

MORROW SODALI

JANUARY 2023

BRAZIL PROXY UPDATES

SUMMARY: BRAZIL PROXY VOTING GUIDELINES UPDATES FOR 2023

In this document, Morrow Sodali summarizes the material updates announced by ISS and Glass Lewis for their voting policies for the 2023 proxy season in Brazil.

The updated policies will generally be applied for shareholder meetings taking place from February 2023 onwards.

KEY FINDINGS – ISS BENCHMARK POLICY CHANGES FOR 2023

SOCIAL AND ENVIRONMENTAL SHAREHOLDER PROPOSALS (GLOBAL)

ISS made minor clarifying changes to its global approach to evaluating social and environmental shareholder proposals related to the factors looking at whether the issuers are being addressed by regulation and legislation, and whether there are significant controversies, fines, penalties, and litigation related to the issues raised in the proposal.

BOARD ACCOUNTABILITY ON CLIMATE

The ISS has extended its climate accountability policy from this year to Brazil and Americas Regional. The policy updates for 2023 introduce a board accountability policy for the assessment of, and focus on, significant greenhouse gas (GHG) emitting companies.

The new benchmark board accountability policy will concentrate on Climate Action 100+ focus companies, and will recommend “Against” votes for the responsible incumbent chair of the board, if presented under a separate/individual election, or the entire board in the event of a bundled board election, in cases where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change for the company and the larger economy.

In the event that there is no director election on the ballot in a respective year, then ISS will on a case-by-case basis, consider voting against the company’s financial statements and/or the discharge of directors, as applicable.

ISS noted that the minimum steps required to mitigate risks to be the following. Both minimum criteria will be required to be in alignment with the policy:

- Detailed disclosure of climate-related risks, such as according to the framework established by the Task Force on Climate-related Financial Disclosures (TCFD), including:
 - Board governance measures;
 - Corporate strategy;
 - Risk management analyses; and
 - Metrics and targets.
- Appropriate GHG emissions reduction targets.

In defining the last bullet, ISS said: **At this time, “appropriate GHG emissions reductions targets” will be medium-term GHG emission reduction targets or Net Zero-by-2050 GHG reduction targets for a company’s operations (Scope 1) and electricity use (Scope 2). Targets should cover the vast majority of the company’s direct emissions.**

CHAIR ACCOUNTABILITY

Under the current policy, support is recommended for the election of the chair despite any lack of sufficient board independence, due to the relevance of the leadership position. However, since the introduction of the gender diversity policy in the Brazil Voting Guidelines, that came into effect in February 2022, ISS considers the chair of the board accountable for the lack of gender diversity. As such, there was a disconnect between the accountability of the chair in the event of lack of gender diversity and the carve out in the event of lack of overall board independence.

Thus, this policy update removes the legacy chair carve-out in the event of low overall board independence, consistent with the evolution of the policy framework and the expectation of institutional investors of greater accountability of the chair of the board not only related to gender diversity, but also independence. Furthermore, this policy update also strengthens the harmonization of ISS global policies, as markets such as Australia, Canada, Continental Europe, India, Singapore, the UK, and the U.S. already apply policies holding the chair accountable for the lack of overall board independence.

In an unbundled election, for boards that meet the minimum independence level recommended by ISS¹, as detailed below, support all director nominees if there are no concerns regarding the candidate(s) and/or the company.

However, if the proposed board falls below the minimum independence level recommended under ISS policy:

- Support the independent nominees presented individually under the majority election; and
- Vote against the non-independent candidates in the majority election.

It is important to highlight that from February 2023 onwards, the two-year phase-in period (applied in 2021 and 2022) to allow companies to gradually increase their overall board independence and adapt to the recommended independence threshold will end.

COMBINED CEO-CHAIR

Based on ISS data, as of June 2022, only five Brazilian issuers, or approximately 2 percent of the country's issuers covered by ISS maintain a combined chair/CEO structure.

Even though the percentage is low, the G20/OECD Principles of Corporate Governance, ICGN Global Governance Principles, IBGC's Code of Best Practices of Corporate Governance and Brazilian Corporate Governance Code for Listed Companies recommend a separation between the roles of CEO and board chair, citing the risks of power concentration and decision-making in a single individual. This is because the combination of these roles raises concerns regarding potential conflicts of interest, given that the board is responsible for monitoring the company's management, including the CEO and setting executive compensation, amongst other duties.

Therefore, ISS stated will recommend voting against:

- The bundled election of directors if the company maintains or proposes a combined chair/CEO structure;
- The election of the company's chair, if the nominee is also the company's CEO, when it is presented as a separate election.

When the company discloses detailed information stating that the chair/CEO would only serve in the combined role on an interim basis, vote case-by-case considering circumstances including, but not limited to the following specific market regulatory exemptions:

- The company is within its first three years of trading on the differentiated corporate governance segments of the Sao Paulo Stock Exchange (B3), Novo Mercado, Nivel 2, and Nivel 1; and
- The chair/CEO was appointed on a temporary basis to fill a vacancy.

