DENKER
CAPITAL

Environmental, Social, and Governance Policy

PREPARED IN TERMS OF:

Denker Capital Responsible Investment Policy and Procedures
United Nations' Principles for Responsible Investment (PRI)
The Second Code for Responsible Investing in South Africa (CRISA 2)

PURPOSE OF THIS POLICY:

This policy sets out the environmental, social, and governance (ESG) criteria which we use to evaluate companies as part of our investment process.

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1. INTRODUCTION

1.1. Our objective

Our objective is to generate sustainable risk adjusted returns for our clients. Researching and understanding ESG issues, and motivating companies we invest in to manage these actively, enables Denker Capital to potentially improve risk adjusted returns for our clients. Therefore, as long-term investors and stewards of our clients' hard-earned savings, it's our duty to include sustainable investment as a focus area in our investment process. As part of this process, our objective is to focus on how the companies we invest in manage ESG issues strategically for the long term.

1.2. Our responsibilities

Our approach to the ESG standards is informed by the United Nations Sustainable Development Goals (SDGs) that best resonate with our values as an organisation. Within the sectors we invest in, accountable institutions are responsible for setting the rules by which value is created and distributed to stakeholders and, when investing, we rely on the parameters created by these institutions. It is not within our remit to exclude companies from our investable universe, however, we will endeavour to influence change within the companies we invest in to benefit stakeholders (the environment, the economy and society as a whole). As stewards of our clients' savings, it is our responsibility to make capital available when we believe it will earn attractive returns given the costs. Our values of accountability, commitment, exploration, sustainability and transparency are best reflected in the following SDGs which we have embraced as responsibilities:

1.2.1. Sustained, inclusive and sustainable economic growth

- Promote sustained and sustainable economic growth by providing capital to companies that have the opportunity to grow, thereby earning attractive returns for our clients.
- By holding companies accountable for the resources they employ and the capital they put at risk.

1.2.2. Peaceful societies, justice for all and strong institutions

- Help build effective, accountable and inclusive institutions by
  - ensuring ethical leadership within Denker Capital;
  - encouraging it within the boards and management teams of the companies we invest in;
  - engaging with regulators, policy makers and industry bodies; and
  - engaging with oversight bodies, thought leaders and supporting a free press.
- In order to achieve the SDGs, and to protect and grow our clients' savings and investments, we partner with boards, management teams and other stakeholders.

1.2.3. Inclusive and equitable quality education and promote lifelong learning opportunities for all

- Contribute to inclusive and equitable quality education through our corporate social investment (CSI) initiatives.
- Promote learning opportunities:
  - Externally, by
    - encouraging the companies we invest in to invest in their staff should we feel there are deficiencies; and
    - sharing knowledge and expertise with clients and industry participants.
  - Internally, by
    - investing in the development of our own staff;
    - mentorship;
    - internships; and
    - conference participation.

Through the implementation of this ESG Policy, we believe that we are able to exert some influence over boards and management teams, thereby supporting the SDGs identified above.

1.3. ESG as part of our investment process

The United Nations' Principles for Responsible Investment (PRI), to which we are signatory, requires us to seek appropriate disclosure on ESG issues by the entities in which we invest. Therefore, we rely on sustainability reporting and appropriate disclosure of activities by the companies we invest in to enable informed investment decisions. This means that as part of our investment process, we will:

- ask companies for standardised reporting on ESG issues;
- ask companies for ESG issues to be integrated within annual financial reports; and
- support shareholder initiatives and resolutions promoting ESG disclosure.

This policy sets out our views, commitments and approach to ESG, as well as what we require of the companies we invest in.

2. ENVIRONMENTAL SUSTAINABILITY

2.1. Our view on environment sustainability

Environmentally sustainable investing entails investing in companies that use natural resources efficiently and sustainably. It is our responsibility to manage our impact on our community, the broader economy, and the natural environment so that we are able to meet clients' needs without compromising the ability of future generations to meet their needs.

2.2. Our commitment to environmental sustainability

To promote environmental sustainability, we aim to:

- Encourage companies to report on their material environmental issues and develop responsible stewardship strategies;
- Require that companies adhere to laws, guidelines and codes of good practice applicable to them in the countries in which they operate;
- Follow the requirements and standards that we require of other companies, and employ sufficient resources to meet environmental challenges, including outsourcing if required;
- Research investment-related environmental risks and opportunities for equity investments;
- Manage risk exposure in portfolios;
- Consider incorporation of environmental criteria in investment mandates;
- Vote all proxies where clients have investments;
- In terms of our escalation policy, we may engage with companies on their material environmental issues and collaborate with other investors in engaging companies; and
- Promote industry best practice, including management of conflicts of interests, should they occur.

