

PROXY PAPER™

GUIDELINES

2016 PROXY SEASON

AN OVERVIEW OF THE GLASS LEWIS
APPROACH TO PROXY ADVICE

ISRAEL



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Guidelines Introduction

CORPORATE GOVERNANCE STRUCTURE

Corporate governance for listed companies in Israel is derived from the Companies Law of 1999 (“Companies Law”) and the Securities Law of 1968 (“Securities Law”) published by the Israeli Securities Authority (“ISA”). Banks are also governed by the Proper Conduct of Banking Business. Best practice in Israel is based primarily on the First Addendum: Recommended Corporate Governance Directives, which was added as part of Amendment 16 to the Companies Law in 2011.

2016 UPDATES FOR THE ISRAEL POLICY GUIDELINES

The significant changes and updates to our 2016 Israel Guidelines are summarized below:

DIRECTOR OVERBOARDING POLICY

Glass Lewis recognizes that the time directors are devoting to their board obligations has increased in recent years. That, coupled with increased investor scrutiny of directors’ commitments, has resulted in directors serving on fewer boards. As such, we have updated our guidelines to reflect that going forward we will recommend voting against a director who serves as an executive officer of any public company while serving on a total of more than two (previously three) public company boards and any other director who serves on a total of more than five (previously six) public company boards. We expect a chairman of any public company to reduce his or her external commitments appropriately and we may not recommend that shareholders vote against overcommitted directors at companies where the director serves as chairman.

We will generally refrain from recommending to vote against a director who serves on an excessive number of boards within a consolidated group of companies or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company.

ISRAELI COMPANIES WITH FOREIGN LISTINGS

We have clarified our approach to companies whose shares are listed on foreign exchanges and which may seek shareholder approval of proposals in accordance with varying exchange-and country-specific rules. We will consider a broad range of factors including the primary exchange listing and the corporate governance structure and features of the company to determine which Glass Lewis country-specific policy is most applicable.

We have also revised our guidelines in order to reflect that Israeli companies without controlling shareholders listed on certain U.S. stock exchanges will no longer be required to appoint external directors provided that the Company complies with the corporate governance and listing requirements applicable to U.S. listed companies.

EXCEPTIONS FOR RECENT IPOs

We have clarified our approach to companies who have recently completed an initial public offering. We believe that companies that have recently completed an initial public offering (“IPO”) should be allowed adequate time to fully comply with marketplace listing requirements as well as to meet basic corporate governance standards.

I. A Board of Directors that Serves Shareholder Interest

REGULATORY FRAMEWORK

Many Israeli companies are dually-listed on other exchanges, often in both the U.S. and Israel, and are frequently owned and controlled by holding companies that invest in other companies characterized by vertical integration. Israeli companies are usually governed by a one-tier management structure. The board of directors includes both executive and non-executive members.

ELECTION OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favor of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance and have members with a breadth and depth of experience.

INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of directors, we will take into consideration, when appropriate, whether a director has a record indicative of making objective decisions. Likewise, when assessing the independence of directors, we will also examine whether a director's record on multiple boards indicates a lack of objective decision-making. Ultimately, the determination of whether a director is independent or not must take into consideration compliance with the applicable independence criteria as well as judgments made while serving on the board.

We examine each director nominee's relationships with the company, the company's executives and other directors to determine if there are personal, familial or financial relationships (not including director compensation) that may influence the director's independent decision-making. We believe that such relationships make it difficult for a director to put shareholders' interests above personal or related party interests.

Thus, we typically put directors into the following categories based on an examination of the type of relationship they have with the company. We note that in Israel, we also have a unique category, labeled as an "external" or "outside" director, who is similar to an independent director and specific to this market.

Independent Director – An independent director has no material financial,¹ familial² or other current

¹ "Material" as used herein means a relationship in which the value exceeds: (i) €50,000, or the equivalent (or 50% of the total compensation paid to a board member, or where no amount is disclosed) for board members who personally receive compensation for a professional or other service they have agreed to perform for the company, outside of their service as board members. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly; (ii) €100,000, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but the individual is not directly compensated. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm; (iii) 1% of the company's consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company); (iv) 10% of shareholders' equity and 5% of total assets for financing transactions; or (v) the total annual fees paid to a director for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan have been provided.

