Vanguard funds

Proxy voting policy for European and UK portfolio companies

Effective 1 February 2022

Primary updates and clarifications to the Vanguard funds' voting policies

The Investment Stewardship Oversight Committee approved several updates and clarifications to the Vanguard funds' UK and European voting policies. The primary updates include:

- ***Director capacity and commitment:*** The Vanguard funds have added an expectation that portfolio companies provide comprehensive disclosure of how the board assesses director commitments (see page 6).
- ***Diversity and qualifications disclosure:*** Boardroom diversity continues to be a key focus of Vanguard's stewardship activities. We have published several Insights that outline our expectations on boardroom and workforce diversity and diversity disclosures. These updates are in line with market expectations on board diversity:
  - For European-domiciled portfolio companies, a fund will generally vote against the nomination committee chair, or another relevant board member, if there is less than 30% of either gender serving on the board of directors (see page 9).
  - For UK-domiciled portfolio companies that are a part of the FTSE 350 Index, a fund will generally vote against the nomination committee chair, or another relevant board member, where there is less than 33% of either gender serving on the board of directors (see page 19).
  - For all other UK-domiciled companies, a fund will generally vote against the nomination committee chair, or another relevant board member, if both genders are not represented on the board of directors (see page 19).
  - For companies in the FTSE 100 Index, a fund will generally vote against the nomination committee chair, or another relevant board member, if there is no ethnic diversity on the board of directors (see page 19).
- ***Oversight failure.*** Consistent with current policy, the Vanguard funds will consider an accountability vote against a director or committee for governance or material risk oversight failures. The following clarifies considerations regarding climate risk oversight (see page 13):
  - the materiality of the risk;
  - the effectiveness of disclosures to enable the market to price the risk;
  - whether the company has disclosed business strategies, including reasonable risk mitigation plans in the context of the anticipated regulatory requirements and changes in market activity in line with the Paris Agreement or subsequent agreements; and
  - company-specific context, market regulations, and expectations.
- ***Hybrid/virtual meetings.*** The funds will generally support the use of a virtual meeting as long as shareholder rights are not curtailed (see page 17).

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Introduction

The information below, organised according to Vanguard Investment Stewardship's four principles, is the voting policy for "European-domiciled companies" and details the general positions of the funds advised by Vanguard (the "funds" and each a "fund")[1] on recurring proxy proposals. For the purposes of this summary, "European-domiciled companies" include those companies domiciled in the European Economic Area, Switzerland, Russia, the UK and the Crown Dependencies (Jersey, Guernsey and the Isle of Man).

It is important to note that proposals often require a facts-and-circumstances analysis based on an expansive set of factors. Proposals are voted on case by case, under the supervision of the Investment Stewardship Oversight Committee and at the direction of the relevant funds' board. In all cases, proposals are voted as determined in the best interests of each fund consistent with its investment objective.

There are general guidelines that apply to all European-domiciled companies ("EU Guidelines"), followed by country-specific guidelines for the UK, Ireland, the Crown Dependencies (Jersey, Guernsey and the Isle of Man) and Germany. Companies should abide by the relevant local laws and regulations of the market in which they are listed and follow any applicable local corporate governance codes and best practices. These local corporate governance codes form the basis of the funds' country-specific guidelines. However, our EU Guidelines may differ from local codes and, in some cases, require a higher level of governance best practice than the local corporate governance code.

The funds' country-specific guidelines outline any deviations from the EU Guidelines that will apply to the local market.

Comply or explain. Local standards in many European markets permit companies to deviate from recommended corporate governance practices so long as they provide an explanation for the deviation. Vanguard supports the underlying principle of European corporate governance best practices. Companies should explain any deviations from recommended governance practices, including providing an explanation of what they do instead of the recommended practice and why their alternative systems and/or processes are in the best interests of shareholders.

Multi-jurisdictional companies. When a company is listed on multiple exchanges or incorporated in a country different from where it is listed, the company should follow the applicable laws and listing rules of the market(s) in which it has its primary listing, as well as apply any local corporate governance codes. If a company deviates from any market standards or local corporate governance codes, it should explain the reasons for such deviations.

[1] This voting policy details the general positions of the funds for each portfolio advised by Vanguard, including Vanguard index funds and ETFs and the fund assets managed by Vanguard Quantitative Equity Group ("Vanguard-advised funds"), on recurring proxy proposals for European-domiciled companies. Each of the US mutual funds advised by Vanguard retains proxy voting authority and this voting policy reflects the US Fund Board's instructions governing proxy voting by the Vanguard-advised funds.

EU Guidelines

Principle I: Board composition and effectiveness

The fund's primary interest is to ensure that the individuals who represent the interests of all shareholders are independent, committed, capable, diverse and appropriately experienced. Diversity of thought, background and experience, as well as of personal characteristics (such as gender, race and age), meaningfully contributes to a board's ability to serve as effective, engaged stewards of shareholders' interests.

Board independence

A fund will generally vote against the nomination committee and all nonindependent, nonexecutive board members of a company if that company does not maintain a majority independent board. In the second year that a board is not majority independent, the fund may vote against the entire board.

A fund will generally vote against the nomination committee and nonindependent, nonexecutive directors if the board of a "non-widely held company" and/or a "controlled company" is not composed of at least one-third independent directors. In the second year, a fund will hold the entire board accountable.

In addition, when analysing the overall level of board independence, only board members who are elected by shareholders will be taken into account, and any government and/or employee representatives will be excluded.

