



M E R G E N C E

## Corporate Governance and Proxy Voting Policy

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## SECTION A

### Corporate Governance

Mergence Investment Managers' (MIM) Corporate Governance and Proxy Voting Policy specifies a framework of principle and action for its stakeholders, primarily the companies in which it invests. The framework reflects the conviction that socially responsible governance and sound management practice are inseparable in South Africa.

The purpose of the Policy is to create guidelines and a consistency of outlook and practice between MIM and its stakeholders to provide an indication of the way that funds entrusted to MIM will be managed.

Corporate governance in South Africa was formalised with the publication of the original King Report in 1994. Since then a second report by the Institute of Directors was published in 2002. This report is popularly known as King II. As the King Report is tailored to the South African institutional environment, it assists MIM when engaging corporates on issues where there might be differences of opinion in matters concerning corporate governance.

The Policy extends on the King II corporate governance view that governance "is concerned with holding a balance between economic and social goals". MIM believes the two are interdependent. Thus the Policy states its expectations as a custodian of pension funds and recommends actions and structures to embed the best economic and social practice in organisational structure and implementation.

#### 1. Approach and assumptions

It is MIM's policy to promote strong corporate governance in the companies that it invests in. This document formulates the MIM voting policy at shareholder meetings to ensure that where applicable, the resolutions adopted comply with the principles of sound corporate governance.

This document also directs the user in assessment and evaluation of corporate governance practices to ensure that the process is consistent, transparent and objective. The emphasis is therefore on practical guidelines rather than lengthy rhetoric.

#### 2. MIM principles

MIM endorses eight characteristics of good corporate governance namely, discipline, transparency, independence, accountability, responsibility, fairness, social responsibility and meeting stakeholder obligations.

The King II report quotes Sir Adrian Cadbury on corporate governance as follows: "*Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. . . the aim is to align as nearly as possible the interest of individuals, corporations and society*".

MIM has adopted a set of principles which will ensure that this balance is not only suggested, but also actively pursued. These principles form the basis of the MIM Proxy Voting Policy. This report will outline these policies in as much detail as is practical. However, when the proposed resolution or situation is not specifically covered in the report, MIM, and/or its external managers, should vote in accordance with the fundamental principles.

##### 2.1. Discipline



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Corporate discipline is a commitment by a company's senior management to adhere to behavior that is universally recognized and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to the underlying principles of good corporate governance, particularly at senior management level.

#### 2.2. Transparency

Transparency is the ease with which an outsider is able to make a meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company.

#### 2.3. Independence

Independence is the extent at which mechanisms have been put in place to minimize or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareholder. These mechanisms range from the composition of the board and external parties such as auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

#### 2.4. Accountability

Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow accountability. These provide investors with the means to query and assess the actions of the Board and its committees.

#### 2.5. Responsibility

With regard to management, responsibility pertains to behavior that allows for corrective action and for penalizing mismanagement. Responsible management would, when necessary, put in place what it would take to set the company on the right path. While the Board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company.

#### 2.6. Fairness

The systems that exist within the company must be balanced in taking into account all those that have an interest in the company and its future. The rights of various stakeholders have to be acknowledged and respected. For example, minority shareholders' interests must receive equal consideration to those of the dominant shareholder(s).

#### 2.7. Social responsibility

A well-managed company will be aware of and respond to social issues, placing high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitive, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.

#### 2.8. Good Stakeholder relationships

Meeting stakeholder's obligations Companies should understand the relationship that they have with stakeholder groups. Boards that strive for active dialogue and cooperation with stakeholders are most likely to have an enhanced understanding of the impacts in relation to society and the physical



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environment. Poor stakeholder relations represent intangible liabilities that could lead to a loss of value to shareholders over the long term. Poor management of environmental and social impact transfers costs to future generations of shareholders in the interest of short-term profit taking.