2.3. Our approach to environmental sustainability

Consumer values and organisational leadership culture has increasingly embraced responsible and environmentally friendly methods of production and consumption. Changing consumer preferences assisted by regulatory and legal processes means that environmental costs have become a more explicit cost in production. Our support for inclusive institutions favours this political and regulatory approach to environmental sustainability. We support effective and accountable institutions that reflect the values of society. More accountable and inclusive democratic institutions will contribute to ethical leadership of public resources necessary for sustainable development.

For institutions to be responsible, it is the duty of boards of directors and management teams to ensure that society's valuable resources, which they are primary custodians of, are not wasted. Because we cannot influence the actions of management teams directly, we rely on the boards of directors to contribute to a sustainable future. We encourage specific commitments so that these companies may lead by example.

2.4. Environmental sustainability as part of our investment process

In order for us to identify environmental risks, we require that the companies we evaluate as part of our investment process, are transparent and held accountable.

Some companies issue separate sustainability reports and others incorporate sustainable development reporting into their integrated reports. An integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term. Although we prefer that ESG issues are integrated within annual financial reports, various forms of reporting are acceptable to us, provided the information reported meets the needs of material stakeholders and provides a holistic view of all elements of the value creation process.

For reporting purposes, companies may rely on the following guidelines and support:

- The Global Reporting Initiative (GRI) can be used as a guideline for sustainability aspects that can be reported on.
- The CDP (formerly the Carbon Disclosure Project) will support companies to disclose their environmental impacts.
- The Task Force on Climate-related Financial Disclosures (TCFD) helps companies disclose financial risks associated with the impact of the environment on themselves.

3. SOCIAL RESPONSIBILITY

3.1. Our view on social responsibility

By being socially responsible, companies are encouraged to think about the long-term contributions they make to the societies in which they operate and for whom they create products, provide service and employment.

3.2. Our commitment to social responsibility

To promote social sustainability, we aim to:

- Encourage companies to report on their material social issues;
- Monitor how companies manage their social challenges and encourage them to strive for continual improvement;
- Require that companies adhere to laws, guidelines and codes of good practice applicable to them in the countries in which they operate;
- Follow the requirements and standards that we require of other companies, and employ sufficient resources to meet the social challenge, including outsourcing if required;
- Research investment-related social risks and opportunities;
- Integrate sustainability considerations into our investment process;
- Vote all proxies where clients have investments;
- We may engage companies on their material social issues and collaborate with other investors in engaging companies; and
- Promote industry best practice, including management of conflicts of interests.

3.3. Our approach to social responsibility

Our objective, both in our role as a South African company and when investing on behalf of our clients, is to meet our clients' needs by enabling the country's economic growth. By making capital available to the economy, by investing in companies that create value for their consumers, their suppliers and shareholders we contribute to economic growth and enable our investors to meet their savings and investing objectives.

3.4. Social responsibility as part of our investment process

We are responsible for ensuring that through our investment process and approach, we contribute to society. Therefore, we rely on reporting and disclosure of activities by the companies we invest in to enable informed investment decisions.

Boards of directors are responsible for promoting an ethical culture and responsible corporate citizenship. Not only is it the responsibility of board to ensure that their companies comply with applicable laws and to consider adherence to non-binding rules, codes and standards, but the leadership of a company should be based on an ethical foundation. The ethical performance of companies should be assessed, monitored, reported and disclosed.

Companies may use the GRI as a guideline for reporting, which advocates that companies identify their key social performance aspects and disclose their strategies and procedures to achieve the relevant goals. The GRI provides several standardised indicators to measure a company's commitment to social aspects as well as impacts on the social systems in which it operates. These indicators are grouped into the areas of labour practices, human rights, society and product responsibility.

4. GOVERNANCE

4.1. Our view on governance

Our objective to generate sustainable risk adjusted returns (often as minority shareholders) relies on the behaviour and incentives of the boards and management teams that oversee the assets entrusted to them. We believe that as investors we should require that companies adhere to laws, guidelines and codes applicable to them in the countries in which they operate and promote governance policies and practices which protect or create long-term shareholder value. Careful consideration of sustainability issues by companies and their boards may enhance business sustainability, improve their competitive position in the market, generate higher returns on invested capital and enhance long-term shareholder value.

We view the right to vote as one of the most important rights of a shareholder and one of the most meaningful ways to influence how companies are governed. This section contains guidelines on how we vote proxies on behalf of clients who have not included their own voting instructions in their investment mandates. They are not exhaustive, but they reflect the responsibilities we accept as shareholders, which we exercise in consultation with our clients. These will be updated periodically to reflect local and global best practise developments.