² Familial relationships include a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person's home. A director is an affiliate if the director has a family member who is employed by the company.

relationships with the company,³ its executives, or other board members, except for board service and standard fees paid for that service.

To be classified as an independent director under Israeli Companies Law, a director may not serve on the board for more than nine years⁴ and must also meet qualifications (ii) through (iv) listed for “external directors” below.

Nonetheless, directors serving at companies whose shares are traded on certain U.S. stock exchanges may be considered independent beyond nine years, provided the audit committee and the board approve that, in light of the director’s expertise and contribution, their appointment is to the benefit of the Company. The Company may appoint such independent directors beyond the nine year threshold for additional terms of no greater than three years at a time.⁵

External Director – Under Israeli law,⁶ boards of Israeli companies generally include at least two directors who qualify as “external” or “outside” directors. On April 17, 2016, the Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000) were amended such that companies listed on the NASDAQ or NYSE that have no controlling shareholder no longer are required to appoint external directors.⁷ For all banks, one-third of its total membership must consist of external directors.⁸ External directors must possess the following qualifications:

- (i) must reside in Israel, unless the company is listed on an exchange outside of Israel;⁹
- (ii) may not be a relative, director,¹⁰ business partner, or employer/relative of a director who has had business dealings (other than of a trivial nature) with the controlling shareholder(s) in the last two years;¹¹
- (iii) may not receive any compensation beyond what is regulated by the Israeli Securities Authority;
- (iv) may not be an employee of the Israeli Securities Authority or the Tel-Aviv Stock Exchange; and
- (v) must be either a financial and accounting expert or have requisite professional qualifications as defined by law (one of the two requisite external directors must be a financial and accounting expert);
- (vi) must be elected with one of the following requirements:
 - support by the majority of shareholders who participate in the meeting (excluding abstentions) who are not controlling shareholders and have no personal interest in the election; or

³ A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

⁴ Amendment 16, Companies Law (March 7, 2011). After nine years, the director must step down for at least two more years before he/she can be re-nominated as an independent director.

⁵ Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trade on an Exchange Outside of Israel), 5760-2000: Article 5τ.

⁶ Articles 239 and 240, Companies Law.

⁷ <http://www.justice.gov.il/SitePages/OpenFile.aspx?d=ak9evgbauyE4aFg%2bZ1QNMCCev3eBRDm4eG79jHJQ8gY%3d>.

⁸ Articles 24-25, Proper Conduct of Business Banking.

⁹ In addition, on March 8, 2016, Article 240(κ) was amended to allow a company whose primary offices are located outside of Israel to appoint external directors who do not reside in Israel, as long as the company’s board has certified that a) the nature of the company’s operations warrant the appointment of a non-Israel resident to this role, b) the director will be capable of attending board meetings, and c) the director has an address in Israel where he or she may receive court documents (Companies Regulations Additional Categories of Companies at which Appointing External Directors Who are Not Residents of Israel is Permitted) https://www.nevo.co.il/law_word/Law06/tak-7639.pdf.

¹⁰ This excludes external director positions when preparing for a company’s IPO.

¹¹ If the company has no controlling shareholder(s), the director may not at the time of appointment have any business dealings (other than of a trivial nature) with the company’s chairman, CEO, significant shareholder, or senior financial officers.

- shareholder(s) who vote against the external director, excluding controlling shareholder(s) and those with a personal interest, may not exceed 2% of the total voting rights in the company.

We also note that external directors may serve a maximum of three three-year terms and two external directors may not serve on each others' boards.

