

Generation Investment Management

Proxy Voting Principles

2022

Introduction

Commitment to responsible ownership

Generation's mission is to deliver superior investment performance by taking a long-term investment view and integrating sustainability research within a rigorous fundamental equity analysis framework¹. The analysis of corporate governance directly informs our assessment of Management Quality of each company and we take our responsibilities as shareholders very seriously. We engage with companies via constructive dialogue as a means of enhancing and protecting our investments and we seek to vote all our proxies. It is our aim consistently to meet the standards of the UK Stewardship Code.

We use Institutional Shareholder Services (ISS) as our independent voting service provider because of the depth of research they provide. However, we do not automatically follow the proxy voting recommendations of any third-party adviser. Nor do we have a separate corporate governance or proxy voting team. We believe that each analyst should review the relevant corporate governance issues on a case-by-case basis and exercise their best judgement given their deep knowledge of the company and the status of our engagement. In part this is feasible because we have a small portfolio and we see each proxy voting decision as an opportunity for analysts to gain additional insight into companies and express their views to management.

Clients with segregated accounts may, if desired, direct their own voting.

Principles for proxy voting

Purpose of this document

This document is intended to assist the analysts in making proxy voting decisions, but should not be seen as prescriptive or as a guide to how Generation will vote in all instances. Generation does not operate a rules-based voting approach and all voting decisions are ultimately at the discretion of the analysts given their knowledge of the company concerned. These guidelines are therefore only an indication of Generation's voting principles that are consistent with the values and mission of the firm and not intended to limit in any way the analysis of individual issues at specific companies.

Use of abstain votes

Proposed positions are expressed as FOR and AGAINST votes. Generally Generation does not use ABSTAIN votes, except where, on a case-by-case basis, the analyst determines that this best conveys Generation's view.

For example, the analyst has established that a company has plans to address a social or environmental issue. At the same time a shareholder resolution is on the ballot proposing an alternative way of addressing the same issue. An ABSTAIN vote may be the best way of expressing, in the circumstances, that Generation supports action on the issue at hand, but does not require the company to change its preferred approach. In this situation a FOR vote would not be warranted but an AGAINST vote could give the erroneous message that Generation was not concerned about the issue at hand.

Another example would be a company that has not yet met the minimum requirements we have communicated to companies on climate change. However, the company has made a firm undertaking that it will address our concerns before the end of the calendar year. An ABSTAIN vote on the re-election of the Chairman may be the best way of

¹ Generation seeks to deliver superior performance, but there can be no guarantee this goal will be achieved.

expressing our concern that our expectations have not been fulfilled with greater urgency, while acknowledging that a commitment has been made to satisfy our requirements.

Auditors & audit committee

We believe the relationship between the company and its auditors should be limited primarily to the audit engagement, although it may include certain closely related activities that do not, in the aggregate, compromise the independence of the audit.

We will evaluate on a CASE-BY-CASE basis instances in which the audit firm has a substantial non-audit relationship with the company (regardless of its size relative to the audit fee) to determine whether we believe independence has been or may be compromised.

We expect companies to ensure that their financial reports and accounts are prepared using assumptions consistent with the Paris Agreement, including net zero GHG emissions no later than 2050 (for example with regard to the valuation of assets). Likewise we expect auditors only to sign off financial statements that have incorporated material climate-related risks in a manner consistent with the Paris Agreement. Where companies face material climate-related risks, we will evaluate the performance of auditors and the audit committee in line with these expectations.

We are supportive of the rotation of auditors. We expect audit contracts to be tendered at least every 10 years and do not expect an auditor to be in place for longer than 20 years.

PROPOSED POSITION

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
- The auditor is an unknown firm lacking capability to perform the audit
- Fees generated from non-audit services are excessive in the context of company size
- The company is not responsive to shareholder questions about specific items that should be publicly disclosed
- There is reason to believe that the independent auditor has rendered an opinion which is neither accurate nor indicative of the company's financial position
- An auditor has signed off financial statements that do not appropriately incorporate material climate-related risks in a manner consistent with the Paris Agreement
- The audit contract has not been tendered in the past 10 years or the auditor has been in place for longer than 20 years

Board election & structure

Board structure provides the essential foundation for strong corporate governance. For that reason, we will monitor and evaluate Board composition at portfolio companies and come to a thorough understanding of the issues.