For ISS this update represents an expansion of the existing policy framework and will standardize and harmonize the policy application across all listing segments of the Brazilian market. The existing policy applied only to Brazilian companies listed on the Novo Mercado, Nivel 2, and Nivel 1 differentiated listing segments, which already represent approximately 90 percent of the Brazilian issuers covered by ISS.

1. 50% for Novo Mercado and Nivel 2 companies, and 2/3 or 2 directors (whichever is highest) for Nivel 1 and Traditional companies.

MANAGEMENT COMPENSATION

In Brazil, shareholders are asked to vote on an annual binding resolution to approve the global remuneration cap for the company's administrators (statutory executives, board members and, when applicable, fiscal council members). While in Brazil compensation disclosure is not individualized, meaning, companies do not specifically disclose the remuneration of the CEO and/or the chair of the board, regulatory requirements mandate the disclosure of the company's highest-paid non-executive director, which is generally assumed to be the chair of the board, as well as the highest-paid executive, which is generally assumed to be the CEO of the company. In addition, while shareholders are asked to approve the global compensation cap for the current fiscal year, the board of directors carries the discretion to allocate the approved remuneration amongst the different administrators' bodies – board, executives, and/or fiscal council members.

Under this updated policy, **to go into effect as of February 1, 2024, after a one-year grace period**, ISS will generally recommend against the annual binding say-on-pay proposal of companies that report such a problematic pay practice, in the absence of a compelling rationale.

This problematic pay practice is most frequently found in controlled companies that have founders and/or controlling shareholders serving as non-independent board chairs. This board structure also raises concerns regarding potential conflict of interests in the allocation of the approved global compensation cap, potentially deepening the misalignment between non-executives and executive compensation and the interest of unaffiliated shareholders.

In addition, the policy change clarifies the current ISS practice of recommending against the annual say-on-pay proposals in cases where there are governance concerns regarding the companies' compensation practices.

ISS will recommend voting for management compensation proposals that are presented in a timely manner and include all disclosure elements required by the Brazilian Securities Regulator (CVM).

Vote against management compensation proposals when:

- The company fails to present a detailed remuneration proposal, or the proposal lacks clarity;
- The figure provided by the company for the total compensation of its highest-paid executive is not inclusive of all elements of the executive's pay;
- There are governance concerns regarding the company's compensation practices; or
- For meetings on or after February 1, 2024, when the figure reported by the company as the highest compensation paid to a non-executive director is larger than the highest executive remuneration disclosed for the most recent fiscal year, in the absence of a compelling rationale.

Vote case-by-case on global remuneration cap (or company's total remuneration estimate, as applicable) proposals that represent a significant increase of the amount approved at the previous AGM (year-over-year increase). When further scrutinizing year-over-year significant remuneration increases, jointly consider some or all of the following factors, as relevant:

- Whether there is a clearly stated and compelling rationale for the proposed increase;
- Whether the remuneration increase is aligned with the company's long-term performance and/or operational performance targets disclosed by the company;
- Whether the company has had positive TSR for the most recent one- and/or three-year periods;
- Whether the relation between fixed and variable executive pay adequately aligns compensation with the company's future performance.

AMEND GLOBAL REMUNERATION CAP

ISS will vote on a case-by-case basis when the company proposes to amend previously-approved global compensation caps, paying particular attention as to whether the company has presented a compelling rationale for the request.

KEY FINDINGS – GLASS LEWIS CHANGES FOR 2023 IN BRAZIL

EXTERNAL COMMITMENTS

Glass Lewis has updated its guidelines to clarify that they have amended and extended the “External Commitments” section of their guidelines to outline cases where they believe a director may be potentially overcommitted and to better clarify how their policies are applied. Specifically, they will consider a director to have a potentially excessive commitment level when they:

- Serve as an executive officer of any public company while serving on more than one additional external public company board;
- Serve as a ‘full-time’ or executive member of the board of any public company while serving on more than two additional external public company boards; or
- Serve as a non-executive director on more than five public company boards in total.

Additionally, Glass Lewis stated they will continue to count non-executive board chair positions as two board seats given the increased time commitment generally associated with these roles.

Morrow Sodali will continue to monitor changes in ISS and GL policies and how those changes may affect our clients and will keep you informed.

Please contact your Morrow Sodali representative with any questions.

CONTACTS



Agnes Blanco Querido

Managing Director

a.blanco@morrrowsodali.com

T. +55 11 3198 7280

M. +55 11 972 783 858



Gabriela Freire

Project Manager

g.freire@morrrowsodali.com

T. +39 06 4521 2829

M. +39 391 465 5753



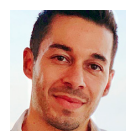
Victor Betini

Manager, Account Management

v.betini@morrrowsodali.com

T. +55 11 3197 6662

M. +55 21 999 137 642



Eduardo Vieira Mattos

Manager, Corporate Governance & ESG

e.mattos@morrrowsodali.com

T. +55 11 4130 3781

M. +55 11 996 026 046