Outlined below are common factors that can affect independence:

- *Current and former employees.* Directors who are current or former employees (other than chief executive officer) may be considered independent five years after they terminate their employment relationship.
- *Former CEOs.* Former CEOs will generally never be considered independent, unless they only held an "interim" CEO position for less than 18 months. An "interim" CEO who held the temporary position for less than 18 months may be considered independent three years after leaving the position.
- *Cross-directorships and CEO interlocks.* Any directors who hold cross-directorships or have significant links with other directors through involvement in other companies or bodies will generally not be considered independent. In addition, CEOs who sit on one another's boards will generally not be considered independent.
- *Shareholder representatives.* Representatives of shareholders will generally not be considered independent.
- *Business connections.* Any director nominee who has had within the last year a material business relationship with the company – either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company – will generally not be considered independent.
- *Familial relationship and other personal relationships.* Any director who has close family ties with any of the company's advisers, directors or senior employees will generally not be considered independent.
- *Performance-related pay.* Any director who participates in a performance-related pay scheme will generally not be considered independent.
- *Tenure.* Excessive tenure of a director (i.e. tenure that exceeds local market best practice, where applicable) can potentially affect independence, especially in a scenario where a board is not majority independent. However, excessive tenure exclusively may not result in a director being considered nonindependent, unless the company considers a director nonindependent for this reason.
- *Other factors.* If it is determined, through engagement or research, that director independence has been compromised, that director may not be considered independent.

Key committee independence

The expectation is that key committees are chaired by independent directors and that companies maintain 100% independent key committees where market practice and/or local corporate governance codes call for such composition. However, a fund will generally vote against nonindependent directors who serve on the following key committees (or its equivalent) if the majority of the committee is not independent:

- audit committee
- remuneration committee
- nomination committee

If a company, regardless of its ownership structure, does not maintain majority independent key committees, then in the second year, a fund will also hold the nomination committee Chair accountable in addition to the nonindependent directors serving on the key committees. In the third year, a fund will hold the entire nomination committee accountable as well.

Shareholder agreements, which include board and/or committee representation for the shareholder representatives that are party to this agreement, will be taken into consideration.

Board Chair independence

Generally, a fund will vote for management proposals to create an independent Chair position or to otherwise separate the CEO and Chair positions.

In evaluating shareholder proposals calling for the separation of CEO and Chair, certain factors are considered:

- *Presence of a lead/senior independent director role.* A strong lead/senior independent director may provide sufficient independent perspective to balance against a nonindependent Chair. Consistent with this perspective, structures that do not provide a strong counter-voice to insider leadership warrant independent oversight.
- *Board accessibility.* Shareholders' ability to communicate directly with independent board members, including a lead/senior independent director or committee chairs, is an important means by which they can share perspectives. Restrictions on access to independent board members may prevent the board from receiving comprehensive feedback from shareholders to incorporate into corporate practices. It may also contribute to a culture of entrenchment of management by controlling the messages the board receives.
- *Overall board independence.* High affiliated representation on the board may outweigh independent voices and further entrench the insider leadership. Enhancing the role of independent directors may offer a counterweight to the nonindependent voices on the board.
- *Governance structural flaws.* Certain governance practices and corporate structures may create an environment more favorable to potential entrenchment by management and other nonindependent board members; for example, multiple share classes with different voting rights limit the voice of shareholders, and key committees that are not fully independent restrict a board's role in oversight of management.
- *Responsiveness to shareholders.* A pattern of being nonresponsive to shareholders may indicate that a board is entrenched and an increased independent role may provide a needed remedy to this. In addition, board decisions that impair shareholder rights may indicate that a board does not properly value shareholder rights.
- *Oversight failings.* Governance crises may indicate management entrenchment or that the board is not receiving sufficient information from management to appropriately serve its oversight role. Evidence of failure to provide appropriate governance oversight, and/ or evidence of failure to oversee material or manifested risks – including those that may be considered "social" or "environmental" – will be taken into account.

Director capacity and commitment

Directors' responsibilities are complex and time-consuming. As a result, a director may be considered "overboarded" when the number of directorship positions they have accepted make it challenging to dedicate the requisite time and attention to effectively fulfill their responsibilities at each company. While no two boards are identical and time commitments may vary, the limitations below are appropriate absent compelling evidence to the contrary.

A fund will generally vote against any director who holds an executive role of any public company and serves on two or more additional outside public company boards. In this instance, the fund will typically vote against the nominee at each company where they serve as a nonexecutive director, but not at the company where they serve as an executive.

A fund will also generally vote against any director who serves on five or more public company boards. In that instance, the fund will typically vote against the director at each of these companies except the one where they serve as Chair or lead independent director of the board.

In certain instances, a fund will consider voting for a director who would otherwise be considered overboarded under the standards above if:

- a director has committed to stepping down from a/the directorship(s) necessary to fall within the thresholds listed above by the following year's annual general meeting;
- a director becomes overboarded as a result of becoming an interim executive officer or has become an executive officer within the last 12 months; and/or
- the company provides specific, verifiable information confirming that (i) the director devotes significantly less than an average amount of time to one or more of the boards on which they sit and (ii) the reduced workload is appropriate based on the nature of the company's board (e.g. the company's business model or governance structure) and the relevant director continues to fulfill their obligations to that company, irrespective of their diminished hours of service. The Vanguard funds expect portfolio companies to provide comprehensive disclosure of how the board assesses director commitments.

Director attendance

A fund will generally vote against directors who attended less than 75% of board or committee meetings (in the aggregate) in the previous year unless an acceptable extenuating circumstance is disclosed or they have served on the board for less than one year.