Affiliated Director – An affiliated director has a material financial, familial or other relationship with the company, its independent auditor or its executives, but is not an employee of the company.¹² This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. In addition, we will consider directors affiliated if they:

- Have been employed by the company within the past five years;¹³
- Own or control 10% or more¹⁴ of a company's share capital or voting rights or are employed by or have a material relationship with a significant shareholder;¹⁵
- Have – or have had within the last three years – a material relationship with the company, either directly or as a partner, shareholder, director or senior employee of an entity that has such a relationship with the company;¹⁶
- Have close family ties with any of the company's advisors, directors or senior employees;
- Hold cross directorships or have significant links with other directors through his/her involvement in other companies or entities; or
- Have served on the board for more than nine years.¹⁷

Inside Director – An inside director simultaneously serves as a director and as an employee of the company. This category may include a chairman of the board who acts as an employee of the company or is paid as an employee of the company.

Employee Representative – An employee representative serves as a director to represent employees' interests. Employee representatives may be nominated by employees and elected by shareholders.

¹² If a company classifies a non-executive director as non-independent, Glass Lewis will classify that director as an affiliate, unless there is a more suitable classification (i.e., shareholder representative, employee representative). However, if the company is listed on a foreign exchange, and the company says the director meets the standards of independence set by the foreign exchange (e.g., NASDAQ or NYSE), we will consider the company's classification of the director to be independent, even if the company discloses that the director is not classified as independent under Israel's Companies Law.

¹³ In our view, a five-year standard is appropriate because we believe that the unwinding of conflicting relationships between former management and board members is more likely to be complete and final after five years. However, Glass Lewis does not apply the five-year look back period to directors who have previously served as executives of the company on an interim basis for less than one year.

¹⁴ We treat 10% shareholders as affiliates because they typically have access to and involvement with the management of a company that is fundamentally different from that of ordinary shareholders. More importantly, 10% holders may have interests that diverge from those of ordinary holders, for reasons such as the liquidity (or lack thereof) of their holdings, potential for materially increasing or decreasing their holdings in response to company performance, personal tax issues, etc. Moreover, we may consider significant shareholders or representatives of significant shareholders owning or controlling less than 10% of a company's share capital to be affiliated when there is evidence of the shareholder having a significant influence on the board or engaging in business transactions with the company.

¹⁵ Evidence of significant ties to a major shareholder may be considered material in some cases, even when no direct employment or consulting relationship exists. For example, a history of serving on boards of entities controlled by a major shareholder may be sufficient for Glass Lewis to consider a director to be affiliated. Moreover, we may affiliate directors based on directorships at entities controlled by a significant shareholder if the company does not disclose a director's independence classification.

¹⁶ For directors who previously worked for the company's auditing firm, we expect a cooling-off period of at least two years between resigning from the audit firm and serving on the board (cf. Companies Law: Article 240(ג), which calls for an independent director to have completed two years without having had any business relations with the company).

¹⁷ Amendment 16, Companies Law (March 7, 2011). While we will classify board members as affiliates in accordance with this standard, we will evaluate voting recommendations based on this issue on a case-by-case basis. When a board or committee does not meet the independence standards set forth in these guidelines solely as a result of a nominee's length of service on the board, we may refrain from recommending voting against the nominee if the board or relevant committee is otherwise sufficiently independent.

VOTING RECOMMENDATIONS ON THE BASIS OF INDEPENDENCE

Best practice for boards in Israel is established by the First Addendum of the Companies Law, which recommends that the majority of the directors sitting on the board of a non-controlled company be independent. Where a board's composition does not meet this local best practice standard, we typically recommend voting against some of the inside and/or affiliated directors in order to satisfy the relevant threshold.¹⁸

Glass Lewis strongly supports the appointment of an independent presiding or lead director with authority to set meeting agendas and to lead sessions without the insider or affiliated chairman's presence. Independent board leadership is even more crucial when a board is insufficiently independent.

In addition, we scrutinize avowedly "independent" chairmen and lead directors. We believe that they should be unquestionably independent or the company should not tout them as such.

Exception for controlled companies: As mentioned previously, many publicly held companies in Israel either have a controlling shareholder or a shareholders' agreement whereby a group of shareholders collectively own a controlling stake in the company and have the power to exert control over the direction of the company as the "controlling shareholder(s)."

