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The International Comparative Legal Guide to:

Corporate Governance 2018

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Country Question and Answer Chapters:

EDITORIAL

Welcome to the eleventh edition of *The International Comparative Legal Guide to: Corporate Governance*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of corporate governance.

It is divided into two main sections:

One general chapter. This chapter provides an overview of Corporate Governance, Investor Stewardship and Engagement, particularly from a US perspective.

The guide is divided into country question and answer chapters. These provide a broad overview of common issues in corporate governance laws and regulations in 38 jurisdictions.

All chapters are written by leading corporate governance lawyers and industry specialists, and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Sabastian V. Niles of Wachtell, Lipton, Rosen & Katz for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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Corporate Governance, Investor Stewardship and Engagement

Wachtell, Lipton, Rosen & Katz

Sabastian V. Niles

Corporate governance is increasingly conceived as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism. The below is an outline of synthesised principles intended to promote the common goal of facilitating sustainable long-term value creation through the governance roles of the board of directors and senior management, the role of investors in impacting corporate strategy and governance decisions within a framework of stewardship, and engagement between companies and investors to forge relationships built on transparency, trust and credibility. Companies and investors would tailor the application of these principles to their specific facts and circumstances.

Guiding Principles

Governance:

1. *Strategy, Management and Oversight*. The board of directors and senior management should jointly oversee long-term strategy and communication of that strategy, ensuring that the company pursues sustainable long-term value creation. The board of directors is responsible for monitoring company performance and for senior management succession.
2. *Quality and Composition of Board of Directors*. Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfil their duties, and represent the interests of all shareholders and other stakeholders. The board of directors as a whole should feature backgrounds, experiences and expertise that are relevant to the company's needs.
3. *Compensation*. Executive and director compensation should be designed to align with the long-term strategy of the company and incentivise the generation of long-term value, while dis-incentivising the pursuit of short-term results at the expense of long-term results.
4. *Corporate Citizenship*. Consideration should be given to shareholders and the company's broader group of stakeholders, including employees, customers, suppliers, creditors, and the community in which the company does business, in a manner that contributes in a direct and meaningful way to long-term value creation.

Stewardship:

1. *Beneficial Owners*. Institutional investors are accountable to the ultimate beneficial owners whose money they invest. As shareholders gain additional empowerment, they should use that power for the goal of long-term value creation for all shareholders.
2. *Voting*. Investors should actively vote on an informed basis consistent with the interests of their clients in the long-term success of the companies in which they invest.
3. *Investor Citizenship*. Investors should consider value-relevant sustainability, citizenship and ESG/CSR factors when developing investment strategies.

Engagement:

1. *By the Company*. The board of directors and senior management should engage with major investors on issues and concerns that affect the company's long-term value and be responsive to those issues and concerns.
2. *By Investors*. Investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.
3. *Shareholder Proposals and Votes*. Boards of directors should consider shareholder proposals and key shareholder concerns but investors should seek to engage privately before submitting a shareholder proposal.
4. *Interaction and Access*. Companies and investors should each provide the access necessary to cultivate engagement and long-term relationships.

Governance

***Strategy, Management and Oversight*. The board of directors and senior management should jointly oversee long-term strategy and communication of that strategy, ensuring that the company pursues sustainable long-term value creation. The board of directors is responsible for monitoring company performance and for senior management succession.**

- The board of directors should oversee the company's management and business strategies to achieve long-term value creation, including having meaningful input over the company's capital allocation process and strategy. The board of directors should ensure that it understands the strategic assumptions, uncertainties, judgments and alternatives that underpin the company's long-term strategy.
- The board of directors sets the "tone at the top" to cultivate an ethical culture and demonstrate the company's commitment to integrity and legal compliance. Companies should have in place mechanisms for employees to seek guidance and alert management and the board of directors about potential or actual misconduct without fear of retribution.
- The board of directors should periodically review the company's bylaws, governance guidelines and committee charters and tailor them to promote effective board functioning. The board

of directors should be aware of the governance expectations of its major shareholders and take those expectations into account in periodic reviews of the company's governance principles. Boards of directors of companies that currently have dual or multiple class share structures should review these structures on a regular basis and establish mechanisms to end or phase out controlling structures at the appropriate time.