Discharge of directors

A fund will generally vote for proposals to discharge the board and/or individual directors, unless there is:

- evidence that there may be concerns in relation to audit failures, egregious pay practices, limits to shareholder rights and/or generally egregious practices;
- evidence that directors may have breached their fiduciary duty;
- a serious legal issue (either civil or criminal) that is aimed at holding the board accountable for a currently alleged action yet to be confirmed.

A fund may also vote against the discharge of the board if the fund's ability to take part in future legal action against the company and/or its directors could be hindered by supporting such a proposal.

A fund may also use the discharge vote to express general governance and oversight concerns, especially where there is no ability to vote on the particular governance and/or oversight issue on the general meeting agenda or where the board has failed to respond to shareholders' concerns repeatedly, expressed through voting activity and/or discovered during engagement.

Election of directors as a slate

It is best practice that directors are elected annually on an individual basis, rather than as a slate. However, a fund will generally vote for a slate of directors, so long as at least a third of directors are independent.

A fund will generally vote against proposals that state that the board will be elected as a slate.

Director liability

A fund will vote case by case on management proposals to limit directors' liability and to expand indemnity provisions.

In general, a fund will vote for proposals to indemnify directors for breach of fiduciary duty of care so long as the director is found to have acted in good faith and will vote against proposals to indemnify directors for activity involving willful breach of fiduciary duties or other criminal activity.

Directors' names and biographies

A fund will generally vote against any director whose name and biographical details have not been disclosed sufficiently in advance of the general meeting.

Diversity and qualifications disclosure

Well-composed boards have perspectives that are informed by a range of backgrounds, skills and experience. The expectation is that public boards consider board diversity and disclose the diversity of their boards on factors such as gender, age, race, ethnicity and national origin, at least on an aggregate basis. Companies that do not have diverse boards should demonstrate a commitment to achieving board diversity, provide insights on progress across multiple factors and prioritise adding diverse voices to their boards.

Increasingly, shareholders are asking companies to provide details on a board's diversity and its additional diversification plans. There is also an expectation that companies provide a "skills matrix" seeking to give shareholders a big-picture view of directors' attributes and how they fit together. Shareholders can then assess how well-suited director nominees are in light of the company's evolving business strategy and risks and the overall mix of director skills and experiences. A fund will generally vote for a diversity-related shareholder proposal if:

- The proposal seeks disclosure related to directors' diversity of personal characteristics (including gender, race, ethnicity and national origin) or skills and qualifications, and this information is not already disclosed.
- The proposal asks companies to adopt policies designed to ensure appropriate diversity on boards, and appropriate policies do not already exist.
- The proposal is not overly prescriptive as to what skills should be included or how this information must be presented.

Escalation process: Director and committee accountability

In certain instances, a fund may vote against a director because of governance failings or as a means to escalate other issues that remain unaddressed by a company.

- *Lack of board independence.* A fund will generally vote against ("hold accountable") nomination committee members of a widely held, noncontrolled company if the board is not majority independent and will vote against nomination committee members of a non-widely held and/or controlled company if the board is not composed of at least one-third independent directors. In the second year, in both instances, a fund will generally vote against the entire board.
- *Lack of key committee independence.* A fund will generally vote against nonindependent key committee directors if a company does not maintain majority independent key committees (audit, remuneration and nomination committee). In the second year, a fund will also hold the nomination committee Chair accountable in addition to the nonindependent directors serving on the key committees. In the third year, a fund will hold the entire nomination committee accountable as well.
- *Audit failures.* A fund will generally vote against audit committee members when non-audit fees exceed audit-related fees without sufficient disclosure or when the fund votes against an audit-related management proposal. A fund will generally vote against audit committee members in instances of a material misstatement or concerns about the integrity of the accounts.
- *Remuneration-related situations*
  - A fund will generally vote against remuneration committee members when the fund votes against a pay proposal for two consecutive years, unless meaningful improvements have been made.
  - A fund will generally vote against the remuneration committee Chair and, if the issues persist, vote against the full remuneration committee in subsequent years when a company exhibits egregious pay practices but a pay proposal is not on the ballot. If it is not possible to vote against directors because they are not up for election, a fund may consider a vote against the discharge of the board, if such a resolution is on the general meeting's agenda.

- *Oversight failure*
  - A fund will generally vote against directors who have failed to effectively identify, monitor and manage material risks and business practices that fall under their purview based on committee responsibilities. These risks may include material social and environmental risks, inclusive of climate change.
  - When a specific risk does not fall under the purview of a specific committee, a fund will generally vote against the lead independent director and/or Chair. If it is not possible to vote against directors because they are not up for election, a fund may vote against the discharge of the board, if such a resolution is on the general meeting's agenda. See page 13 for more detail on the considerations for risk oversight failures.
- *Lack of board diversity.* A fund will generally vote against the nomination committee chair, or another relevant board member if the nomination committee chair is not up for re-election, if there is less than 30% of either gender serving on the board of directors. See page 8 for more detail on the considerations for diversity.
- *Limited shareholder rights.* A fund may vote against the Chair, lead/senior independent director and/or any other relevant director(s) if the company has abused minority shareholder rights and/or somehow meaningfully limited shareholder rights.

Generally, a fund will vote for new directors who would otherwise fail under any of the preceding circumstances regarding committee accountability, but have served for less than a year, unless a given director fails to carry out the basic responsibilities that would be expected for even a new director.