As it relates to board independence, Israeli law generally defines "control" as holding at least 25% of the voting rights at shareholder meetings or the right to appoint directors or the CEO. Controlled companies present an exception to our independence recommendations. The board's function is to protect shareholder interests; however, when an individual or entity holds such rights in the company, the interests of the majority of shareholders are the interests of that entity or individual. Consequently, Glass Lewis does not recommend voting against boards whose composition reflects the makeup of the shareholder population. In other words, affiliates and insiders who are associated with the controlling entity are not subject to the one-half independence rule.

So long as the insiders and/or affiliates are connected with the controlling entity or controlling block and represent no more than two-thirds of the total number of directors, we accept the presence of non-independent board members.

Special Considerations for Pyramid Structures: On December 11, 2013, the Law on the Advancement of Competition and the Reduction of Concentration, 5774-2013, aimed at diffusing the concentration of market share held by conglomerates, took effect. In a pyramid structure, where one public company (A) controls another public company (B), which in turn controls a third public company (C, and so on), the following new rules apply:

A B-level company may no longer take on a controlling stake in another public company or to allow one of its holdings to become a public company under its control. If a B-level company already held a controlling stake in a C-level company when the law took effect, the B-level company must relinquish control of the C-level company within six years. If a C-level company (or D, etc.) already held a controlling stake in D (or E, etc.) when the law took effect, the C-level company must relinquish control of the D-level company within four years.

From six months after the law took effect until the end of the six years for C-level companies and four years for D-level companies (or E, etc.) companies, these companies must abide by stricter governance requirements, including:

- (i) The majority of the board must be independent; and

¹⁸ With a staggered board, if the affiliates and/or insiders that we believe should not be on the board are not up for election, we will express our concern regarding those directors. We may not recommend voting against the affiliates or insiders who are up for election solely to achieve a sufficient threshold for independence. However, we may recommend voting against affiliates or insiders who are up if there are independence concerns and if we have concerns with said directors.

- (ii) External directors must make up half of the total number of directors minus one, with the proportion of external directors rounded up. That is, if the board has five or six members, at least two of its members must be external directors. If the board has seven or eight members, at least three of its members must be external directors. If the board has nine or ten members, at least four must be external directors.

On June 11, 2014, the Law on the Advancement of Competition and the Reduction of Concentration (Concessions Regarding the Number of External Directors), 5774-2014, took effect, imposing further conditions. According to this law, if the board of a C-level company (or D, etc.) includes a director who was:

- (i) nominated by or received the approval of a shareholder who is not a controlling shareholder and who does not hold shares together with the controlling shareholder, or
- (ii) appointed through a labor organization represented at the company according to a collective agreement.

The minimum number of external directors that must serve on the board is reduced to one-third of the board.

In our view, companies in a pyramid structure should always comply with at least the minimum required levels for board independence and external directors.

CONTROL-ENHANCING MECHANISMS

Shareholder Agreements: Where a group of shareholders, acting in concert, have entered into an agreement to control a company and its board or cooperate on significant strategic issues, we will consider the shareholder group a single entity for the purposes of identifying the company's shareholder structure and recommended thresholds for independence.

OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

PERFORMANCE

The most crucial test of a board's commitment to a company and its shareholders lies in the actions of the board and its members. We look at the performance of these individuals as directors and executives of the company and of other companies where they have served. We also look at a director's experience, analyze possible conflicts of interest and consider how directors voted while on the board.

Voting Recommendations on the Basis of Performance

We disfavor directors who have a record of not fulfilling their responsibilities to shareholders at any company where they have held a board or executive position. We typically recommend voting against:

1. A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.¹⁹
2. However, if a board member has served for less than a full year, we will not typically recommend voting against him/her for attendance issues. Rather we will note the failure and track the situation going forward.
3. A director who is also the CEO of a company where a serious and material restatement occurred after the CEO had previously certified the pre-restatement financial statements.

¹⁹ We will apply this threshold when attendance information is available. We will also refrain from voting against directors when the proxy discloses that the director missed the meetings due to serious illness or other extenuating circumstances.

4. Some or all board members in the event a company's performance has been consistently lower than its peers and the board has not taken reasonable steps to address the poor performance.