While stakeholder groupings are different from company to company, and the responses differ according to size, sector and geographic location, MIM would require companies to:

- 2.8.1. Identify stakeholder groupings. Stakeholders can, in short, be described as those whose relations to the enterprise cannot be completely contracted for, but whose cooperation and creativity it depends on for its survival and prosperity.
- 2.8.2. Establish communication channels with such groupings to ensure that the company is aware of their views.
- 2.8.3. Understand the impact of its operations through both internal and external processes.
- 2.8.4. Establish a set of ethics and core values for the company and principles of business practices that will support these values. These values and principles should be communicated to stakeholders, and the company should constantly monitor how these principles are applied.
- 2.8.5. Seek to address the impact of its operations at both strategic and operational level, and communicate its strategies and programs to both stakeholders and shareholders.
- 2.8.6. Monitor progress with respect to such programs and communicate this to both stakeholders in manner that engenders their trust.
- 2.8.7. Participate in broader initiatives that contribute towards lowering the overall negative impact on business and to development of a more equitable society. It should be noted that the later these issues are addressed, the more costly it becomes to rectify them as remedial costs invariably far outweigh the costs of prevention.

Corporate governance, as a balancing mechanism aligning the interests of individuals, corporation and society, must be accompanied by financial performance, the primary motivation of the shareholder. Directors must be accountable for failures affecting shareholders' investments including insufficient earnings growth, profitability, inappropriate gearing and acquisitions.

Corporate governance is not only an ethical issue, as a lack thereof has severe negative economic implications. This is not only for a company and its shareholders but also for the wider economy as a whole. Countries where corporate governance structures are regarded as well functioning are also countries which attract domestic and foreign investment.



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## SECTION B

### UN Principles for Responsible Investment

*“An investor initiative in partnership with the UNEP Finance Initiative and the UN Global compact”*

*“The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issue to investment practices. The process was convened by the United Nations Secretary-General.*

*In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society”*

*(UN Principles for Responsible Investment).*

Mergence Investment Managers, as signatories to the UN Principles for Responsible Investment, believe that the environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, therefore, where consistent with our fiduciary responsibilities, we endorse and commit to the following 6 Principles:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will report on our activities and progress towards implementing the Principles.



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## SECTION C

### Proxy Voting Guidelines

MIM's provided guidelines for proxy voting flow from the principle of equitable treatment of shareholders, especially minorities, and the direct and indirect safeguarding of their interests. Directly, safeguarding involves enfranchising shareholders to express their interests in an informed way. Indirectly, this Policy favours the mechanisms that safeguard these interests. Proxy voters are informed of MIM's attitude to specific actions that might benefit certain classes of shareholder and prejudice others, or impair the rating of a share. The Policy informs proxy voters, too, of MIM's dividend policy preferences and how proxy voting should express these.

- a. Recommendations about the directors emphasise the importance of separation of powers between executive and non-executive directors; empowering directors with the skills and independence to fulfil their mandates knowledgeably and effectively; and creating a corporate environment that benefits from the diversity of backgrounds, outlooks, skills and experiences it contains.
- b. The Policy looks at BEE deals from the point of view of transparency, equity, responsibilities, integrity and compliance. It commends structures and approaches to ensure that partnerships are significant, not nominal; on creating value without excessively diluting existing rights; and recognising the need for innovative and unconventional funding mechanisms.
- c. Recommendations of best practice by auditors involve structures and processes to bolster their independence, protect their ability to fulfil their fiduciary duties and obviate relationships that might limit their independence. Vigilance on fees is also a requisite.
- d. MIM lays out a policy for executive remuneration. It should, in addition to being openly and fully disclosed, respect a broader social context; be consistent with remuneration approaches and levels throughout the company – and firmly link reward to performance.
- e. Guidelines for sustainability reporting, organisational integrity and social transformation are also given. The Policy outlines reporting and operational procedures to entrench corporate, environmental, safety and responsiveness into structures of management action.



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## SECTION 1: Ordinary Business/Ordinary Resolutions

### 1. To “Approve” or “Receive” the Annual Financial Statements and Reports

The responsibility of the approval of the annual financial statements rests with the directors, as defined by Section 298 of the Companies Act. Thus, while this resolution calls on shareholders to approve the financial statements this approval is merely ‘symbolic’ and is traditionally interpreted to imply that the shareholders have read and considered the statements contained in the annual financial statements and reports. Thus voting for such a resolution indicates that the shareholders are not voting on the other resolutions placed before them without having read the financial statements and reports.

- 1.1. Voting against the approval of the annual financial statements and reports
- Given the ‘symbolic’ nature of the resolution of receiving the financial statements, Mergence will only vote against the resolution should they wish to send a message to management aimed at highlighting areas of concern or omission within the company or financial statements that Mergence is unable to vote on through other resolutions. A vote against this resolution will always require an explanation detailing the grounds on which Mergence is voting in the negative.