Contested director elections

A fund will vote case by case on shareholder nominees in contested director elections. The analysis of proxy contests focuses on three key areas:

- *The case for change at the target company*
  - How has the company performed relative to its peers?
  - Has the current board's oversight of company strategy or execution been deficient?
  - Is the dissident focused on strengthening the target company's long-term strategy and shareholder returns?
- *The quality of the company and dissident board nominees*
  - Is there reason to question the independence, engagement or effectiveness of the incumbent board?
  - Has the board delivered strong oversight processes with long-term shareholders' interests in focus?
  - Are the directors proposed by the dissident (whether the full slate or a subset) well-suited to address the company's needs, and is this a stronger alternative to the current board?
- *The quality of company governance*
  - Did the board engage in productive dialogue with the dissident?
  - Is there evidence of effective, shareholder-friendly governance practices at the company?
  - Has the board actively engaged with shareholders in the past?

Principle II: Oversight of strategy and risk

Boards are responsible for effective oversight and governance of the risks most relevant and material to each company and for governance of the company's long-term strategy. They should take a thorough, integrated and thoughtful approach to identifying, quantifying, mitigating and disclosing risks that have the potential to affect shareholder value over the long term. Boards should communicate their approach to risk oversight to shareholders through their normal course of business.

Capital structures

- *Dividends.* A fund will generally vote for proposals to allocate income and for proposals to allow a stock (scrip) dividend, unless the proposal does not allow for a cash option or is not in line with market standards.
- *Share issuance requests.* The total dilution to existing shareholders and the company's history of issuing capital will be considered.
  - A fund will generally vote for routine capital issuance requests with preemptive rights up to a maximum of 50% of the current issued share capital, provided that the issuance authorities' periods are clearly disclosed and in line with market practice.
  - A fund will generally vote for routine capital issuance requests without preemptive rights up to a maximum to 20% of the current issued share capital, provided that the issuance authorities' periods are clearly disclosed and in line with market practice.
- *Private placements.* A fund will generally vote for a private placement proposal if the dilution does not exceed 20% or is within a reasonable range of this threshold.
- *Contingent convertible securities.* A fund will generally vote for proposals to issue contingent convertible securities so long as the company explains that these are to be used to meet capital adequacy requirements for financial institutions set by regulators.
- *Debt issuance.* A fund will vote case by case on proposals to issue debt and/or restructure debt, taking into account:
  - any convertible features and the potential effect on dilution;
  - the company's financial position; and
  - the company's ability to take on the proposed debt.
- *Share repurchase*
  - For Denmark and France, a fund will typically vote for routine authorities to repurchase shares up to 10% of the current issued share capital, so long as the terms of the repurchase appear to be in the best interests of shareholders, there is no history of abuse of such authorisations, and the pricing premium is equal to or less than 20% of fair market price.
  - For all other European markets (excluding the UK and Germany – please see the relevant country-specific guidelines for these markets), a fund will typically vote for routine authorities to repurchase shares up to 20% of the current issued share capital, so long as the terms of the repurchase appear to be in the best interests of shareholders, there is no history of abuse of such authorisations, and the pricing premium is equal to or less than 20% of fair market price.
- *Reverse stock split.* A fund will typically vote for a reverse split of outstanding shares if the number of shares authorised is proportionately reduced and the difference in reduction results in dilution equal to or less than 100%. Regardless of the level of dilution, it will generally vote for a reverse split if it is necessary for the company to remain listed on its current exchange.
- *Preferred stock.* A fund will typically vote case by case on proposals to create/amend/issue preferred stock, taking into account the reason for the issuance, the ownership profile of the company, any historical abuses of share issuances and the company's general approach to shareholder rights.

Mergers, acquisitions and financial transactions

A fund will vote case by case on all mergers, acquisitions and financial transactions.

The strategic, operational and financial benefits (and drawbacks) of the transaction are evaluated based on a number of criteria, including the following:

- board and management oversight of the deal process
- valuation

- prospects for long-term enterprise value under a standalone/alternate scenario
- market reaction
- the surviving entity's governance profile
- fairness opinions from independent financial advisers
- effect on stakeholders, if relevant to long-term value

In evaluating board oversight, the fund will consider independence, potential conflicts of interest and management incentives.

Related-party transactions

In general, companies should refrain from entering into related-party transactions with nonexecutive directors, executive directors and shareholders because of the potential conflicts of interest that can arise. If a company does decide to enter into such a transaction, then the expectation is that the company will comply with the relevant corporate law in its jurisdiction and/or the listing rules on the exchange on which it is listed.

When evaluating related-party transactions, considerations include:

- whether it is part of the normal course of business;
- clear disclosure of the details of the transaction, including who is involved, the price and any financial conditions, and the board's justification of the transaction;
- whether there has been independent verification of the transaction, either by a third party (e.g. an auditor) or an independent board committee; and/or
- the length of the approval process of the transaction (preferring annual approval).

A fund may vote against a related-party transaction if:

- it is a substantial transaction with a nonexecutive director (especially when the company classifies such director as independent) and there are concerns about the level of independence on the board;
- the disclosure provided by the company is incomplete or is lacking detail;
- the approval length for the transaction is excessive;
- there are serious concerns about the independent verification and/or pricing of the transaction; and/or
- the transaction may not be in the interest of minority shareholders and/or it diminishes shareholder rights.

Independent auditors

Auditor appointment and auditor's fees. A fund will generally vote against the appointment of the auditor and setting the auditor's fees in instances where tax and all other fees exceed the audit and audit-related fees and/or a reasonable amount, unless the company's disclosure makes clear that the non-audit fees are for services that do not impair independence and/or the imbalance was due to an event that was transactional and one-off.