4.2. Our commitment to governance

To promote good corporate governance, we aim to:

- Monitor how boards manage their governance challenges.
    - Encourage companies to report on their material governance issues;
    - Require that companies adhere to laws, guidelines and codes of good practice applicable to them in the countries in which they operate; and
- Research investment-related governance risks and opportunities.
- Incorporate sustainability considerations into our fiduciary duties and our investment process.
    - Vote on all material shareholdings held by Denker Capital, and on behalf of our institutional investors and investors in our unit trust funds;
    - Vote on all company resolutions where clients have a right to vote, either by proxy or representation at meetings;
    - Vote for, or against, each resolution.
    - Ensure that all resolutions are voted on by poll, and oppose voting by show of hands;
    - Communicate by email with a representative of the Board, preferably the company secretary, should we intend to decline a resolution;
    - We may engage with boards on governance issues, either alone or collaboratively, and participate in consultations regarding regulations and laws which will affect corporate governance.
- Report on our proxy voting and engagement efforts to clients as well as the public on request.

4.3. Our approach to governance

We believe it is our responsibility to exercise our voting rights and be active investors on behalf of our clients. Therefore, we will vote at shareholder meetings and engage with boards when we can make a contribution. We may also participate in consultations regarding regulations and laws which will affect corporate governance.

- We will obtain a mandate from our clients in the form of a written policy on proxy voting, where applicable. We will vote on all material shareholdings held by Denker Capital, and on behalf of our institutional investors and investors in our unit trust funds. Where requested or appropriate, we will engage with our clients prior to voting.
- We may lend scrip with the prior written consent of clients. In such cases we will explain that we do not vote on shares that are lent out, which means that such clients will favour the economic benefit of scrip lending over the loss of voting rights.
- We will give particular consideration to resolutions which require the approval of governance policies and implementation - for us to support these resolutions, they should accord with evolving best practices. To do this, we will establish constructive dialogue with company boards, to share views and to discuss areas of potential conflict, should our objectives differ from those of their management teams.
- We will report to clients on the outcomes of our voting activities when voting on their behalf. Because we mostly vote by proxy, we will inform companies of our reasons for declining resolutions on behalf of clients. In some cases, we may also signal our intention to decline resolutions in future, should requested changes not be implemented.

In general, when voting, we:

- Oppose any measures aimed at restricting the ability of shareholders to vote unambiguously. Accordingly, we will vote against the bundling of resolutions, as this may result in our not being able to give clear direction on a portion of the bundled resolution.
- Pay particular attention to the level and composition of remuneration. Refer to section 4.5 for our policy on incentive schemes for more detail.
    - Executive directors should be fairly and responsibly paid, so that they are motivated to act in the best interests of the company. Their remuneration should be structured to enhance company value.
    - We support variable pay that is aligned with shareholder objectives.
    - Executive directors should be aligned with shareholder interests. Minimum shareholdings should not be hedged or pledged.
    - Companies should use a remuneration database to establish fair ranges for remuneration, and should seek to approve remuneration arrangements, including targeted mix of base and variable pay, in advance.
    - Companies should also be transparent in disclosing details of the remuneration of their non-executive directors, to enable shareholders to determine whether the levels of remuneration are justified in terms of the overall performance of the Board and individual contributions.
- Vote to limit issuance of shares for general purposes.
- Vote against resolutions which provide for new shares to be issued at a discount price except in qualifying circumstances.
- Are pragmatic in considering further issuance of existing classes, based on the nature and circumstances of the company and its shareholders.
- Limit share buybacks if the majority has abused dominance; or the company has destroyed value in the past. We will apply judgement in the light of financial benefits and the company's track record, and will permit the buy-back of shares provided that it meets listings and solvency criteria and does not unduly increase the dominance of majority shareholders
- Support resolutions seeking authority to provide financial assistance (normally inter-company loans and guarantees) to corporate entities, which include incentive schemes. However, we do not support provision of such assistance to individuals.
- In certain cases, we may seek to limit the powers of directors.

4.4. Governance as part of our investment process

We rely on integrated (and other) reports by companies when evaluating matters that could significantly affect the organisation's ability to create value for shareholders, and indirectly our clients. Listed below are what we require of the companies we invest in.

4.4.1. Governance principles

Effective oversight requires commitment, transparency and accountability. We aim to influence boards to embrace these three values. In order to create shared value we look for boards that view their responsibilities in the following light:

- To hire (and when necessary replace) the chief executive officer (CEO), monitor his/her performance, advise the CEO and to provide the CEO with a broader perspective of the world. In our view, these are the most important functions of the board.
- We expect boards to:
    - Take responsibility for the strategic priorities, challenges and risks faced by companies;
    - Include an array of perspectives and competencies to encourage honest debate and discussion; and
    - Use independent thinking and diverse perspectives to avoid 'groupthink'.
- CEOs, chairpersons, lead directors, and boards in general need to demonstrate through their actions that they understand and value dissent and that dissent is not considered disloyal.
- We believe boards that foster respect, trust and candour are high functioning.
- Board/director habits should include diligence, honesty and preparation.
- When addressing problems boards should act fairly, swiftly and decisively.

- Frequent re-election ensures accountability that is essential to well-functioning boards.
- To enable appropriate diligence we prefer boards to have frequent performance reviews and for members to sit on a limited number of boards.