EXPERIENCE

We find that a director's past conduct is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance of directors across companies worldwide.

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with records of poor performance, over-remuneration, audit- or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.²⁰

Similarly, we examine the backgrounds of those who serve on key board committees to ensure that they have the required skills and diverse backgrounds to make informed judgments about the relevant subject matter.

CONFLICT OF INTEREST

In addition to the three key characteristics — independence, performance and experience — that we use to evaluate board members, as described above, we also consider conflict-of-interest issues in making voting recommendations.

We believe that a board should be wholly free of people who have identifiable and substantial conflicts of interest, regardless of the overall presence of independent directors on the board. Accordingly, we recommend that shareholders vote against the following:

- A director who is on an excessive number of boards. We typically recommend shareholders vote against a director who serves as an executive officer of any public company while serving on more than two public company boards and any other director who serves on more than five public company boards. For companies that are not listed in the U.S, we count chairmanships as double given the increased time commitment.²¹ When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size and location of the other companies where the director serves on the board, and the director's attendance record at all companies. Further, because we believe that executives will presumably devote their attention to executive duties, we may not recommend that shareholders vote against overcommitted directors at the companies where they serve an executive function. We will also generally refrain from recommending to vote against a director who serves on an excessive number of boards within a consolidated group of companies or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company. Finally, we may also refrain from recommending against the director if the company provides a sufficiently compelling explanation regarding his or her significant position on the board, specialized knowledge of the company's industry, strategic role (such as adding expertise in regional markets or other countries), etc.
- Directors who provide, or whose immediate family members provide, material professional services to the company. These services may include legal, consulting or financial services. We question the need for the company to have consulting relationships with its directors. We view such relationships as creating conflicts for directors, since they may be forced to weigh their own interests against shareholder interests when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's directors.

²⁰ We typically apply a three-year look-back period to such issues, and we also research to see whether the responsible directors have been up for election since the time of the failure.

²¹ For companies primarily listed in the U.S, we will count board chairmanships as one board, consistent with our guidelines for U.S companies.

- Directors who engage in, or whose immediate family members engage in airplane, real estate or similar deals, including perquisite-type grants from the company.
- Directors who have interlocking directorships. We believe that CEOs or other top executives who serve on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.²²

BOARD STRUCTURE AND COMPOSITION

In addition to the independence of directors, other aspects of the structure and composition of a board may affect the board's ability to protect and enhance shareholder value.

SEPARATION OF THE ROLES OF CHAIRMAN AND CEO

Israeli law provides that the CEO of a company may only simultaneously serve as the chairman if a resolution is passed at the general meeting with the approval of the majority²³ of shareholders not affiliated with the controlling shareholder(s). Moreover, a relative of the chairman may not serve as CEO unless a similar resolution is passed.²⁴

In general, Glass Lewis believes that separating the roles of corporate officer and chairman creates a better governance structure than a combined executive/chairman position. An executive manages the business according to a course the board charts. Executives should report to the board regarding their performance in achieving goals the board sets. This is needlessly complicated when a CEO sits on or chairs the board, since a CEO presumably will have a significant influence over the board.

It can become difficult for a board to fulfill its role of overseer and policy setter when a CEO/chairman controls the agenda and the boardroom discussion. Such control can allow a CEO to have an entrenched position, leading to longer-than-optimal terms, fewer checks on management, less scrutiny of business operations, and limitations on independent, shareholder-focused goal-setting by the board.

A CEO should set the strategic course for the company, with the board's approval, and the board should enable the CEO to carry out his or her vision for accomplishing the board's objectives. Failure to achieve the board's objectives should lead the board to replace that CEO with someone in whom the board has confidence.

Likewise, an independent chairman can better oversee executives and set a pro-shareholder agenda without the management conflicts that a CEO and other executive insiders often face. Such oversight and concern for shareholders allows for a more proactive and effective board of directors that is better able to look out for the interests of shareholders. When the company has not separated the two positions, we generally believe the presence of a lead independent director or vice chairman can serve to oversee any potential conflicts of interest that may affect the performance of the board.