A fund will vote case by case on the auditors' appointment/reappointment when there is a material misstatement of financials or other significant concern regarding the integrity of the company's financial statements.

Auditor indemnification

- A fund will generally vote against proposals to indemnify external auditors.
- A fund will generally vote case by case on proposals to limit external auditors' liability, taking into account the explanation provided by the company for such liability limitation.

Environmental/social proposals

Disclosure proposals

A fund will vote case by case on disclosure-related management and shareholder proposals based on environmental and social risks to a company.

Clear, comparable, consistent and accurate disclosure enables shareholders to understand the strength of a board's risk oversight. Because sustainability disclosure is an evolving and complex topic, a fund's analysis of related proposals aims to strike a balance in avoiding prescriptiveness and providing a long-term perspective.

Targets, policies and practices proposals

Similarly, a fund will vote case by case on management and shareholder proposals that request adoption of specific targets or goals and on proposals that prescribe adoption of environmental or social policies and practices.

Shareholders typically do not have sufficient information about specific business strategies to propose specific targets or environmental or social policies for a company, which is a responsibility that resides with management and the board. As a result, shareholder proposals that are more prescriptive in nature will generally not be supported by a fund. Other proposals, such as requests for the company to set goals that further articulate the path to implementing a disclosed company priority, are more likely to receive support from a fund.

Considerations for environmental and social proposals

Each proposal will be evaluated on its merits and in the context that a company's board has ultimate responsibility for providing effective oversight of strategy and risk management. This oversight includes material sector- and company-specific sustainability risks and opportunities that have the potential to affect long-term shareholder value.

While each proposal will be assessed on its merits and in the context of a company's current practices and public disclosures, vote analysis will also consider these proposals relative to market norms or widely accepted frameworks endorsed or already referenced by Vanguard's Investment Stewardship program. Input from the board, management and proponents will also be taken into consideration. To assist companies in understanding relevant principles, research or past voting decisions, Vanguard will publish perspectives on notable issues, best practices and guidance for companies to consider on specific environmental or social matters.

A fund is likely to support shareholder proposals that:

- address a shortcoming in the company's current disclosure relative to market norms or to widely accepted frameworks endorsed or referenced by Vanguard's Investment Stewardship program (e.g., the Sustainability Accounting Standards Board, the Task Force on Climate-related Financial Disclosures);
- reflect an industry-specific, materiality-driven approach; and
- are not overly prescriptive about time frame, cost or other matters.

If the above criteria are met, a fund is likely to support the following types of proposals (the lists below are not exhaustive):

Environmental proposals:

- Request disclosure related to companies' Scope 1 and Scope 2 emissions data, and Scope 3 where climate-related risks are material;
- Request that companies assess the climate's impact on them, disclosing appropriate scenario analysis and related impacts on strategic planning; or
- Request that a company set goals or targets for relevant greenhouse gas emissions.

Social risk proposals:

- Request disclosure on workforce demographics inclusive of gender and racial/ethnic categories, considering other widely accepted industry standards, and if appropriate under applicable laws and regulations;
- Request disclosure on the board's role in overseeing material diversity, equity and inclusion risks or other material social risks; or
- Request the adoption of targets or goals related to board diversity (without prescribing what such targets should be, unless otherwise specified by applicable laws and regulatory requirements).
- Request inclusion of sexual orientation, gender identity, minority status or protected classes, as appropriate under applicable laws and regulations, in a company's employment and diversity policies when the company has not already formally established such protections. A fund will generally not support proposals asking companies to exclude references to sexual orientation and/or gender identity, interests or activities in their employment and diversity policies.

Oversight failure

If a situation arises in which the board has failed to effectively identify, monitor and ensure management of material risks and business practices under its purview based on committee responsibilities, a fund will generally vote against the relevant committee chair. These risks may include material social and environmental risks, inclusive of climate change.

To assess climate risk oversight failures, factors the fund will consider include:

- the materiality of the risk;
- the effectiveness of disclosures to enable the market to price the risk;
- whether the company has disclosed business strategies, including reasonable risk mitigation plans in the context of the anticipated regulatory requirements and changes in market activity in line with the Paris Agreement or subsequent agreements; and
- consideration for company-specific context, market regulations and expectations.

A fund will also consider the board's overall governance and effective independent oversight of climate risk. When a specific risk does not fall under the purview of a specific board committee, a fund may vote against the lead independent director and/or chair.

Principle III: Remuneration

Compensation policies linked to long-term relative performance are fundamental drivers of sustainable, long-term value for a company's investors. Providing effective disclosure of these practices, their alignment with company performance, and their outcomes is crucial to giving shareholders confidence in the link between incentives and rewards and the creation of long-term value.

Advisory and binding votes on executive remuneration

Because norms and expectations vary by industry type, company size, company age and geographic location, the following guidelines are intended to represent preferences for executive remuneration and are not a "one-size-fits-all" tool.

For that reason, a fund will vote case by case on executive remuneration proposals and will support those that enhance long-term shareholder value. It may also vote for remuneration proposals that reflect improvements in practices, even if the proposals are not perfectly aligned with all these guidelines but are clearly in the interests of long-term shareholder value.

Considerations fall into two broad categories:

- *Pay for performance*. This is mainly assessed through analysis of three-year total shareholder return and realised pay over the same period. If there are concerns that pay and performance are not aligned, a fund may vote against a pay-related proposal.
- *Structure*. Plan structures should be aligned with the company's long-term strategy and should support pay-for-performance alignment. Where a plan includes a number of structures that could lead to pay-for-performance misalignment, a fund may vote against a pay-related proposal.