Below are various scenarios that may occur that might warrant a vote against the ordinary resolution to receive the annual financial statements.

- 1.1.1. Mergence should vote against the acceptance of the financial statement where it feels that there has been insufficient transformation of the board along racial and gender equity lines. This vote should be followed up with a similar no vote on the re-appointment of certain directors as highlighted below in the section on “Re-election of Directors”. Additionally transformation should flow beyond the board and to the company as a whole, Mergence may vote against the acceptance of the financial statements should it feel that transformation and employment equity at the company is inadequate and not being rectified at a suitable pace.
- 1.1.2. Where there is no differentiation between the chairman of the board and the chief executive officer roles within the company Mergence may choose to vote against the resolution to accept the financial statements, additionally Mergence will not support any proposals aimed at allowing the chief executive officer to move into the role of chairman following their retirement.
- 1.1.3. Mergence should vote against the acceptance of the financial statements where it feels that there is insufficient disclosure on issues which it deems to have a material impact on the company, society and/or the environment as a whole. Mergence will only vote against the acceptance of the financial statements after it has raised its concerns over the lack of disclosure on a particular issue or issues and the management and/or directors of the company have not been forthcoming with providing adequate assurance or disclosure on the issues raised. Particular issues that may be highlighted include:
- 1.1.3.1. Ethical considerations, including codes of conduct and general core values associated with the company.



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- 1.1.3.2. Financial considerations, including consistency of reporting, related party transactions, and adequate detail provision on contingent liabilities including environmental liabilities where appropriate.
  - 1.1.3.3. Environmental consideration, in particular disclosure on i) environmental policy and management systems, ii) consistent disclosure on resource usage with specific focus on identifying and quantifying the three core environmental measures as highlighted by DEFRA, namely Greenhouse Gases, Water Consumption and Waste production, (these three measures should be reported on by all companies). Companies should, however, be encouraged to report on those indicators within the additional 23 environmental Key Performance Indicators (KPI's) as identified by the Trucost "Developing Environmental Key Performance Indicators for UK Companies" (Trucost, 2004) that are relevant and material to its operations. Where possible and material the financial implications and/or values associated with the environmental exposure should be disclosed.
  - 1.1.3.4. Social consideration, including engagement with labour force, customers, and suppliers. Additionally the company should provide clear guidance regarding its social (labour) practices in countries that have a history of human rights violations. Lastly the company should disclose its activities within the surrounding communities in which it operates and it should highlight its corporate social investment activities.
  - 1.1.3.5. Government consideration. In particular the company should disclose all its dealings with government this will include, amongst other things, any donations made to political parties and taxation paid.
- 1.1.4. Mergence should vote against the acceptance of the financial statements where it feels that executive pay and or executive pay increases are of an excessive nature and are inappropriate when compared to the financial, social and environmental performance of the company over the financial period concerned. Similarly Mergence should choose to vote against the acceptance of the financial statements where it feels that the level of disclosure around executive pay is insufficient, or not comparable against the previous period. This vote should be coupled with a vote against the re-appointment of any Directors that hold positions on the Remuneration or Compensation Committee.

## 2. The re-election of Directors

The election and/or appointment of director's to the board is of paramount importance and requires significant reflection and consideration. The directors represent the core link between shareholders and the assets in which they are invested, and as such shareholders place a considerable amount of faith in the directors to act in their best interests. In particular directors are expected to act in the long-term interests of all shareholders and the company as a whole.

Directors should be re-elected/elected by means of individual resolutions as opposed to a collective resolution. Where there is no provision to vote by means of individual resolutions Mergence should choose to abstain from voting on the resolution and should raise its concern around the use of collective voting by the company. However, in the instances where Mergence has already raised its concerns with the company and the company persist with the use of a collective voting resolution Mergence should vote against the resolution.



In re-electing directors Mergence will take into consideration a number of broader issues around the makeup of the board as outlined below, as well as, considering individual member specific criteria required to be fulfilled in order to warrant a for vote.

Each director is individually and conjointly responsible for all decisions made by the board, thus it is important to ensure that there does not arise any concentration of power within a small quorum of directors.

Critical to the decision of re-election of any individual director will be his/her ability to hold this office as well as the general balance and representation of the board as a whole. In particular, the make of the board with regards to i) the number of executive versus non-executive directors, ii) the ratio of non-independent versus independent<sup>1</sup> directors, iii) the gender profile of the board as well as iv) the racial profile) should be considered when re-electing directors in order to ensure that the board is truly representative of the relevant country demographics (this is of particular importance in South Africa, but should be consistently applied throughout all countries) and is compliant with recommendation on board structure<sup>2</sup> as defined under the King II report.