- The board of directors has two key roles with respect to management: oversight of management; and partnership with management. The board of directors should work to foster open, ongoing dialogue between members of the board and management. This dialogue requires directors to have access to senior management outside of board meetings. Management has an obligation to provide information to directors, and directors should seek clarification and amplification where necessary.
- The board of directors and senior management should jointly determine the company's reasonable risk appetite, oversee implementation of standards for managing risk and foster a culture of risk-aware decision-making. The board of directors should consider significant risks, including cybersecurity and reputational risks, to the company, but should not be reflexively risk averse; the board should seek proper calibration of risk to benefit the long-term interests of the company and its shareholders.
- Even with effective risk management, crises will emerge and test the board of directors, with potential situations ranging from unexpected departures of the CEO to risk management failures and major disasters. Each crisis is different, but in most instances when a crisis arises, directors are best advised to manage through it as a collegial body working in unison with the CEO and management team. Once a crisis starts to unfold, the board of directors needs to be proactive and provide careful guidance and leadership in steering the company through the crisis. If there is credible evidence of a violation of law or corporate policy, the allegation should be investigated and appropriate responsive actions should be taken. The board of directors, however, should be mindful not to overreact, including by reflexively displacing management or ceding control to outside lawyers, accountants and other outside consultants.
- The board of directors and senior management should maintain a close relationship with the CEO and monitor the performance of the CEO and key members of management.
- The board of directors and senior management should maintain a succession plan for the CEO and other key members of management. The board of directors should address succession planning on a regular rather than reactive basis. Direct exposure to employees is critical to the evaluation of the company's "bench strength".
- Companies should frame required quarterly reporting in the broader context of their articulated strategy and use quarterly financial results to show progress toward long-term plans. Companies should not feel obligated to provide earnings guidance.
- The board of directors should carefully consider extraordinary transactions and receive the information and time necessary to make an informed and reasoned decision. The board of directors should take centre stage in a transaction that creates a real or perceived conflict of interest between shareholders and management, including activist situations.

Quality and Composition of Board of Directors**. Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfil their duties and represent the interests of all shareholders and other stakeholders. The board of directors as a whole should feature backgrounds, experiences and expertise that are relevant to the company's needs.**

- Every director should have integrity, strong character, sound judgment, an objective mind, collegiality, competence and the ability to represent the interests of all shareholders and other stakeholders.
- The composition of a board should reflect a complementary diversity of thought, background, skills, experiences, and tenures. The board of directors should develop a system for identifying diverse candidates, including women and minority candidates.
- A substantial majority of the board of directors should be independent. The board of directors should consider all relevant facts and circumstances when evaluating independence. Long-standing board service should not, by itself, disqualify a director from being considered independent.
- The board of directors should decide, based on the circumstances, whether to have separate or combined chairman and CEO roles. The board of directors should explain its decision to shareholders, and, if the roles are combined, should appoint a strong lead independent director. The lead independent director should serve as a liaison between the chairman of the board and the independent directors, preside over executive sessions, call meetings of the independent directors, guide the board's self-assessment or evaluation process, and guide consideration of CEO compensation and succession.
- The size of the board of directors will depend on the nature, size and complexity of the company and its state of development. In general, the board of directors should be large enough for a variety of perspectives and as small as practicable to promote open dialogue.
- Companies should consider limitations on the number of other boards of directors on which a director sits to ensure a director's ability to dedicate sufficient time to the increasingly complex and time-consuming matters that the board of directors and committees are expected to oversee.
- The composition of a board of directors should reflect a range of tenures. The board of directors should consider whether policies such as mandatory retirement ages or term limits are appropriate, but board refreshment should be tempered with the understanding that age and experience bring wisdom, judgment and knowledge. Substantive director evaluation and re-nomination decisions will serve better than arbitrary policies.
- Directors must spend the time needed and meet as frequently as necessary to discharge their responsibilities and should endeavour to attend all board and committee meetings, as well as the annual meeting of shareholders. The full board of directors should have input into the board agenda.
- Time for an executive session without the CEO or other members of management should be on the agenda for each regular board meeting.
- The board of directors should have a well-developed committee structure with clearly understood responsibilities. Decisions about committee membership should be made by the full board based on recommendations from the nominating and governance committee, and committees should meet all applicable independence and other requirements. Committees should keep the full board of directors and management apprised of significant actions.
- Companies should conduct a robust orientation for new directors and all directors should be continually educated on the company and its industry. Companies may find it useful to have an annual two- to three-day board retreat with senior executives to conduct a full review of strategy and long-range plans.
- The board of directors should evaluate the performance of individual directors, the full board of directors, and board committees on a continuing basis. Evaluations should be substantive exercises that inform board roles, succession planning, and refreshment objectives. Evaluations should be

led by the non-executive chair, lead independent directors, or appropriate committee chair, and externally facilitated evaluations may be appropriate from time to time.