Additional considerations:

- *Fixed pay*. The expectation is that salary is reasonably set based on the role scope, the industry and the region, as well as benchmarked against an appropriate peer group (based on company size and complexity). If fixed pay is significantly increased, a compelling rationale should be disclosed.
- *Variable pay*
  - *Long-term focus*. Plans should generally be weighted toward long-term outcomes rather than short-term outcomes; therefore, long-term plans should make up the majority of variable remuneration. Long-term plans should generally have performance measured over multiple years, ideally for a period of three years or more.
  - *Metrics*. Remuneration plans should incorporate rigorous metrics aligned with corporate strategy and long-term company performance. Since pay should ultimately align with relative performance, incorporating relative metrics (particularly relative total shareholder return) into plans is preferred. Prospective performance metric disclosure, including targets, is expected where possible to allow shareholders to assess the rigor of the plan.
- *One-off awards*. Payments that occur in addition to the regular incentive plan(s) may indicate that the current remuneration structures may not be working as designed. The expectation is that one-off awards are granted in exceptional circumstances only. If a one-off award is granted, disclosure of a compelling rationale is expected and will be scrutinised.
- *Disclosure*. Shareholders should be able to easily understand pay expectations and outcomes. Therefore, a company should clearly articulate the compensation plan's structure and the compensation committee's processes for determining that structure. Retrospective disclosure is generally expected for performance achievements. Effective disclosure may include:
  - award limits for an incentive plan;
  - the weightings of each metric in an incentive plan;
  - the performance metrics and targets used to evaluate performance in an incentive plan (ideally including the minimum, the maximum and the target performance for each metric); and
  - a clear description of any qualitative metrics used in an incentive plan and how the remuneration committee evaluated whether they were met.
- *Malus and clawback*. Such provisions are expected to be adopted and detailed in a company's incentive plans. When necessary, malus and clawback provisions should be exercised by the remuneration committee.

- *Severance*. The expectation is that such arrangements should be set in line with market best practice and are double-trigger. Generally, severance arrangements should not be more than two years of fixed pay, taking into account any specific market best practice or nuances.
- *Discretion*. The remuneration committee should feel empowered to exercise discretion when formulaic pay outcomes do not align with company and share-price performance or shareholders' experience. A remuneration committee should provide enhanced disclosure when exercising discretion, clearly explaining the rationale for such discretion and how the committee arrived at this decision.
- *Responsiveness to shareholders*. If pay proposals receive low support or shareholder feedback, especially year over year, the board and remuneration committee should demonstrate responsiveness to shareholder concerns.

Factors considered "red flags" when evaluating a company's remuneration structures and plans may include:

- pay outcomes that are higher than those of peers, but total shareholder return that is lower than those of peers;
- a target for total pay that is set above the peer-group median;
- a long-term plan that makes up less than 50% of total pay and/or an annual bonus that accounts for the majority of executives' variable pay;
- incentive plans that do not have clearly disclosed limits;
- a long-term plan that has a performance period of less than three years;
- performance targets for incentive plans that are reset, retested or not rigorous;
- one-off awards where there is unclear disclosure or a lack of compelling rationale for their use; and
- a remuneration committee that shows a lack of responsiveness to shareholder dissent in relation to pay.

Factors considered "yellow flags" may include:

- a peer group used to benchmark pay that is not completely aligned with the company in size or strategy;
- incentive plans that use absolute performance metrics only;
- long-term plans that do not have an additional holding period once the performance period ends;
- a lack of disclosure of performance metrics, targets and actual pay outcomes, particularly in retrospective situations;
- a lack of malus and/or clawback provisions;
- a lack of a shareholding requirement for executives or one that is out of line with peers or market practice;
- severance arrangements that are excessive or out of line with market best practice; and
- the remuneration committee's use only of positive discretion and/or holding of excessive authority to use discretion to determine pay outcomes.

Equity remuneration plans

A fund will vote case by case on equity remuneration plans for employees.

In general, a fund supports companies adopting equity-based compensation plans for employees, so long as the plan or plans align with long-term shareholder interests and value. When evaluating equity remuneration plans, three main factors are considered:

- dilution to shareholders;
- the company's grant history; and
- alignment with market practice.

Nonexecutive director remuneration

In general, a fund will vote for nonexecutive director fees that seem reasonable, are in line with peers and take into account the amount of time required of the nonexecutive directors to fulfill their roles.

A fund will generally vote against the approval of any nonexecutive director fees where nonexecutive directors receive performance-related remuneration as part of their remuneration package. A fund will also generally vote against retirement benefits for nonexecutive directors.

Principle IV: Shareholder rights

Governance structures empower shareholders and ensure accountability of the board and management. Shareholders should be able to hold directors accountable as needed through certain governance provisions.

Annual report and accounts

Generally, a fund will vote for the annual report and accounts.

A fund may consider voting against the annual report and accounts if:

- there are concerns about the integrity of the financial statements and/or the external auditors;
- there has been a financial misstatement; and/or
- the auditor elected not to provide an audit opinion, provided a qualified audit opinion or highlighted an emphasis of matter that was particularly concerning.