With regards to board structure, should Mergence feel that the board is of an unacceptably large size, Mergence will apply its discretion when voting for the re-appointment of directors and will vote in favour of independent non-executive directors over executive directors and other non-executive directors.

Mergence endorses the JSE listing requirements which states that there should be a clear and distinct separation of responsibilities between the board chairman and the chief executive officer and more specifically that the chief executive officer must not hold the position of chairman. This separation of duty is of critical importance in ensuring that the board is able to hold executive directors and management accountable and for ensuring a balance of power and authority within the head of the company.

Board meetings should be held on a regular basis with a minimum of one meeting per quarter being conducted. The number of meetings held as well as individual's attendance at board and committee meetings should be captured and disclosed in the company's annual financial statements. Consistent non-attendance of board and/or committee meetings by any individual member would constitute grounds for an 'against' vote on the re-election of the individual director in question. Similarly Mergence should vote against the re-election or election of any director and/or directors that are associated with poor governance procedures and/or practices within the company or in any other company for that matter.

Mergence should vote against directors that occupy positions on the Audit and Risk Committees and/or the Sustainability or Social, Health and Environment (SHE) committees (in so far as they exist) if Mergence feels that there is inadequate structures for dealing with financial risks and risks associated with ethical, workplace, social and environmental concerns respectively.

Finally, when deciding on the merit of voting for the re-election or election of independent and non-executive directors to the board, Mergence should consider the number of other board positions held by the director. Independent and non-executive directors should be able to commit sufficient time and effort to the role on the board and should be able to ensure constant attendance at all meetings.

<sup>1</sup> With reference to the Combined Code (FRC, 2006) the board should identify in the annual report each non-executive director it considers independent. The Combined Code (FRC, 2006) outlines a number of circumstances that it defines as potentially undermining the independence of the director (Combined Code (2006), A .3.1, pg 6).

<sup>2</sup> The board structure should, preferably, be comprised of a majority of non-executive directors of whom a sufficient number should be independent of management. Notwithstanding the need to have a majority of the board made up by non-executive directors the board should comprise a sufficient number of executive directors on order to provide the board with an accurate and up to date understanding of the financial and operational situation of the company.



### 3. The Re-Appointment and Remuneration of Auditors

#### 3.1. Re-appointment of Auditors

While the Companies Act (1973) requires the company's auditors be reappointed annually at a general meeting; the right of shareholders to appoint the auditors is indicative of the fact that the auditors are there to provide them with an external, independent, and objective opinion with respect to the financial performance and affairs of the company.

The Audit Committee is charged with selecting and monitoring the auditors and is responsible for ensuring that the audit remains independent. To this effect it is important to ensure that the Audit committee is made up of non-executive (the majority of which should preferably be independent) directors. In particular the chairman of the audit committee should be an independent non-executive director.

Mergence should vote against the appointment of any audit firm that it sees as not having the competence and/or capacity to conduct a thorough and rigorous audit on the company.

King II sets out a number of functions that are required to be performed by the Audit Committee, Mergence should choose to abstain from voting on the re-appointment of the auditors should the audit committee not fulfil its functions. Additionally Mergence should also vote against the re-appointment of the directors currently holding positions within the Audit committee that come up for re-appointment. The functions that the Audit Committee are required to perform by King II include:

3.1.1. Setting the fees and the auditor's terms of engagement

3.1.2. The recommendation to shareholders of an auditor that is independent

Where appropriate, and if required by law, the Audit Committee should appoint for a limited period of time an individual auditor, this will allow for the rotation of audit partners and ultimately continued independence of the auditors.

3.1.3. Oversight over nature and extent of any non-audit services provided to the company

This function is of particular importance where the services conducted by the audit firm may compromise the independence of the auditor; specifically the auditor should not conduct other (non-audit) work with the company that it will be required to provide an opinion on at a later date.

3.1.4. Including a statement within the financial statements that the audit is in compliance with the law and has been independently conducted.