We do not recommend that shareholders vote against CEOs who serve on or chair the board. However, we may recommend voting against the chairman of the nominating committee when the chairman and CEO roles are combined without explanation and one of the following criteria is met: (i) the board is not sufficiently independent; or (ii) the board has failed to implement adequate measures to prevent and manage the potential conflict of interests deriving from the combination of the two positions such as appointing an independent lead or presiding director or adopting other countervailing board leadership structures. In the absence of a nominating committee, we may recommend voting against the chairman of the board under these conditions. Further, we typically encourage our clients to support separating the roles of chairman and CEO whenever that question is posed in a proxy, as we believe that it is in the long-term best interests of the company and its shareholders.

²² There is no look-back period for this situation. This only applies to public companies and we only footnote it for the non-insider.

²³ On February 17, 2016, Amendment 27 to the Companies Law took effect, requiring approval by a simple majority of disinterested shareholders in order for one person to serve as both chairman and CEO. Previously, the approval of two-thirds of such shareholders was required.

²⁴ Articles 95 and 121, Companies Law.

SIZE OF THE BOARD OF DIRECTORS²⁵

While we do not believe there is a universally applicable optimum board size, we do believe boards should have at least five directors (or three directors in small-cap companies) to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of “too many cooks in the kitchen” and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices can make it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

To that end, we typically recommend voting against the chairman of the nominating committee²⁶ if a board has: (i) fewer than five directors; provided, however, that this will generally not apply to small-cap companies with smaller boards;²⁷ or (ii) more than 20 directors.

AGE LIMITS

Glass Lewis believes that age limits are not in shareholders’ best interests. Academic literature suggests that there is no evidence of a correlation between age and director performance. Like term limits, age limits are a crutch for boards that are unwilling to police their membership and decide when turnover is appropriate.

While we understand some institutions’ support for age limits as a way to force change where boards are unwilling to make changes on their own, the long-term impact of age limits is to restrict experienced and potentially valuable board members from service through an arbitrary cut-off date. Further, age limits unfairly imply that older (or in rare cases, younger) directors cannot contribute to company oversight. A director’s experience can be valuable to shareholders because directors navigate complex and critical issues when serving on a board.

We believe that shareholders are better off monitoring the board’s approach to corporate governance and the board’s stewardship of company performance rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders. As such, we will generally recommend voting for any proposal that seeks to repeal or increase age limits.

BOARD-LEVEL RISK MANAGEMENT OVERSIGHT

Glass Lewis evaluates the risk management function of a public company board on a strictly case-by-case basis. Sound risk management, while necessary at all companies, is particularly important at financial firms, which inherently maintain significant exposure to financial risk. We believe financial firms should have a chief risk officer and/or a risk committee that reports directly to the supervisory board or a committee of the supervisory board charged with risk oversight. Moreover, many non-financial firms maintain strategies that involve a high level of exposure to financial risk. As such, any non-financial firm that has a significant hedging strategy or trading strategy that includes financial and non-financial derivatives should likewise have a chief risk officer and/or a risk committee that reports directly to the board or a committee of the board.

When analyzing the risk management practices of public companies, we take note of any significant losses or write-downs on financial assets and/or structured transactions. In cases where a company has disclosed a sizable loss or write-down, and where a reasonable analysis indicates that the company’s supervisory board-level risk committee should be held accountable for poor oversight, we would recommend that shareholders vote against such committee members on that basis. In addition, in cases where a company maintains a significant level of financial risk exposure but fails to disclose any explicit form of board-level risk oversight

²⁵ There are no legal constraints on board size in Israel. The company’s articles of association may establish its proper size. Article 219, Companies Law.

²⁶ In the absence of a nominating committee, we will recommend voting against the chairman of the board.

²⁷ Because voting against the chair of the nominating committee could result in the board becoming even smaller, we will signal our concern to investors and monitor the issue going forward.

(committee or otherwise),²⁸ we will consider recommending to vote against the chairman of the board on that basis.