Board structure and director elections

- *Classified ("staggered") boards.* Annual reelection of directors is considered a general best practice. A fund will generally vote for proposals to declassify an existing board and vote against management or shareholder proposals to create a classified board.
- *Term limits.* A fund will generally vote for management proposals to limit terms of directors and generally vote against shareholder proposals to limit such terms.
- *Cumulative voting.* A fund will generally vote for management proposals to eliminate cumulative voting and vote against management or shareholder proposals to adopt cumulative voting.
- *Majority and supermajority voting.* A fund will generally vote for management proposals to implement majority voting for director elections and will vote case by case on related shareholder proposals.

A fund will generally vote against any proposal to extend supermajority voting requirements to decisions that are not stipulated by law and/or not in the best interest of minority shareholder rights. It will vote case by case on shareholder proposals asking to remove supermajority voting requirements where not required by law.

Additional share classes

This guideline applies when a company issues more than one class of stock, with different classes carrying different voting rights. The Vanguard Investment Stewardship approach to this issue is principled yet practical. It remains philosophically aligned to "one-share, one-vote" but also is mindful of the need not to hinder public capital formation in the equity markets. To that end, alignment of voting and economic interests is a foundation of good governance. The approach supports the idea of a newly public, dual-class company adopting a sunset provision that would move the company toward a one-share, one-vote structure over time. A fund will vote case by case on proposals to eliminate dual-class share structures with differential voting rights.

Caps on voting rights. A fund will vote for proposals to remove or increase any cap on voting rights and vote against proposals to introduce a cap or lower any existing cap on voting rights.

Ownership reporting requirements

A fund will typically vote against a proposal to reduce the share ownership reporting requirements for shareholders to lower than the legal mandate, unless there is a specific reason and/or there are extraordinary circumstances.

Amendments to articles of association

A fund will generally vote for minor amendments that include any administrative or housekeeping updates and corrections. When evaluating all other amendments to the articles of association, the following will be considered:

- any changes to corporate law and/or listing rules that may require an amendment to the articles of association;
- whether the amendments may result in corporate governance structures and/or processes that are not best practice or are a regression from what the company already does (taking into account any explanation provided by the company for the change); and/or
- whether the amendments are detrimental to shareholder rights generally.

Reincorporation/Change of domicile

A fund will vote case by case on proposals to reincorporate to another country and/or proposals for companies to change their primary listing.

A fund will consider the reasons for the relocation, including the company's history, the company's strategy and the company's shareholder base, along with any differences in regulation, governance and shareholder rights.

Shareholder meeting rules and procedures

- *Quorum requirements.* A fund will generally vote against proposals that would decrease quorum requirements for shareholder meetings below a majority of the shares outstanding, unless there are compelling arguments to support such a decrease.
- *Approve "other such matters that may come before the meeting" or "any other business."* A fund will generally vote against a proposal to approve "other such matters that may come before the meeting."
- *Approve deliberations on possible legal action against directors if presented by shareholders.* A fund will generally vote against such a proposal because of the lack of disclosure regarding the proposed deliberation.
- *Adjourn meeting to solicit more votes.* In general, a fund will vote for the adjournment if the fund supports the proposal in question and against the adjournment if the fund does not support the proposal.
- *Bundled proposals.* A fund will vote case by case on all bundled management proposals.
- *Change of date, time or location of Annual General Meeting.* A fund will typically vote for management proposals to change the date, time or location of the annual meeting if the proposed changes are reasonable.
- *Virtual meetings.* A fund will generally support proposals seeking to conduct "hybrid" meetings (in which shareholders can attend a meeting of the company in person or elect to participate online). A fund may vote for proposals to conduct virtual-only meetings (held entirely through online participation with no corresponding physical meeting). Virtual meetings should not curtail shareholder rights, for example by limiting the ability for shareholders to ask questions. A fund will consider support if:
  - meeting procedures and requirements are disclosed ahead of a meeting;
  - a formal process is in place to allow shareholders to submit questions to the board;
  - real-time video footage is available and attendees can call into the meeting or send a recorded message; and
  - shareholder rights are not unreasonably curtailed.

Country-specific guidelines: UK, Ireland, Isle of Man, Jersey and Guernsey

These country-specific guidelines supplement, and should be read in conjunction with, the *EU Guidelines* (pages 5–17). To the extent there is any conflict between these country-specific guidelines and the *EU Guidelines*, these guidelines shall prevail.

For information on Principle III: Remuneration, see the Principle III: Remuneration section of the *EU Guidelines* starting on page 14 of this document.

Principle I: Board composition and effectiveness

Board independence

- A fund will generally vote against nonindependent, nonexecutive directors when the board is not at least 50% independent, excluding the Chair.
- For investment funds and trusts, a fund will generally vote against nonindependent directors if a majority of the board is not independent.
- For Irish collective investment schemes and management companies, a fund will generally vote against nonindependent directors when the board does not have at least one independent director.

The same criteria will be applied to evaluate the independence of directors as outlined in the Board Independence section of the EU Guidelines outlined on page 5 of this document. The one exception is:

Business connections. Any director nominee who has had within the last three years a material business relationship with the company – either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company – will generally not be considered independent.

For investment funds and trusts, two additional aspects will be considered when evaluating board members' independence:

- any board member who has a close family relationship with the manager of the fund/ trust generally will not be considered independent; and
- directors who sit on the boards of more than one company managed by the same manager generally will not be considered independent.

Key committee independence

Typically, a fund will vote against nonindependent directors who serve on the audit and remuneration committees (or their equivalent).

A fund will generally vote against the Board Chair if they are a member of the remuneration committee and are not an independent appointment. A fund will generally vote against the Board Chair if they chair the remuneration committee, regardless of independence on appointment.

A fund will generally vote against the Board Chair if they are a member of the audit committee, regardless of independence on appointment.