3.1.5. Dealing with any complaints with respect to the accounting practices and any related matters.

Mergence should be very cognisant when casting its vote on the re-appointment of the auditors of any issues or potential issues that may compromise the audit firm's independence and objectivity with respect to the company. Particular focus and attention should be placed on any other non-audit work conducted by the auditor for the company over the past year.

Lastly, in the event that the company intends to change its auditors the company should provide comprehensive reason(s) for the dismissal or resignation of the auditors.



### 3.2. Remuneration of Auditors

Practically the remuneration of the auditor is determined by agreement between the auditor and the directors acting on behalf of the company. A vote against the remuneration fee would thus be used by Mergence to enforce any concerns raised when voting on the re-appointment of the auditors, as well as if Mergence wishes to raise concerns around any of the following issues:

- 3.2.1. A significant and unsubstantiated increase in the level of remuneration over the prior period.
- 3.2.2. Where the audit fee varies significantly from external benchmarks such as competitor's rates and other similar audits conducted by the audit firm.
- 3.2.3. Where there has been insufficient disclosure, and/or failure on the part of the Audit Committee to issue a statement around the amount of non-audit work conducted by the company's audit firm including highlighting such measures that were taken to ensure that the audit firm's independence was not compromised by the undertaking of such non-audit work.
- 3.2.4. Where the level of remuneration for non-audit work is considered to be excessive or unreasonable given the nature and extent of work conducted.

## 4. Directors Remuneration

At present the placing of executive remuneration before shareholders for their approval is not required in South Africa. Executive remuneration is decided on by the remuneration or compensation committee of a company and as such shareholders do not have any direct rights to vote to stop executive pay abuse in South Africa. Mergence is aware that remuneration needs to set at a level that will attract, retain and motivate executives of a significant quality, and thus executive remuneration should always be reviewed with this in mind.

Where non-executive directors' fees are placed before shareholders for approval, Mergence should assess each submission on a case-by-case basis taking the following into account: the size and increase in the fee, the director's attendance figures at general, board and board committee meetings, and whether the board committee in question has met its remit.

Mergence is of the opinion that companies should, at the very least, submit remuneration policies to shareholders for analysis and/or disclose executive remuneration annually in the company financial statements. In the event that Mergence feels that executive pay (and/or increases in pay) is excessive or at levels which are deemed inappropriate given the performance of the company over the financial period concerned Mergence should vote against the re-election of any directors up for re-election that are members of the Remuneration or Compensation Committee and/or vote against the Chairman or deputy chairman. Additionally Mergence should vote against the acceptance of the company financial statements as set out and defined above.

Mergence can also send a strong message of disapproval of executive remuneration by voting against any additional or amendments to share based incentive schemes and associated resolutions as identified under the section "Share Option Schemes" below.



Where companies are required by law to submit remuneration reports to shareholders to vote on, Mergence will assess each submission on a case-by-case basis taking the following into account: Size of and increases in the basic salary component, pension contributions, service contracts (highlighting any golden parachutes and length of contracts). Mergence should also ensure that all performance based incentives are aligned to shareholder interests and do not promote short-termism. Performance based incentives should be broader than merely financially based and should include the achievement or maintenance of social, environmental and governance targets within the firm. Where Mergence feels that the remuneration report is not satisfactorily clear in its definitions, and detailed enough in how basic and incentive remuneration is calculated and if Mergence feels that the individuals in question have not performed in accordance with what is required of them as detailed in the report Mergence should vote against the report.

Remuneration should be voted on by means of individual resolutions as opposed to a collective resolution. Where there is no provision to vote by means of individual resolutions Mergence should choose to abstain from voting on the resolution and should raise its concern around the use of collective voting by the company. However, in the instances where Mergence has already raised its concerns with the company and the company persist with the use of a collective voting resolution Mergence should vote against the resolution.

Mergence should vote against any resolution seeking retrospective approval or ratification of non-executive directors' fees. All approvals sought by the board and the company must be sanctioned by shareholders in advance.

## **5. Distributions to Shareholders, Odd-Lot Offers, Share Splits and Consolidations and BEE Transactions**

Distributions to shareholders can take a number of forms, including the Payment of Ordinary Dividends, Capitalisation Issues, and Reductions in Capital by way of Special Dividends. Each of these methods has their merits and de-merits and Mergence should view each on a case-by-case basis bearing the following in mind:

### **5.1. Payment of Ordinary Dividends**

Mergence should vote against the payment of dividends were it feels that such a payment is likely to place the company in a precarious position with regards to the availability of cash resources.