BOARD COMMITTEES

Pursuant to the Companies Law, the board shall establish an audit, compensation, and a financial statements review committee.²⁹ However, the audit committee may simultaneously serve as the financial statements review committee in some cases, as further explained below. Further, a company's audit committee may serve as the company's compensation committee, as well, if the composition of the committee meets the requirements for compensation committees under the Companies Law.³⁰ In the absence of the requisite committees, we will recommend voting against the chairman of the board, as we believe he/she should be held accountable for the company's failure to meet a legal requirement.

We note that Israeli companies are not required to establish nominating and/or governance committees. However, a large number of Israeli companies are dually-listed on foreign exchanges, primarily the NASDAQ. In these cases, the existence of the aforementioned committee(s) is more common.

AUDIT COMMITTEE PERFORMANCE³¹

In general, an audit committee member monitors and oversees the process and procedures that management and auditors perform. In Israel, the audit committee should consist of at least three members and include a majority of independent directors.³² Audit committees should also consist entirely of non-executive directors and include all external directors on the board. Furthermore, it should be chaired by an external director³³ and the board chairman should not serve on this committee. Directors or affiliates of controlling shareholder(s) also should not serve on the audit committee.

When assessing an audit committee's performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosure provided to investors. Rather, an audit committee member monitors and oversees the process and procedures that management and auditors perform. The audit committee should ensure the quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors.

For an audit committee to function effectively on investors' behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. We are skeptical of audit committees that include members that lack expertise in finance and accounting or in any other equivalent or similar areas of expertise. While we will not necessarily vote against members of an audit committee when such expertise is lacking, we are more likely to vote against committee members when a problem such as a restatement occurs and such expertise is lacking.

Glass Lewis generally assesses audit committees against the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the

28 A committee responsible for risk management could be a dedicated risk committee, or another board committee (usually the audit committee or the finance committee), depending on a given company's board structure and method of disclosure. In some cases, the entire board is charged with risk management.

29 Israeli banks also are required to have a risk management committee. Section 301, Article 33, Proper Conduct of Banking Business.

30 As of February 17, 2016, pursuant to Amendment 27 of the Companies Law.

31 Article 115, Companies Law.

32 Companies listed on the NASDAQ, however, are required to maintain an audit committee that is 100% independent. Rule 5615-3, NASDAQ Marketplace Rules.

33 On April 17, 2016, the Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000) were amended such that companies listed on the NASDAQ or NYSE that have no controlling shareholder no longer are required to appoint external directors. Thus requirements related to external directors mentioned in this section and the section on compensation committee performance do not apply to such companies.

completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and recommend voting in favor of its members, but we would recommend voting against the following members under the following circumstances:³⁴

- **The audit committee chair** when: (i) audit and audit-related fees total less than 50% of the total fees billed by the auditor for two consecutive years; and/or (ii) the committee did not hold a sufficient number of meetings considering the company's financial situation and reporting requirements.
- **All members of an audit committee in office** when: (i) material accounting fraud occurred at the company; (ii) financial statements had to be restated due to serious material fraud; (iii) the company repeatedly fails to file its financial reports in a timely fashion for more than one year in a row; and/or (iv) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements.

FINANCIAL STATEMENTS REVIEW COMMITTEE PERFORMANCE

Financial statements are approved by the board only after the financial statements review committee has provided recommendations on matters such as the following: (i) valuations and estimates in the financial statements; (ii) internal controls over financial reporting; (iii) completeness of disclosure; (iv) accounting policies.³⁵

The financial statements review committee should consist of at least three members and include a majority of independent directors. This committee should consist entirely of non-executive directors. Furthermore, it should be chaired by an external director and consist entirely of individuals who can read and understand financial statements, including at least one independent, accounting and financial expert.³⁶ The board chairman and directors or affiliates of controlling shareholder(s) also should not serve on this committee.