***Compensation*. Executive and director compensation should be designed to align with the long-term strategy of the company and incentivise the generation of long-term value, while dis-incentivising the pursuit of short-term results at the expense of long-term results.**

- The board of directors should develop management compensation structures that are aligned with the long-term strategy and risk compliance policies of the company. A change in the company's long-term strategy or risk compliance policies should merit a re-evaluation of management compensation structures.
- Executive compensation should have a current component and a long-term component. A substantial portion should be in the form of stock or other equity, with a vesting schedule designed to ensure economic alignment with shareholders. In general, executives should be required to hold a meaningful amount of company stock during their tenure and beyond.
- The board of directors or its compensation committee should understand the costs of compensation packages and the maximum amount payable in different scenarios. In setting executive compensation, the compensation committee should take into account the position of the company relative to other companies, but use such comparison with caution, in view of the risk of an upward ratchet in compensation with no corresponding improvement in performance.
- Companies should be sensitive to the pay and employment conditions elsewhere in the company and take into account the pay ratios within the company. The board of directors should also consider the views of shareholders, including as expressed in "say-on-pay" votes, but should not abdicate its role in deciding what is best for the company.
- Companies should monitor, restrict or prohibit executives' ability to hedge the company's stock and oversee the adoption of policies to mitigate risks, such as compensation recoupment or clawbacks.
- Directors should receive compensation that fairly reflects the time commitment of public company board service, with appropriate benchmarking against peer companies. Independent directors should be equally compensated, although lead independent directors and committee chairs may receive additional compensation and committee fees may vary.
- Director compensation should be a mix of cash and equity, with appropriate stockholding requirements to promote continued alignment between directors and shareholders.
- If directors receive additional compensation not related to service as a director, such compensation should be disclosed and explained to shareholders.

***Corporate Citizenship*. Consideration should be given to shareholders and the company's broader group of stakeholders, including employees, customers, suppliers, creditors, and the community in which the company does business, in a manner that contributes to long-term value creation.**

- Companies should strive to be good citizens of the communities in which they do business and consider relevant sustainability issues in operating their businesses.
- The board of directors and senior management should integrate relevant ESG and CSR matters into strategic and operational planning.
- Companies have an important perspective to contribute to public policy dialogue. If a company engages in political activities, the board of directors should oversee such activities and consider whether to adopt a policy of disclosure of the activities.

Stewardship

***Beneficial Owners*. Investors are accountable to the beneficial owners whose money they invest. As shareholders gain additional empowerment, they should use that power for the goal of long-term value creation for all shareholders.**

- Investors should provide steadfast support for the pursuit of reasonable strategies for long-term growth and speak out against conflicting short-term demands.
- Investors should establish a firm-wide culture of long-term thinking and patient capital, including through the design of employee compensation to discourage the sacrifice of long-term value for short-term gains.
- Investors should adopt and disclose guidelines and practices that help them oversee the corporate governance practices of investee companies. Disclosure should include investors' long-term investment policies, evaluation metrics, governance procedures, views on quarterly reports and earnings guidance, and guidelines for relations with short-term activists.
- Investors should evaluate the performance of boards of directors, including director knowledge of governance and interest in understanding key shareholder concerns, as well as the board of directors' focus on a thoughtful long-term strategic plan.

***Voting*. Investors should actively vote on an informed basis consistent with the interests of their clients in the long-term success of the companies in which they invest.**

- Investors should devote sufficient time and resources to the evaluation of matters for shareholder vote in the context of long-term value creation.
- Investor votes should be based on the independent application of internal policies and guidelines. Investors may rely on a variety of information sources to support their evaluation. Third-party analyses and recommendations, including proxy advisory firms, should not substitute for individualised decision-making that considers the facts and circumstances of each company.
- Investors should disclose their proxy voting and engagement guidelines and report periodically on stewardship and voting activities.
- Investors should have clear procedures that help identify and manage potential conflicts of interest in their proxy voting and engagement and disclose such procedures.

***Investor Citizenship*. Investors should consider value-relevant sustainability, citizenship and ESG/CSR factors when developing investment strategies.**

- Investors should integrate material ESG factors into investment analysis and investment decisions.
- Investors should disclose their positions on ESG and CSR matters.

Engagement

***By the Company*. The board of directors and senior management should engage with major investors on issues and concerns that affect the company's long-term value and be responsive to those issues and concerns.**

- The board of directors and senior management should establish communication channels with investors and be open to dialogue on a "clear day". Boards should be responsive to shareholders and be proactive in order to understand their perspectives.

- Companies should clearly articulate for investors the company vision and strategy, including key drivers of performance, risk and evolution of business model.
- Companies should make adequate disclosures on a variety of topics, including: how compensation practices encourage and reward long-term growth; the director recruitment and refreshment process; succession planning; consideration of relevant sustainability, citizenship, and ESG/CSR matters; climate risks; political risks; corporate governance and board practices; anti-takeover measures; material mergers and acquisitions; and major capital commitments. Companies should explain the bases for their recommendations on the matters that are submitted to a shareholder vote.
- Companies should disclose their approach to human capital management: employee development, diversity and a commitment to equal employment opportunity; health and safety; labour relations; and supply chain labour standards; amongst other things.