Additionally changes in the dividend policy of the company that is likely to see the company returning more cash to shareholders than historically should be assessed on its sustainability both from the company's operational requirements perspective as well as from a shareholders expectations perspective.

### **5.2. Capitalisation Issues**

With regards to the use of a capitalisation issue to return funds to shareholders Mergence should vote against or abstain from voting where:

5.2.1. The difference between the value of the capitalisation issue versus the cash offer (if a choice is provided) is of a significant size that shareholders will effectively be in a worse of position by taking the cash offer and are in effect being 'forced' into selecting the capitalisation offer.

5.2.2. The size of the capitalisation offer in relation to the current shares in issue would significantly increase the total number of shares in issue and potentially have a significantly negative impact on the company's earnings per share going forward.



### 5.3. Reductions in Capital by way of Special Dividends

As with the decision to vote against normal dividend payments made to shareholders (section 5.1 above) Mergence should vote against the reduction in capital by way of special dividends were it feels that such a payment is likely to place the company in a precarious position with regards to the availability of cash resources going forward.

### 5.4. Odd-Lot Offers

On a whole Mergence should vote in favour of those resolutions aimed at reducing the costs and administrative burden associated with being a listed company. Thus Mergence will vote in favour of odd-lot offers and related resolutions (permission to repurchase and issue shares in relation to the odd-lot offer) as long as the odd-lot offer will not concentrate voting power or increase existing concentration of voting power in a small number of shareholders.

Mergence may choose to vote against any odd-lot offers that pertain to a specific sub-class of voting shares (for example lower voting rights shares) where such an odd-lot offer will ultimately result in the increase in voting power of other shareholders within the company.

### 5.5. Share Splits and Consolidations

Share splits are generally understood to increase the liquidity of shares and are usually conducted for just such a reason. Mergence is of the opinion that the improved liquidity of stocks should be promoted and thus would vote in favour of most share splits. However, share splits will be considered on a case-by-case basis in order to ensure that the company is acting in the best interest of the existing shareholders through the implementation of a share split.

Conversely consolidations of shares would be expected to reduce the overall liquidity of the stock. Mergence will look to the company to provide a sufficient rationale for the share consolidation and will only vote in favour of such a resolution where it feels satisfied that a share consolidation makes sense and is in the interest of all shareholders.

### 5.6. BEE Transactions

Mergence is highly aware of the need for BEE transactions as a both a license to operate imperative by the company as well as a social requirement aimed at redressing historical economic and social imbalances caused by apartheid. Mergence will assess the merits, economic rationale and practicality / feasibility of BEE transactions on a case-by-case basis. Mergence should vote in favour of such transaction provided that it is satisfied that the firms in question have provided sufficient disclosure on the following issues:

5.6.1. The degree to which the BEE transaction can be seen to be broad-based in its structure and incorporation of previously disadvantaged groups. The long-term sustainability of the broad-based nature of the transaction should also be ensured.

5.6.2. The level to which the transaction is being conducted at a discount to the prevailing share price and whether or not this discount is warranted, fair and reasonable and is accompanied by a sufficient lock-in period restricting the transfer of ownership to non-BEE individuals.



- 5.6.3. The level to which and conditions attached to any funding schemes being provided to the BEE company, including hurdle rates, share conversion conditions (specifically where a second class of shares has been issued to fund the deal) and the treatment and impacts of such a funding scheme under IFRS.

Before voting against any BEE transaction, regardless of whether or not Mergence feels the deal is problematic and/or not in shareholders' interest, Mergence will consult with its segregated clients on whether they may wish to vote, in their own capacity, on the transaction in a manner other than that advised by Mergence.

## **6. The Placing of Unissued Ordinary Shares Under the Control of the Directors**

The placement of authorised but unissued shares under the control of management is designed and intended to give management unrestrained ability to issue shares for acquisitions or to fend off being acquired. Note that this resolution, unlike issuing shares for cash (see Section 2 on Extraordinary Majority Resolutions below) does not require an extraordinary majority to approve it.

The practice of issuing shares to acquire or avoid being acquired ultimately dilutes existing shareholders and in practice can result in significant wealth destruction. Mergence should thus oppose all requests to place unissued shares under the control of directors (even where such allocation is limited to a specified percent of issued share capital). Instead Mergence requires that they be entitled to vote on a case-by-case basis on specific resolutions requesting the allocation of shares under control of the directors such that the motivation for the issue of shares can be thoroughly assessed.