Voting on director nominees

In general, unless there are specific concerns about a nominee, we should support management's selection.

Where there are serious concerns about a director's performance of their specific responsibilities on the Board, we should vote against the election of that director.

As an escalation measure in the cases of most serious concern, where a company has not been at all responsive to engagement, it may be appropriate to vote against all members of a Board committee or a wider selection of directors.

PROPOSED POSITION

Vote FOR director nominees, after examining the following factors:

- Independence of the Board, including of Chairman vs. CEO and presence of lead independent director, and key Board committees
- Diversity of the Board, including gender, under-represented minorities, age and background
- Reputation, relevant skills and expertise of the Board (i.e. understanding of business and competitive landscape, regulation, critical sustainability factors, customers, key risks, strategic priorities, broader stakeholders, company culture, etc.)
- Attendance at Board meetings and time availability (generally no more than 1 NED position at another public company for executives; and no more than 4 NED positions at public companies for NEDs, including the position at the company being voted)
- Tenure (Generation does not specify a single tenure limit; analysts should consider NEDs' ongoing suitability on a case-by-case basis)
- Corporate governance provisions
- Takeover activity
- Long-term company performance
- Responsiveness to shareholder concerns
- Concerns about past performance of the company or the Board concerning Board activities
- Performance of their specific responsibilities as Chair of a Board committee or Chairman of the Board:
- the Chair of the Compensation Committee should be held to account for serious concerns about the determination of executive compensation
- the Chair of the Audit Committee should be held to account for serious concerns with regards to accounting or auditing
- the Chair of the Nomination Committee should be held to account for serious concerns with regards to appointments, including the diversity of the Board or, where within their responsibilities, the diversity of the executive committee
- the Chair of the Board should be held to account for serious governance concerns, including failure to meet our previously communicated expectations with respect to climate disclosure and/or action

Board classification

All Board members should be accountable to shareholders on an annual basis. The re-election of Board members by shareholders on an annual basis is important to ensure that directors serve in the shareholders' best interests. Classified Boards (also known as Staggered Boards) make it more difficult to effect a change of control through a proxy contest because it takes at least two elections to replace a majority of the Board.

PROPOSED POSITION

- Vote AGAINST proposals to classify the Board
- Vote FOR proposals to repeal classified Boards and to elect all directors annually
- Vote FOR proposals to fix Board size
- Vote AGAINST the Chairman or lead independent director in cases of elevated concern

Separate Chairman and CEO

Because some companies have governance structures in place that counterbalance a combined position, certain factors should be taken into account in determining whether the proposal warrants support. These factors include the presence of a lead independent director, Board and committee independence, governance guidelines, company performance, and annual review by outside directors of CEO pay. Where possible, we should support the separation of the CEO and Chairman position.

PROPOSED POSITION

- Vote FOR shareholder proposals requiring that the positions of Chairman and CEO are held separately

Proxy contest

Votes in a contested election of directors should be evaluated on a CASE-BY-CASE basis, considering factors that include the company's long-term financial performance, management's track record, qualifications of director nominees (both slates), and an evaluation of what each side is offering shareholders.

Majority of independent directors/establishment of committees:

Independent directors have the ability to distance themselves from the company and make decisions that are in the best interests of shareholders.

PROPOSED POSITION

- Vote FOR shareholder proposals asking that a majority or more of directors be independent
- Vote FOR shareholder proposals asking that Board audit, compensation and/or nomination committees be composed exclusively of independent directors if they currently do not meet that standard

Non-executive director compensation

In most countries, proposals to approve fees for non-executive directors are not controversial unless the compensation is excessive. Here it is important to look at the aggregate amount paid to non-executive directors, as well as any past history of abuse. Most of the decisions related to director compensation will have to be taken on a CASE-BY-CASE basis.