These principles have been embraced in all best practise guidelines, which we endorse. These guidelines include South Africa's King Code on Corporate Governance (the King III Report), extracts from which can be found in Appendix 2. We wish to encourage a board culture that goes beyond simple procedural compliance and instead embraces responsibility for the important task of promoting sustained and sustainable economic growth through responsible production and ethical leadership.

4.4.2. Separation of the roles of chairperson and CEO

A chairperson should be responsible for coordinating the activities of the board and setting an ethical tone. We believe there is an advantage to a company, the CEO, and the directors of having an independent non-executive chairperson, who can deal with matters and oversee management from the board's point of view. In cases where a chairperson is not independent, we will support the appointment of a lead independent director.

The CEO should be a person other than the chairperson, who is responsible for the day-to-day operations, management and executive direction of the company, answerable to the board, including the chairperson, and ultimately to the shareholders.

In turn, the board should be responsible for evaluating the performance of the company and its' CEO.

4.4.3. Board independence and non-executive directors

'Independence' generally means the exercise of objective, unfettered judgement. A director acts independently if that director expresses opinions, exercises judgment and makes decisions impartially.

Best practise recommends boards with a majority of independent directors, and whose key committees are staffed with independent directors. We believe that this enables superior support to the CEO and critical evaluation of management and the performance of the company against set indicators.

We will vote for proposals that boards comprise of a majority of independent non-executive directors, and that key board committees, such as the audit committee, are comprised wholly of independent directors.

4.4.4. Appointment of directors

Directors with varying skills and backgrounds bring different perspectives that contribute to a more varied approach and analysis of issues. In order to foster the long-term success of a company, the board should include directors with a variety of backgrounds and expertise.

Where necessary, directors who have limited experience in certain areas, but who are able to make a meaningful contribution in others, should be given the opportunity to develop and learn from their more experienced colleagues, or to receive specialised training. Director training and education are important elements of continuous development.

When directors are nominated, these nominations should be confirmed at the next shareholder meeting following the nomination/s. Appointed directors should be able to make a meaningful contribution to the board through devoting sufficient time, energy and expertise. Indicators include the number of other boards served on, other positions held and attendance record.

We will vote against the appointment of a director who has a large number of main board appointments, has executive responsibilities at another company, or if their ability to devote sufficient time and expertise is compromised and if there is potential for interests to conflict.

4.4.5. Re-election and tenure

We support directors being re-elected at least every three years. Independent directors, prior to standing for re-election, should be evaluated by the board to confirm their independence.

We will vote against the re-election of directors who have poor attendance records.

We support proposals to limit the tenure of directors, either through term limits or mandatory retirement age.

4.4.6. Evaluation

We support regular self-evaluations of board, committee and director functioning ('board reviews'), as well as independent evaluations to promote candid responses. Chairpersons should ensure that evaluations are carried out regularly and that results are reported to shareholders.

To facilitate this process, boards should consider establishing key performance indicators for themselves and their committees, and periodically review and report on their performance against them.

4.4.7. Board committees

Boards appoint sub-committees to facilitate their functioning. In our view, the committees of most importance are the Audit and Risk Committee and the Remuneration Committee.

4.4.7.1 Audit and Risk Committee

This committee should oversee the preparation of the integrated report, internal controls and risk management, management information systems, the annual independent audit of the company, and fulfil statutory duties. In some cases boards appoint two separate committees, an Audit Committee and a Risk Committee, which we also support.

All members of the Audit and Risk Committee must be independent non-executive directors, appointed individually by shareholders. They should be financially literate and collectively capable of discharging their duties. Financial literacy is essential for the committee to oversee the complexities of the annual audit and to deal with the technical aspects of the financial information.

An independent audit process is a condition of good governance. Our preference is that this committee retains the services of a well-known and reputable auditing firm. While the company may use other services offered by its auditing firm, we prefer that the audit function itself, and the accuracy of the audit, is the primary focus.

In 2023 it will become mandatory for companies to rotate their auditing firm every 10 years.

4.4.7.2 Remuneration Committee

This committee should be knowledgeable in the field of director and senior management remuneration and chaired by an independent non-executive director.

This committee is responsible for development of a remuneration policy. The policy should be comprehensive, fair and consistent with market norms and aligned to the achievement of the company strategy. The updated remuneration policy, and details of its implementation, should be tabled for approval annually at the annual general meeting.

4.5. Our policy on incentive schemes

4.5.1. Our approach to incentive schemes

A good incentive scheme is that one that achieves alignment between executives and shareholders, and so incentivises management on incremental shareholder value creation. In failing to achieve this ideal, our preferred approach to management incentives is to encourage incentive structures that improve alignment. Therefore, we may vote in favour of schemes that do not achieve all our preferred outcomes but which do move towards achieving this goal.

We support three levels of remuneration of employees:

- Base pay (salary and benefits);
- Short-term incentivisation (annual performance bonus); and
- Long-term incentivisation.