Note that, the permission to issue shares to option schemes and executive share schemes should be put forward in a separate resolution as required by s222 of the Companies Act (1973). Mergence will assess the relevance and appropriateness of such a resolution separately to the 'blanket' authority to issue shares by directors. Mergence will vote in favour of such placement of shares where it feels that the share issue is in line with the company's remuneration policy and that it forms part of a broader set of incentives aimed to link management remuneration with the overall financial, social and governance performance of the company.

## **7. The Renoucement of Pre-Emptive Rights**

This resolution is aimed at enabling the company to avoid having to conduct a rights offer to existing shareholders on a pro-rata basis as required by the JSE Listing Requirements (Schedule 10.2). The effect of granting such a resolution would be to enable management to issue shares to a select group of investors thereby potentially concentrating voting power in a small group of investors, and/or potentially enabling management to utilise share issues to fend off take-over attempts to highlight two examples.

Mergence should thus vote against the renoucement of pre-emptive rights resolutions on similar voting grounds to that of placing unissued shares under the control of management.



## **SECTION 2: Extraordinary Majority Resolutions**

### **1. Providing Directors the Authority to Issue Shares for Cash**

The authority to issue shares for cash enables directors to place shares in the hands of select individuals and similarly to the placement of unissued shares under control of directors the resolution can result in existing shareholders being diluted, in directors issuing shares to avoid take-overs or defend themselves against shareholder bodies, and/or issuing shares to conduct acquisitions.

The current limits as per the JSE Listing Requirements on the amount of shares that may be issued for cash in any one period is 15% of the issued share capital. Mergence is of the opinion that the general authority to issue shares for cash without a valid and substantiated reason is inappropriate regardless of the limit set by the JSE and or the Company as it does not enable Mergence to consider the rationale and dilutive effect that such an issue would have on its position in the company.

Mergence should thus vote against any unmotivated or unsubstantiated resolutions enabling directors to issue shares for cash.



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## SECTION 3: Special Resolutions

### 1. Authority to Repurchase Shares

On the whole, Mergence is in favour of share repurchases as an efficient and tax effective mean of returning funds to shareholders, however, Mergence is cognisant that share repurchases can have significant negative consequences on shareholders and the firm itself.

- 1.1. Impact on cash resources and day to day operations  
Mergence should vote against a share repurchase when they believe that such a share repurchase will not be in the best interest of shareholders as it will place undue strain on the cash resources of the company and/or the company's ability to efficiently and profitably perform its day to day operations.
- 1.2. Impact on "free float"  
Mergence should vote against a share repurchase when the share repurchase is anticipated to reduce the liquidity of the company's shares or if the free float of the company is currently of such a nature that the company's shares are already considered to be illiquid. The latter is of particular significance when there is a pyramid holding company structure in place and/or when the existing public shareholding of the company is below 50%. Mergence should make an exception to the 50% public holding criteria in the event that the share repurchase is to be conducted on a pro-rata basis and this will not decrease the relative shareholding of public shareholders.
- 1.3. Unequal treatment of different classes of shares  
Mergence should vote against a share repurchase when there exists control within a small minority of shareholders and/or there exists a pyramid structure unless the repurchase is to be conducted on a pro-rata basis. Additionally Mergence should vote against a share repurchase when there exists various classes of shares of unequal voting and/or economic rights unless the shares are to be repurchased on a pro-rata basis and each class of share are provided with the opportunity to vote on the resolution separately.
- 1.4. Concerns around share incentive schemes  
As share repurchases will increase the number of treasury shares available for allocation towards option holders, Mergence should vote against the share repurchase where there is disagreement with the structure, conditions and/or method of allocation of the share option scheme. A negative vote here should be done in conjunction with a vote against the issue of shares to the share incentive scheme.

### 2. Share Option Schemes



Share options are a common and widely accepted form of management remuneration and incentive scheme within South African companies. The vesting of awards and/or the exercising of options granted should be governed by clear, challenging and appropriate performance conditions.

Proposed new schemes as well as changes to existing schemes should be made available for inspection to all shareholders well prior to the meeting. Details pertaining to the tax implications, the costs to the company of implementing the scheme as well as the performance conditions, maximum levels of awards, dilution limits and the overall policy for granting conditional share or option awards should be clearly stated in plain accessible English.