If a company does not maintain 100% independent audit and remuneration committees, a fund generally will also hold the nomination committee Chair accountable in addition to the nonindependent directors serving on the committees. In the second year, the fund may hold the entire nomination committee accountable as well.

Chair tenure

Pursuant to the 2018 UK Corporate Governance Code, a company should provide rationale as to why a Chair should remain in the post beyond nine years from the date of the person's first appointment to the board.

A fund will vote case by case on the reelection of any Chair who has served on the board for more than nine years and will consider:

- the independence of the Chair upon appointment to the board and as Chair;
- whether the Chair is an executive Chair and whether there is a compelling business rationale for that structure to remain; and/or
- the succession planning process.

Diversity and qualifications disclosure

The Hampton Alexander Review, which focuses on increased representation of women on boards and in senior executive positions, recommended that FTSE 350 companies should aim for a minimum of 33% representation of women on their boards by 2020. In line with the context of the Hampton Alexander Review, for FTSE 350 companies, a fund will generally vote against the nomination committee chair, or another relevant board member, if there is less than 33% of either gender serving on the board of directors. For all other UK companies, a fund will generally vote against the nomination committee chair, or another relevant board member, if both genders are not represented on the board of directors.

In addition, the Parker Review, which aims to increase the ethnic diversity of UK boards, recommends that each FTSE 100 board should have at least one director of color by 2021, and that each FTSE 250 board should have at least one director of color by 2024. In line with the context of the Parker Review, for FTSE 100 companies, a fund will generally vote against the nomination committee chair, or another relevant board member, where there is no ethnic diversity on the board of directors. For companies in the FTSE 250, we expect an assessment of how they plan to meet the Parker Review targets.

Principle II: Oversight of strategy and risk

Authorise the issue of equity with and without preemptive rights

With preemptive rights. A fund will typically vote for proposals to increase issued share capital with preemptive rights up to 33% of a company's issued share capital, and an additional 33%, provided that it is applied fully to a preemptive rights issue and that the authority is for 15 months or less.

Without preemptive rights. A fund will typically vote for proposals to increase issued share capital without preemptive rights up to 5% of a company's issued share capital, or 10%, provided that the additional 5% is applied to acquisitions or other specified capital investments only and that the authority is for 15 months or less.

Share repurchase

A fund will generally vote for proposals to allow a company to buy back up to 15% of its shares in any given year, provided that the maximum price paid is not more than 5% above the average trading price and that the authority is for 15 months or less.

Political donations and expenditure

A fund will typically vote against proposals seeking approval by the company to make political donations if political donations were paid during the year under review.

Mandatory offer waivers

A fund will generally vote for proposals to waive requirements for a mandatory takeover offer, unless there is a particularly compelling reason not to support management's proposal.

Principle IV: Shareholder rights

Authorise the company to call a general meeting with two weeks' notice

A fund will generally vote for proposals to allow a company to call a general meeting on at least 14 clear days' notice.

Country-specific guidelines: Germany

These country-specific guidelines supplement, and should be read in conjunction with, the *EU Guidelines* (pages 5–17). To the extent that there is any conflict between these country-specific guidelines and the *EU Guidelines*, these guidelines shall prevail.

For information on Principle III: Remuneration, see the Principle III: Remuneration section of the *EU Guidelines* starting on page 14 of this document.

Principle I: Board composition and effectiveness

Board independence

- Taking into account general market practice and criteria for independence, a fund will generally vote in line with the policy outlined in the Board independence section of the *EU Guidelines* outlined on page 5 of this document.
- A fund will generally vote against nonindependent directors if the supervisory board of a controlled company with more than six members does not have at least two independent directors.
- A fund will generally vote against nonindependent directors if the supervisory board of a controlled company with fewer than six members does not have at least one independent director.
- A fund will generally vote against directors who were former management board members if there are more than two on the supervisory board.

Key committee independence

- Taking into account general market practice and criteria for independence, a fund will generally vote in line with the policy outlined in the Key committee independence section of the *EU Guidelines* outlined on page 6 of this document.
- In addition to having an expectation that a remuneration committee is majority independent, a fund will generally vote against the remuneration committee Chair if they are not independent from the company and/or management board.
- In addition to having an expectation that a remuneration committee is majority independent, a fund will generally vote against the nomination committee Chair if the nomination committee includes any individuals who are not shareholder-elected members of the supervisory board.

Principle II: Oversight of strategy and risk

Authorised and conditional capital

A fund will generally vote for proposals for authorised and conditional capital pools, as long as:

- the aggregate capital pool does not exceed 50% of the company's issued share capital, as prescribed under German law;
- the capital pool is valid for a maximum of five years, as prescribed under German law; and
- no more than 20% of the capital pool can be issued without preemptive rights.

Share repurchases

A fund will generally vote for proposals to provide companies with the authority to repurchase shares, as long as the authority:

- allows for no more than 10% of the share capital to be repurchased;
- is valid for a maximum of five years; and
- sets the maximum repurchase price at 110% of market price.

Principle IV: Shareholder rights

Exemption from remuneration reporting regulations

A fund will generally vote against proposals to amend the company's articles of association so that companies do not have to disclose individual management board's remuneration separately.

Limited partnership

A fund will vote case by case on proposals to transfer a company from a German public stock corporation (Aktiengesellschaft or "AG") to a limited partnership (Kommanditgesellschaft auf Aktien or "KGaA").

Shareholder counter-motions

A fund will vote case by case on all shareholder counter-motions.

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