Incentive schemes form part of variable compensation and are used to attract, retain and motivate staff. Their purpose is to foster sustainable performance, or value creation, over the long term, which is aligned with the company's strategy and which enhances shareholder value. Their main characteristic is that they conditionally promise to deliver value over a future vesting period once performance hurdles are exceeded.

These are some features we look out for when evaluating an incentive scheme:

- Is the Remuneration Committee correctly constituted? In other words, do we observe appropriate experience, independence, attendance and service of members of the committee?
- Does the incentive scheme fall within the approved remuneration policy developed by the Remuneration Committee? It should not overlap with remuneration from other sources or schemes, to ensure there's no duplication.
- Are schemes for incentivisation and retention either separate, or separately identifiable? We support limited use of retention schemes only.
- Are scheme details fully disclosed and approved in advance?
- Are cumulative scheme issues limited per participant, irrespective of whether shares are bought in or not?
- Is the life of the scheme less than 10 years? We want there to be scope for companies to refresh schemes.
- Are awards made consistently and regularly (preferably annually) to motivate value creation over rolling periods at acceptable risk?
- What are the scaled performance hurdles of the scheme? Awards should be subject to hurdles which have been approved by shareholders in advance. Hurdles should be fair and achievable.

- There should be a performance hurdle and a vesting period. Vesting should take place after a suitable period. Settlement may be in cash or shares over the vesting period, once performance hurdles have been exceeded. The source of shares, whether from buybacks or new issues, should be disclosed.
- Is there scope for companies to modify vesting terms if incentivisation outcomes are not warranted or excessive, for example by deferral or clawback, or for malus? 'Clawback' is the recovery of sums already paid, for example for fraud or unjustified windfalls. 'Malus' is forfeiture of a short- or long-term incentive award before it is paid, on grounds of deficient performance. *(Source: The Investment Association, UK)*. The circumstances of each should be disclosed to shareholders.

We require that schemes are approved in advance and not retrospectively and encourage companies to make necessary disclosures in relation to incentive schemes.

4.5.2. Requirements of companies

This section sets out our interpretation of what current best practice is for some of the associated details of incentive schemes. It is intended to serve as a template for assessing scheme proposals.

4.5.2.1 Participation and limits

- Participants should be limited to executives and key employees who most influence performance.
- We will support schemes that are limited to a percentage of shares currently in issue and have a maximum lifespan.
- We believe it's important to apply participation limits.
- The proposed mix of base, short- and long-term incentive pay should be reasonable for executive directors, in terms of quantum and risk-taking. A suggested mix for CEOs is equal thirds in each, so that bonuses and incentive awards individually match base pay.

4.5.2.2 Awards

- Awards are made in shares – whether ordinary, forfeitable, restricted or even phantom - or their derivatives such as options or appreciation rights. Of these, options are least favoured, due to non-alignment of risk. They may be settled in shares or cash. If shares are used in settlement, the source, whether new issue or buybacks, should be disclosed – we favour buybacks, provided that makes valuation sense.
- Awards should be made frequently. Our preference is that they are made annually in order to incentivise rolling performance and to smooth receipts (i.e. reduce risk of receiving awards advantageously or disadvantageously). One way to achieve regularity and consistency is to determine the issuance or 'flow' rate in advance. So, for a scheme with an eight year award period, the flow rate could be set at 1.25% of shares in issue (10% divided by eight) per annum. An alternative would be to establish flow rates in terms of award values.
- Further conditions of awards should be:
    - They should be made at current market value or 30 day volume weighted average price (VWAP), not at a premium or discount, nor backdated;
    - The valuation methodology and present/face value should be disclosed in advance, together with anticipated/ fair value;
    - They should not be geared, nor matched. For example, 1 option = 1 share;
    - No backdating;
    - No repricing or regranting or softening of hurdles. (Further awards should address retention concerns); and
    - Hedging should not be allowed until awards have vested.
- Best practice is increasingly to grant shareholder rights to voting and dividends with awards, where appropriate, or pay accumulated dividends on vesting.

4.5.2.3 Performance hurdles

- 100% of awards should be subject to performance hurdles. The intention is to link pay with company (and individual) performance. We pay particular attention to the use of hurdles in long term incentive schemes, because we believe that is where shareholders can add the most value.
- The features we require of performance hurdles are:
    - Performance should be verifiable. Ideally, public information should be used. For this reason, we do not support the use of budgeted figures to construct hurdles;

- They should be relevant (controllable), fair and achievable and long-term in nature;
- We prefer that hurdles succeed rather than precede share awards, and that they be measured over a performance period of at least three years;
- They should be scaled and exceeded for vesting to occur; and
- Best practice is that they should be approved by shareholders in advance and not be reset or retested.