PROPOSED POSITION

- Vote AGAINST proposals to introduce retirement benefits for non-executive directors

Compensation (including stock options) and employment contracts

Executive compensation can have an impact on behaviour to promote the firm's long-term interest. Overall compensation packages with performance-based incentives can be effective to align management with improved company performance.

Executive director compensation & stock options

Disclosure of executive compensation is important to the level of transparency within a company. To align management with long-term shareholder value, equity-based awards are particularly attractive. These may be in the form of stock options, restricted stock/restricted stock units and performance shares/performance share units. A company's stock option treatment gives an indication of transparency and financial discipline, and we believe broadly that companies should expense stock options.

We believe any well-designed compensation programme should include the following: (1) balanced scorecards, with both financial and non-financial metrics, reflecting the interests of shareholders, customers, employees and other stakeholders; (2) financial metrics that are long-term and correlated with shareholder interests (e.g. return on capital, cash flow per share); (3) outsized rewards only for strong performance, paid largely in shares subject to meaningful holding periods; (4) transparent terms, verifiable and easily understood by all stakeholders; and (5) limited Board discretion for upward adjustments when performance has been weak.

Non-financial criteria must not be vague nor easy to manipulate; they should be well-thought through, objective and, where possible, supported by independent metrics, such as achievement of carbon emissions reduction targets, achievement of diversity targets, net promoter scores or employee satisfaction scores.

Our preferred financial metric is rolling 3-year free cash flow per share. For practical purposes, we view EPS, and to a lesser extent EBITDA, as satisfactory. However, this is only the case if they include a capital charge for acquisitions and minimal other adjustments.

Outsized awards must only be made when they are warranted by exceptional and ethical results. Awards should be largely paid in shares (i.e., >80%) and subject to both meaningful holding periods (at least 3 years but preferably longer) and robust clawback terms for malus and/or subsequent underperformance.

Large annual cash awards incentivise short term behaviour, do little to improve alignment with shareholders and should be avoided.

Compensation committees should be comfortable paying zero on "performance-based awards" if results are poor (50th percentile or below relative TSR does not merit a performance award many multiples of the average associate's pay).

We dislike large severance payments for underperforming executives.

We like to see executive compensation articulated within the context of the compensation policy of the company as a whole, including through disclosure of pay ratios including to the median, upper and lower quartile employee. We expect pension contribution rates to be aligned with those available to the majority of the company's workforce.

A shareholder shouldn't need a lawyer to interpret a proxy statement, and disclosure should include sufficient data to verify that compensation decisions were well-grounded.

Board members can become captive to management teams. In our experience, there is always an excuse for missing performance targets. Therefore the compensation committee should have limited discretion to make adjustments after the performance period. In particular, long-term incentive plans are already intended to reflect performance over the cycle and there must be truly exceptional reasons for adjustments to long-term incentive plans. We will be much better disposed to upward discretion if we have also seen downward discretion being exercised.

PROPOSED POSITION

Compensation packages should be reviewed on a CASE-BY-CASE basis. Factors to be considered include:

- Long-term orientation (generally no less than 3 years vesting and long lock-up / holding period for shares)
- Weight of stock vs. cash compensation
- Shareholder value creation, including in relation to peers
- Metrics used to determine compensation: we favour a balanced scorecard approach, with metrics such as cash flow and ROCE which are less subject to adjustments; we favour inclusion of sustainability metrics
- Overall size of compensation packages, including in relation to value created and compensation policy of the company as a whole: outsized rewards must be clearly justified by exceptional performance
- Transparency
- Use of discretion
- Vote AGAINST equity plans that explicitly permit re-pricing or where the company has a history of re-pricing without shareholder approval
- Vote on management proposal seeking approval to re-price options on a CASE-BY-CASE basis, evaluating historic trading patterns, option vesting, term of the option, exercise price and rationale

Anti-takeover mechanisms

Common mechanisms include poison pills, Staggered Boards, and super-voting shares. These mechanisms generally limit shareholder value by eliminating the takeover or control premium for the company. Generally, we are against such defences and supportive of the principle of “one share, one vote”.

