

Monitoring Compliance with Investor Stewardship Group Principles

Executive Summary

- State Street Global Advisors (SSGA) led the creation of the Investor Stewardship Group (ISG), which debuted a set of Stewardship Principles and Corporate Governance Principles for the US market in January 2017
- With the ISG principles taking effect as of January 2018, SSGA will now be holding companies accountable for meeting the ‘comply or explain’ expectations established by the principles
- SSGA has created an ISG compliance screen that identifies 13 voting guidelines that are encompassed in the six principles; in the pilot year, SSGA will apply its ISG compliance screen to the S&P 500 companies
- We encourage companies to proactively evaluate and disclose/explain their level of compliance with the principles and have provided a framework to help directors assess their positions on the principles
- In instances of non-compliance, when companies cannot explain the nuances of their governance structure effectively, either publicly or through engagement, SSGA will vote against the independent board leader for non-compliance with the principles

Overview

In January 2017, SSGA, as part of the Investors Stewardship Group (ISG), published the first ever investor-led Stewardship and Governance Principles for the US market using a comply-or-explain approach. The six corporate governance principles, which are based on the commonalities of the public proxy voting guidelines of the founding ISG members, went into effect in January 2018. The principles establish minimum investor expectations regarding the corporate governance structures and practices of companies publicly listed in the US.

Starting in March 2018, SSGA will review governance practices at S&P 500 companies for their adherence to the principles and seek to proactively engage with companies to better understand the reasons for non-compliance. In the event that non-compliant companies fail to adequately explain their governance approaches, SSGA may hold the board accountable by voting against select independent directors.

ISG Corporate Governance Principles

Principle 1 Boards are accountable to shareholders.

Principle 2 Shareholders should be entitled to voting rights in proportion to their economic interest.

Principle 3 Boards should be responsive to shareholders and be proactive in order to understand their perspectives.

Principle 4 Boards should have a strong, independent leadership structure.

Principle 5 Boards should adopt structures and practices that enhance their effectiveness.

Principle 6 Boards should develop management incentive structures that are aligned with the long-term strategy of the company.

Visit isgframework.org

Screening Methodology

The six principles (see Box above) are not intended to be prescriptive or comprehensive. There are many ways to apply a principle. However, as guidance, the ISG has provided the rationale and expectations that underpin each principle on its website,¹ which reflect the proxy voting guidelines of the different signatories.

In order to identify companies for engagement, SSGA has created an ISG compliance screen that identifies 13 voting guidelines encompassed in the six principles. Companies that do not meet at least three of the 13 voting guidelines will be targeted for further review and engagement.

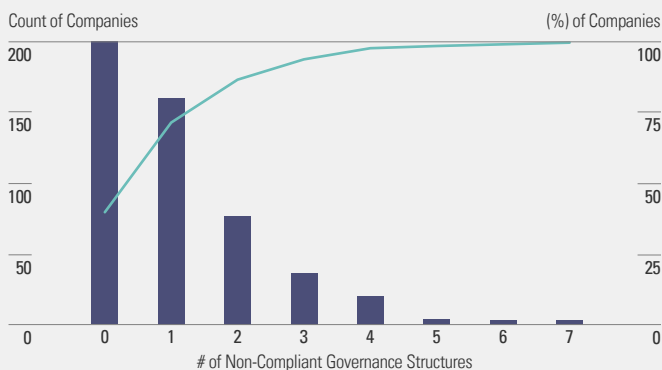
In the pilot year, SSGA will apply its ISG compliance screen to the S&P 500 companies. Based on the 2017 proxy filings of companies, SSGA found that:²

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- 66 companies or 13% of the S&P 500 fail to adhere to three or more of the guidelines and will be targeted for review and engagement
- 199 companies or 40% of the S&P 500 fully comply with SSGA's ISG compliance screen
- Lack of proxy access is the most common reason for non-compliance with the principles — 81 of the 150+ companies with one non-compliant governance structure would be in full compliance if they provided shareholders with access to the proxy
- Other common non-compliance governance structures include:
 - Lack of annual director elections
 - Inadequate board refreshment practices
 - Insufficient board independence

Figure 1 below, shows the distributions of companies that screen out against SSGA's ISG compliance screen.

