						2022							
		Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun		
Annual Roadmap Review	N/S														
Biennium Budget	●														
FYE 2022	N/S														
Retirement Wave 2022	N/S														
Commonwealth Bond Disclosure	●														
ORPHE Surcharge Billing for FY 2023	N/S														
Data Fixes	●														
ALM Backlog Prioritization	●														
Employer Compliance Review	N/S														
VRS Fund Sensitivity and Stress Testing Report for GA	N/S														
Legislation FY 2022 - Placeholder	N/S														

<sup>1</sup> Initiatives led directly by Technology Services.

<sup>2</sup> Other initiatives are led by other business units and supported by Technology Services.

<sup>3</sup> Update Employee Job Descriptions Phase 1 scope focuses on updating, reviewing and finalizing job descriptions. The corresponding system changes (RAMS) will be part of phase 2.

### Yellow Status Items

Item	Due Date	Comments
Cloud Migration	TBD	Due to scope and schedule issues with the migration vendor, VRS leadership decided to pause the project and re-evaluate the approach. However, necessary foundational work such as documenting current systems will continue and a revised approach and roadmap will be finalized in the next few months.

### Red Status Items

Item	Due Date	Comments
N/A		

### Realignments/Adjustments

Item	Due Date	Comments
N/A		