- We prefer vesting to take place according to a sliding scale. If management fails to achieve objectives full vesting should be improbable.
- Companies currently adopt three paradigms for performance hurdles: earnings growth, operational returns and shareholder returns. The last two are sometimes mixed by using change in net asset value (NAV) plus dividends. They may be expressed in relative or absolute terms. Best practice is to use them in combination.
- We will support a combination of two hurdles – one an absolute measure and the other relative – because as capital allocators, we require that companies create value for shareholders over rolling time periods in absolute terms first and then in relative terms. We suggest that these hurdles be weighted in favour of the absolute criterion.
    - We recommend that the first hurdle measures operational returns in excess of cost of capital, plus a margin. Appropriate metrics are return on assets (ROA) for banks, return on embedded value (ROEV) for insurers, and return on invested capital (ROIC) for other companies. For companies that do not meet these economic profit requirements, a recommended approach is to measure improvement in returns (or average increase for cyclical companies), to retain the important link between earnings growth and capital expenditure, or between theincome statement and balance sheet. Likewise, measurement of the sub-drivers of value may be more appropriate for specific business models, for example in companies exposed to commodity prices.
    - The second could be expressed in terms of total return to shareholders (TSR) relative to a benchmark of named peer companies (peers in terms of size or complexity and industry segment, or opportunity cost). The TSR hurdle mainly measures share price performance, which is beyond managements' control but when used on a peer-relative basis, it does have the advantage of rewarding outperformance only.
- We do not support the popular earnings growth hurdle, as there is no association with the productive use of the capital required to generate it.

4.5.2.4 Variations: awards without performance hurdles

There are several creative applications of awards which are not conditional on achieving performance hurdles. Amongst them are:

- Deferred bonuses: Where bonuses in any one year exceed their cap, the excess may be deferred into, and retained in, shares without further performance hurdles for a holding period. We prefer that hurdles succeed rather than precede share awards, and that they be measured over a performance period of at least three years.
- Matching shares: To reward staff shareholdings, companies may match shares held for a specified period with further grants. We prefer that awards are not geared in this way.
- Allowances: Shares awarded in the form of allowances do not have performance hurdles, but rather extended holding periods. In response to regulations that cap the ratio of variable to base pay, allowances may be deemed not to constitute variable pay. Because they do not have hurdles, we regard them as being for retention, and so will favour limited use only.
- Retention schemes: We support limited use of retention schemes only, as they do not have performance hurdles, being solely time-based.

4.5.2.5 Scheme life (performance and vesting periods)

- The life of a scheme would ideally match the time frame over which the firm needs to deliver on strategic objectives, divided conceptually into:
    - Performance periods of no less than three years (this could vary with the operating cycle of the company); and
    - Vesting, or exercise, periods.

A depiction is shown in Appendix 1. There could also be provision for holding periods thereafter, or minimum shareholding requirements.

- Awards vest during the vesting period, once the scaled performance hurdles have been exceeded. Where awards are made annually, we favour vesting after the performance period (also known as cliff vesting), for simplicity. Where awards are irregular, vesting should take place over a reasonable phasing period in order to smooth the relationship between benefit and risk, for both participants and shareholders.
- We will vote against evergreen schemes (in other words, schemes that reserve a specified percentage of shares for award into perpetuity). Such awards may maximise transfer of shareholder value and minimise the frequency that companies seek shareholder consent.

4.5.2.6 Grounds for adjustment (including malus and clawback)

- The distinction should be made between ‘good and bad leavers’. If an employee resigns or is dismissed before awards vest, there should be no settlement. Disability and retrenchment are grounds to negotiate settlement.
- A change to a company’s capital base may be grounds for adjustment to awards, which should be made to preserve the value of awards rather than restore the proportion of equity awarded.
- In the case of change of control, we favour a rollover of the scheme into a new scheme rather than accelerated settlement (which could influence the judgement of scheme participants). If not possible, the scheme should be settled pro rata to performance and time and in cash.
- There should be no scope for companies to change the terms of schemes without shareholder approval, other than to modify vesting terms if the outcome is not warranted, for example by deferral or clawback, or for malus.

4.5.2.7 Implementation (disclosure and review)

- The Remuneration Committee should ensure that a scheme is ‘justified, correctly valued and suitably disclosed’ (see Appendix 2 for an excerpt from King III). Disclosure of long-term incentives should form part of reporting on the value of total remuneration awarded to, and realised by, executive directors per financial year, resulting from implementation of remuneration policy.
- Realised remuneration should be compared with the targeted mix of base pay and short- and long-term incentive payments, as well as proportionally against the stretch targets for short- and long-term incentives. For shareholders to be able to measure and vote on the implementation of long-term schemes, awards, scaled hurdles and the targeted mix should be disclosed from inception, together with amounts received on vesting.
- There should be an independent check that hurdles were met and that the scheme did not overlap with other forms of remuneration. The scheme should also be checked for compliance with risk guidelines. Ideally, we propose that company auditors should sign off incentive schemes at the end of their life.