#### 2.1. Share option beneficiaries

Mergence should vote against any scheme that does not restrict the definition of participants to those involved in the business.

Mergence should vote against any schemes that allow for the inclusion of non-executive directors (with additional focus being placed on non-executive directors serving on the remuneration or compensation committees) as their inclusion is likely to impact on their independence.

Mergence should vote against any scheme whose trustees are executive directors, employees of the company or service providers to the company, or any other party whose independence may be compromised by inclusion in the scheme. Additionally Mergence should vote against the scheme should the scheme not stipulate the terms of any loans made to employees in order to facilitate their participation in the scheme.

Mergence should vote against any scheme which does not have in place provisions that provide incentives to employees to remain with the organisation for a period of over three years. Similarly, Mergence should vote against any scheme which does not require the options allocated to any individual are automatically cancelled should that individual cease to be employed by the company (for reasons other than retrenchment, disability, retirement or death). Should the employee leave between vesting dates falling after the initial three year period his/her remaining options should be forfeited and all loans made to such employees should be recalled as defined in the scheme.

Lastly, Mergence should vote against any scheme which enables the allocation of more than 1% of the total share capital to any individual.

#### 2.2. Share option scheme specific criteria

Mergence should vote against any scheme that has an expiry period of greater than 10 years and a vesting period of less than three years. Additionally Mergence should vote against any scheme that would result in the aggregate number of securities that may be issued across all existing schemes being in excess of 10% of the total issued share capital of the company.

### 3. Phantom share schemes

Mergence should treat all long-term share-based incentive plans (including share appreciation rights schemes, “phantom” share schemes and share purchase schemes) on the same basis as if these plans were share option schemes. When considering resolutions relating to these plans, Mergence should refer to the section “Share Option Schemes” above.



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## 4. Changes to the Company's Articles of Association

All changes to a company's articles of association will be assessed on a case-by-case basis. Articles should be written in plain, accessible language and the excessive use of legal jargon and legal ramblings should be avoided. Mergence has identified the following common changes to articles of association that it has formulated voting policy guidelines on:

### 4.1. The introduction of new share classes and/or debt instruments

Mergence should generally vote against those resolutions that propose to introduce or divide share capital into two or more classes with unequal voting and/or dividend rights. The proposal to introduce or divide share classes into different voting rights is normally associated with the desire by the company to maintain or create control within small groups of shareholders, a practice that Mergence takes a dim view on.

Exceptions to the general view expressed above will be entertained where there is an irrevocable undertaking that the non-ordinary class of shares will convert to ordinary shares or expire within a specified and acceptable time period and where the use of such non-ordinary shares is designed to either improve the capital structure of the group or to facilitate Black Economic Empowerment and/or similar governance enhancing issues.

### 4.2. Changes that enable share repurchases

Mergence should vote against amendments that allow the repurchase of shares when i) there are different classes of shares of which only one class is proposed to be repurchased yet all classes are being given the right to vote (in particular; high voting shares should not be entitled to vote on resolutions proposing the repurchase of low voting shares), ii) there are different classes of shares and it is not specified that the repurchase will be done on a pro-rata basis across all classes, iii) there is a pyramid control structure in place and the repurchase of shares in the company will further entrench the control of a minority of shareholders and iv) there is a holding company and existing or potentially poor tradability.

### 4.3. Directors' Indemnification

Changes to articles of association around directors' indemnification will be dealt with on a case-by-case basis with significant emphasis placed on the wording and implications of any changes. However, as a general rule Mergence will look favourably on the company committing to paying indemnity insurance for its directors as opposed to carrying the risk on balance sheet.

### 4.4. The release of executive directors from re-election by rotation

Mergence should vote against any resolutions aimed at releasing any executive director from re-election by rotation as this will prevent shareholders from challenging the office of an executive director thus preventing shareholders from removing executive directors that are deemed to have acted not in the interest of shareholders and/or have failed in their general fiduciary duties as a director.



## **SECTION 4: Miscellaneous Operational Items**

### **1. Retrospective Authority or Ratification of Directors' Actions**

Mergence should vote against any authority sought by the board and the company which approval will have a retrospective effect. Where directors seek ratification of a previously unsanctioned act, Mergence should vote against such proposed resolution. In all instances, the actions of the directors should be sanctioned by shareholders through the powers granted to them in terms of the Articles of Association, or by specific resolution authorising such an act in advance.