***By Investors*.** **Investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.**

- Investors should actively listen to companies, participate in meetings or other bilateral communications and communicate their preferences, expectations and policies with respect to engaging with and evaluating companies. Investors should address and attempt to resolve differences with companies in a constructive and pragmatic manner that is intended to build trust and a common understanding and should give due consideration to the company's rationale.
- Investors should assume some accountability for the long-term interest of the company and its shareholders as a whole, provide companies with candid and direct feedback and give companies prompt notice of any concerns.
- Investors should invite companies to privately engage and work collaboratively with boards of directors and management teams to correct subpar strategies and operations. If an investor discloses a negative opinion about the company, it should state whether the investor first provided an opportunity for the company to engage privately.
- Investors should disclose their preferred procedures and contacts for engagement and establish clear guidelines regarding, and disclose, what further actions they may take in the event they are dissatisfied with the outcome of their engagement efforts.

***Shareholder Proposals and Votes*.** **Boards of directors should consider shareholder proposals and key shareholder concerns but investors should seek to engage privately before submitting a shareholder proposal.**

- Boards of directors should respond to shareholder proposals that receive significant support by implementing the proposed change if the board of directors believes it will improve governance, or providing an explanation as to why the change is not in the best long-term interest of the company if the board of directors believes it will not be constructive.
- Investors should raise critical issues to companies as early as possible in a constructive and proactive way, and seek to engage in a dialogue before submitting a shareholder proposal. Public battles and proxy contests have real costs and should be viewed as a last resort where constructive engagement has failed.
- Long-term shareholders should recommend potential directors if they know the individuals well and believe they would be additive to the board.
- Shareholders have the right to elect representatives and receive information material to investment and voting decisions. It is reasonable for shareholders to oppose re-election of directors who have persistently failed to respond to shareholder feedback.
- Boards of directors should communicate drivers of management incentive awards and demonstrate the link to long-term strategy and sustainable economic value creation. If the company clearly explains its rationale regarding compensation plans, shareholders should consider giving the company latitude in connection with individual compensation decisions. The board of directors should nevertheless take into account "say-on-pay" votes.

***Interaction and Access*.** **Companies and investors should each provide the access necessary to cultivate engagement and long-term relationships.**

- Engagement through disclosure is often the most practical means of engagement, though in other cases, in-person meetings or interactive communications may be more effective.
- Independent directors should be available to engage in dialogue with shareholders in appropriate circumstances without undermining the effectiveness of management to speak for and on behalf of the company.
- Investors' ultimate decision-makers should have access to the company, its management, and in some cases, its board of directors, and likewise the company should have access to investors' ultimate decision-makers.
- Boards of directors and senior management should consider cultivating relationships with the government, the community and other stakeholders.

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Sabastian V. Niles is a Partner at Wachtell, Lipton, Rosen & Katz where he focuses on rapid response shareholder activism, engagement and preparedness, takeover defense and corporate governance; risk oversight, including as to cybersecurity and crisis situations; U.S. and cross-border mergers, acquisitions, buyouts, investments, divestitures, and strategic partnerships; and other corporate and securities law matters and special situations.

Sabastian advises worldwide and across industries, including technology, financial institutions, media, energy and natural resources, healthcare and pharmaceuticals, construction and manufacturing, real estate/REITs and consumer goods and retail.

In addition to serving as Consulting Editor for the New York Stock Exchange's Corporate Governance Guide, Sabastian writes frequently on corporate law matters and has been a featured speaker at corporate strategy and investor forums. His speaking engagements have addressed topics such as Shareholder Activism; The New Paradigm of Corporate Governance; Hostile Takeovers; Strategic Transactions and Governance; M&A Trends; Board-Shareholder Engagement; Confidentiality Agreements in M&A Transactions; Negotiating Strategic Alliances with U.S. Companies; Current Issues in Technology M&A; Corporate Governance: Ethics, Transparency and Accountability; and Developments in Cross-Border Deals.

Wachtell, Lipton, Rosen & Katz is one of the most prominent business law firms in the United States. The firm's preeminence in the fields of mergers and acquisitions, takeovers and takeover defence, shareholder activism, strategic investments, corporate and securities law, and corporate governance means that it regularly handles some of the largest, most complex and demanding transactions in the United States and around the world. It features consistently in the top rank of legal advisers. The firm also focuses on sensitive investigation and litigation matters and corporate restructurings, and in counselling boards of directors and senior management in the most sensitive situations. Its attorneys are also recognised thought leaders, frequently teaching, speaking and writing in their areas of expertise.

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