4.5.2.8 Tax issues

Schemes should be tax efficient. For example, companies should ensure that charges to the income statement qualify for a tax deduction, especially where payments are made in cash. The scheme rules should also provide for the company to recover all taxes (e.g. Pay-As-You-Earn tax, as it’s known in South Africa), levies and other costs payable by employees as a result of vested benefits.

4.6. **Our approach to retention schemes**

Retention schemes differ from incentive schemes in that there are no performance hurdles, and therefore no performance periods. Nevertheless, since retention is time based, vesting should still take place after a suitable period to achieve retention (preferably a minimum period of at least three years).

An alternative form of retention is a share purchase scheme, whereby the company provides loans to specified employees, which are used to buy shares in the company. The shares are held to secure the loans. The loans (reduced by dividends accrued) are repayable over the life of the scheme and as they are repaid shares are released.

The life of a share purchase scheme should also be limited to 10 years, with vesting commencing after the third year, for retention.

The benefits to employees in buying shares this way are:

- The price is fixed;
- The price may be discounted (we will not support this);
- Loan to value, being 100%, is higher than otherwise obtainable; and

- Lower interest cost (we will not support a cost lower than the company's weighted cost of debt; or cost of South African debt for South African-based staff).

Another implied benefit is that because share purchase schemes no longer serve their intended purpose when they are underwater, the temptation may be to release employees from their liability by assuming the liability in the company. For this reason, and because performance hurdles are not applicable, we will support such retention schemes if used in moderation by limiting the number of participants. Our preferred limit is 1% of issued shares. New shares may be issued, but we would prefer that they be bought in the market, depending on valuation. Retention payments may also be made in cash.

Schemes should be approved by shareholders in advance. Details of awards made should be disclosed in the remuneration report.

Appendix 1: Suggested life of a scheme

<table>
<tr><th colspan="12">Ideal incentive scheme life</th></tr>
<tr><td>Years</td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td><td>6</td><td>7</td><td>8</td><td>9</td><td>10</td><td>11</td></tr>
<tr><td>Award period (start)</td><td>award 1
12.5%</td><td>award 2
12.5%</td><td>award 3
12.5%</td><td>award 4
12.5%</td><td>award 5
12.5%</td><td>award 6
12.5%</td><td>award 7
12.5%</td><td>award 8
12.5%</td><td colspan="3"></td></tr>
<tr><td rowspan="8">Performance period (end)</td><td colspan="3">award 1</td><td colspan="8"></td></tr>
<tr><td></td><td colspan="3">award 2</td><td colspan="7"></td></tr>
<tr><td colspan="2"></td><td colspan="3">award 3</td><td colspan="6"></td></tr>
<tr><td colspan="3"></td><td colspan="3">award 4</td><td colspan="5"></td></tr>
<tr><td colspan="4"></td><td colspan="3">award 5</td><td colspan="4"></td></tr>
<tr><td colspan="5"></td><td colspan="3">award 6</td><td colspan="3"></td></tr>
<tr><td colspan="6"></td><td colspan="3">award 7</td><td colspan="2"></td></tr>
<tr><td colspan="7"></td><td colspan="3">award 8</td><td></td></tr>
<tr><td>Vesting period (start)</td><td colspan="3"></td><td>award 1</td><td>award 2</td><td>award 3</td><td>award 4</td><td>award 5</td><td>award 6</td><td>award 7</td><td>award 8</td></tr>
</table>

For a scheme with a 10 year life, there is scope to make eight equal annual awards. The eight awards in this example vest from the start of year 4, to the start of year 11. However, if vesting is phased over three years, or a two year holding period is introduced, there is reduced scope for awards. To ensure vesting continuity, new schemes should commence awards before old ones run off, rather than shorten initial vesting periods.

Appendix 2: Extracts from King III Report

The relevant provisions of the King III Report relating to remuneration of directors and senior executives, particularly the provisions relating to long term incentive schemes, are reproduced in this Appendix for ease of reference.

(Extracted for reference from King III Report by JSE Pty Ltd, September 2009)

Remuneration of directors and senior executives

Principle 2.25: Companies should remunerate directors and executives fairly and responsibly.

147. Companies should adopt remuneration policies and practices for executives that create value for the company over the long term. The policies and practices should be aligned with the company's strategy, should be reviewed regularly and should be linked to the executive's contribution to company performance.

148. Factors affecting company performance, but outside the control of senior executives, and to which they have made no contribution should only be considered to a limited extent. At lower levels in the company the effect of outside factors should be ignored.

149. The board should promote a culture that supports enterprise and innovation with appropriate short-term and long-term performance-related rewards that are fair and achievable.

151. In proposing the remuneration policy, the remuneration committee should ensure that the mix of fixed and variable pay, in cash, shares and other elements, meets the company's needs and strategic objectives.