Figure 1: SSGA ISG Compliance Screen of S&P 500 Companies



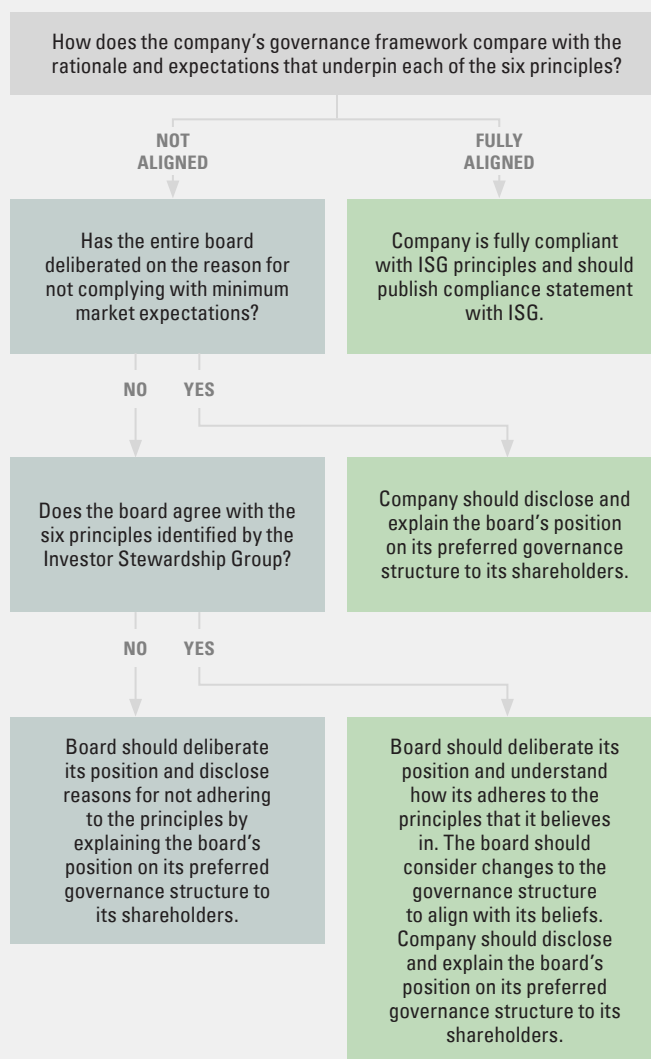
Potential Proxy Vote Implications for Screened Out Companies

Since SSGA's ISG compliance screen is based on our existing proxy votes and engagement guidelines, there are no new governance-related expectations. However, the screen allows SSGA to proactively monitor corporate governance practices at portfolio companies and assess if they are aligned with our long-term interests and market expectations.

At SSGA, we do not believe in a one-size-fits-all approach to corporate governance, and therefore, our preference is to engage with companies to better understand their perspectives for why their internal governance structure does not meet minimum investor expectations.

We encourage companies to proactively evaluate and disclose their level of compliance with the principles and have provided a framework to help directors assess their position on the principles. In instances of non-compliance, when companies cannot explain the nuances of their governance structure effectively, either publicly or through engagement, SSGA will vote against the independent board leader³ for non-compliance with the principles.

Framework for Disclosing ISG Compliance



Global Perspective

While the ISG introduces a set of minimum governance expectations for the US market, such standards have existed in other markets for many years. As a global investor we have developed principle compliance screens that align with the corporate governance codes in different markets (such as the UK, Australia, and the EU) and will proactively screen companies in these markets to better understand their preferred governance structures.

Conclusion

Until now, SSGA has applied its proxy voting guidelines to address specific board concerns such as excessive tenure and lack of diversity. With the introduction of SSGA's ISG compliance screen, we are now proactively monitoring companies for compliance with our voting guidelines on a

comprehensive basis. This screen helps us engage and review company governance practices in a holistic manner against the expectations of a multitude of investors that support the ISG. In addition, it helps SSGA, as an institutional investor, meet and demonstrate our commitment to the ISG principles by holding portfolio companies accountable for compliance with them.

We hope board members of our portfolio companies find this guidance useful. Any questions or comments may be directed to Matthew DiGuiseppe, Head of Americas, Asset Stewardship at Matthew_DiGuiseppe@ssga.com or Rakhi Kumar, Managing Director and Head of ESG Investing and Asset Stewardship, at Rakhi_Kumar@ssga.com

¹ isgframework.org.

² Source: ISS Analytics as of November 2017.

³ The independent Chair, Lead Independent Director or most senior independent director up for election in that order.

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