PROPOSED POSITION

- Review on a CASE-BY-CASE basis anti-takeover proposals. Ensure that they are structured in such a way that they give shareholders the ultimate decision on any proposal
- Review on a CASE-BY-CASE basis shareholder proposals to redeem a company’s poison pill and management’s proposals to ratify a poison pill

Mergers & acquisitions

Mergers & Acquisitions have significant impact on shareholder value and any vote should carefully consider this impact. The requirement to vote on M&A activity varies by company and by country, and must be understood by each analyst in the appropriate context.

PROPOSED POSITION

- Vote CASE-BY-CASE on mergers and corporate restructurings based on such features as the fairness opinion, pricing, strategic rationale, and the negotiation process

Shareholder proposals/shareholders rights

Most shareholder proposals can be classified in three areas: corporate governance, social and environmental. Generation has typically found that shareholder proposals on ESG issues merit support. Where the analyst judges that support is not warranted, a clear rationale will be recorded.

Corporate governance issues

We believe that shareholders should have an appropriate voice in the company's decisions in line with generally accepted good governance provisions.

PROPOSED POSITION

Vote CASE-BY-CASE on proposals to allow or make easier shareholder action by written consent / proposals to restrict or prohibit shareholder ability to take action by written consent. Take into account:

- Current shareholders rights to call special meetings
- Consent threshold
- Exclusionary language
- Ownership structure
- Management's response to previous shareholder proposals
- Current anti-takeover provisions
- Requirement of majority vote in uncontested director elections

Vote AGAINST proposals to restrict or prohibit shareholder ability to call special meetings. The generally accepted minimum ownership threshold is 10%

- Vote AGAINST proposals to require a supermajority shareholder vote / Vote FOR proposals to lower supermajority vote requirements. Exceptions should be considered on a CASE-BY-CASE basis for companies with shareholders with significant ownership levels
- Vote AGAINST confidential voting
- Vote FOR proposals for proxy access. Generally accepted thresholds include: ownership threshold $\leq 3\%$ of voting power; ownership duration requirement of up to 3 continuous years; cap on nominees of $\sim 25\%$ of the Board
- Vote FOR proposals to require a majority vote in uncontested director elections

Social & environmental issues

Generally, we support transparency on non-financial measurements where they are deemed to be of material importance to a company's performance. This is where the analysts' understanding of the drivers of business quality and management quality will guide the decision. Several examples of common shareholder proposals are listed below. In general, we would support such social and environmental resolutions, although there may be some common sense exceptions to certain companies reporting or acting on issues that are simply not material; we do not want to encourage a "box-ticking" approach. Analysts should note that ISS may have different views on these issues.

PROPOSED POSITION

- Vote FOR the development of, or report on, human rights policy
- Vote FOR a review of political spending/lobbying
- Vote FOR a review of energy efficiency & renewables
- Vote FOR a mandate to control generation of pollutants
- Vote FOR a report on environmental impacts and use of natural resources

- Vote FOR a report, or to take action, on climate change, including proposals for an annual ‘say on climate’ vote
- Vote FOR disclosure on or measures to promote equal opportunity/diversity including racial equity audits
- Vote FOR disclosure on gender pay-gap and pay ratios (where not already required by law)
- Vote FOR a review of labour rights, codes of conduct, etc.
- Vote FOR the inclusion of sustainability-related performance in executive compensation

Capital structure

The decision of the best mix of capital structure should generally be left to senior management. However, shareholders should be aware that many financing decisions could have an adverse effect on shareholder returns. For example, additional equity financing may dilute existing shares. We generally support a “one share, one vote” policy.

Common stock & dual stock authorization

Votes on proposals to increase the number of shares of common stock authorized for issuance should be determined on a CASE-BY-CASE basis.

PROPOSED POSITION

- Vote AGAINST proposals at companies with dual class capital structures to increase the number of authorized shares of the class of stock that has superior voting rights
- Vote AGAINST proposals to create a new class of common stock with superior voting rights

Reincorporation proposals

Any proposals to change a company’s state of incorporation should be evaluated on a CASE-BY-CASE basis. Both financial and corporate governance concerns should be addressed.

Internal controls

Generation supports compliance with Sarbanes Oxley standards and will support companies that are striving to comply.

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