     Incentives should be based on targets that are stretching verifiable and relevant. The remuneration committee should satisfy itself as to the accuracy of recorded performance measures that govern vesting of incentives. Risk-based monitoring of bonus pools and long-term incentives should be exercised to ensure that remuneration policies do not encourage behaviour contrary to the company's risk management strategy.

152. The remuneration committee should scrutinise all benefits including pensions, benefits in kind and other financial arrangements to ensure they are justified, correctly valued and suitably disclosed.

Base pay and bonuses

156. In setting remuneration policies, the remuneration committee should ensure that remuneration levels reflect the contribution of senior executives and executive directors and should be rigorous-in selecting an appropriate comparative group when comparing remuneration levels. There should be a balance between the fixed components and the bonus component of total remuneration of executives so as to allow for a fully flexible bonus scheme.

157. Yearly bonuses should clearly relate to performance against yearly objectives consistent with long-term value for shareholders. Individual and corporate performance targets, both financial and sustainability related, should be tailored to the needs of the business and reviewed regularly to ensure they remain appropriate.

158. Depending on the nature of the business it may be appropriate to have overriding conditions for the award of bonuses (often termed 'gatekeepers'), such as achieving safety goals or minimum levels of financial performance. Targets for threshold, expected and stretch targets for performance should be robustly set and monitored and the main performance parameters should be disclosed.

159. Incentives may be given for both long-term and short-term goals. However, the performance drivers should not be duplicated, and a balance should be struck with the need to reward success over the long term. Multiple performance measures should be used to avoid manipulation of results or poor business decisions. Targets may be linked to bonuses.

Share-based and other long-term incentive schemes

166. The remuneration committee should regularly review incentive schemes to ensure their continued contribution to shareholder value. The committee should guard against unjustified windfalls and inappropriate gains from the operation of share-based incentives.

167. Participation in share incentive schemes should be restricted to employees and executive directors, and should have appropriate limits for individual participation, which should be disclosed.

168. All share-based incentives, including options and restricted or conditional shares, whether settled in cash or in shares, should align the interests of executives with those of shareholders and should link reward to performance over the longer term. Vesting of rights should therefore be based on performance conditions measured over a period appropriate to the strategic objectives of the company.

169. Highly leveraged incentive schemes should be used with care as they may result in excessive cost or risk for the

company.

170. The regular and consistent granting of share incentive awards and options, generally yearly, is desirable as it reduces the risk of unanticipated outcomes that arise out of share price volatility and cyclical factors, allows the adoption of a single performance measurement period and lessens the possibility and impact of 'underwater' options or excessive windfall gains.

171. The price at which shares are issued under a scheme should not be less than the mid-market price or volume weighted average price (or similar formula) immediately preceding the grant of the shares under the scheme. There should be no re-pricing or surrender and re-grant of awards on 'underwater' share options.

172. The rules of a scheme should provide that share or option awards should not be granted within a closed period. No backdating of awards should be allowed.

173. Options or other conditional share awards are normally granted for the year in question and in expectation of service over a performance measurement period of not less than three years. Accordingly, shares and options should not vest or be exercisable within three years from the date of grant. In addition, options should not be exercisable more than 10 years from the date of grant. For new schemes it is best practice to restrict the exercise period to less than seven years.

174. To align shareholders' and executives' interests, vesting of share incentive awards should be conditional on achieving performance conditions. Such performance measures and the reasons for selecting them should be fully disclosed. They should be linked to factors enhancing shareholder value, and require strong levels of overall corporate performance, measured against an appropriately defined peer group or other relevant benchmark where yearly awards are made. If performance conditions for share-based incentive schemes are not met, they should not be re-tested in subsequent periods. Where performance measures are based on a comparative group of companies, there should be disclosure of the names of the companies chosen.

175. Vesting of awards should be made on a sliding scale to avoid an 'all or nothing' vesting profile and should start at a level that is not significant compared with base pay. Awards with high potential value should be linked to commensurately high levels of performance. Full vesting should require significant value creation.

176. When companies face the risk of losing key employees, remuneration policies to retain them may be adopted. Incentive schemes to encourage retention should be established separately, or should be clearly distinguished, from those relating to reward performance and should be disclosed in the annual remuneration report voted on by shareholders.

177. There should be no automatic waiving of performance conditions in any of these situations:

177.1 a change of control;

177.2 a 'roll over' of options and awards for a capital reconstruction; and

177.3 early termination of the participant's employment.

Depending on the circumstances, it may be appropriate to pro rate the benefit both on time and performance, or to create new instruments to preserve the value of the outstanding awards. In the case of change of control, it may be appropriate to allow pro rata early vesting, to the extent that performance conditions have been satisfied, and the time for vesting periods has been served.

178. Where individuals leave voluntarily before the end of the service period, or are dismissed for good cause, any unvested share-based awards should lapse.

179. In other cases of the end of employment, where the remuneration committee decides that early vesting is appropriate, the extent of vesting should depend on performance criteria over the period to date as well as the time served of vesting periods.”