By law, the audit committee may simultaneously serve as the financial statements review committee, if the audit committee composition satisfies the aforementioned criteria. Note that companies classified as "small corporations" under Israeli law, as well as companies within five years of their initial public offering, are exempt from establishing a financial statements review committee, subject to certain conditions.³⁷

COMPENSATION COMMITTEE PERFORMANCE

In Israel, the compensation committee should consist of at least three members and include a majority of external directors. Furthermore, it should be chaired by an external director, include all external directors on the board, and the board chairman should not serve on this committee. Directors or affiliates of controlling shareholder(s) also should not serve on the compensation committee. Given the potential for conflicts of interests, executives and employees should also not be members of the compensation committee.³⁸

³⁴ Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will simply express our concern with regard to the committee chair. In the absence of an audit committee, we will recommend voting against the chairman of the board.

³⁵ Instructions and Conditions Regarding the Procedure for Approval of Financial Statements, Companies Law (February 4, 2010).

³⁶ The law considers a director to have "financial and accounting expertise" if "the director is an accounting and financial expert who, as part of his education, experience, and skills, has a high level of skill and comprehension in business matters - accounting, internal auditing, and financial statements - in a manner that enables him to thoroughly comprehend the company's financial statements and to raise discussions regarding the way the financial data are presented. The evaluation of the accounting and financial expertise of the director shall be done by the board. Conditions and Criteria for a Director with Accounting and Financial Expertise, Companies Law (2005).

³⁷ Pursuant to a 2016 amendment to the Companies Regulations (Directives and Conditions Regarding the Procedure for Approving Financial Statements), 5776-2016 https://knesset.gov.il/committees/heb/material/data/H24-02-2016_09-35-38_28022016.doc.

³⁸ Article 118(1), Companies Law. At banks, at least one member of the compensation committee must be an expert in risk management and control. Section 301, Article 38(1), Proper Conduct of Banking Business.

Compensation committees are responsible for evaluating and prescribing the remuneration of directors, supervisors and executives. This oversight includes deciding the bases on which remuneration is determined, as well as the amounts and types of remuneration to be paid. It is important that remuneration be consistent with, and based on, the long-term economic performance of a business' and long-term shareholder returns.

Compensation committees are also responsible for overseeing the transparency of remuneration. This oversight includes the disclosure of remuneration arrangements, the matrices used in assessing pay-for-performance and the use of remuneration consultants. It is important for investors to have clear and complete disclosure of all the significant terms of remuneration arrangements in order to reach informed opinions regarding the compensation committee.

Finally, compensation committees are responsible for overseeing internal controls in the executive remuneration process. This includes monitoring controls over gathering information used to determine remuneration, establishing equity award plans and granting equity awards. Lax controls can contribute to conflicting information through the use of nonobjective consultants, for example. Lax controls can also contribute to the granting of improper awards, such as backdated or spring-loaded options, or the granting of bonuses when triggers for such payments have not been met.

We evaluate compensation committee members on the basis of their performance while serving on the compensation committee in question, and not for actions taken solely by prior committee members who are not currently serving on the committee.

When assessing the performance of compensation committees, we will recommend voting against the following members under the following circumstances:³⁹

- **The compensation committee chair** if: (i) the compensation committee did not meet during the year, but should have (e.g., because executive compensation was restructured or a new executive was hired); (ii) the company has received consistent poor structure and disclosure ratings from Glass Lewis without indicating any proposed changes; and/or (iii) the company has bundled the approval of a compensation policy or report with other governance proposals.
- **All members of the compensation committee** (that served during the relevant time period) if: (i) the company entered into excessive employment agreements and/or severance agreements; (ii) performance goals were lowered when employees failed or were unlikely to meet original goals, or performance-based compensation was paid despite goals not being attained; (iii) excessive employee perquisites and benefits were allowed; (iv) we have identified other egregious policies or practices; (v) the committee failed to address shareholder concerns following majority shareholder rejection of the say-on-pay proposal in the previous year; and/or (vi) the say on pay proposal was approved but there was a significant shareholder vote (i.e., greater than 25% of votes cast) against the proposal in the prior year, and there is no evidence that the board responded accordingly to the vote including actively engaging shareholders on this issue.

NOMINATING AND/OR GOVERNANCE COMMITTEE PERFORMANCE

The nominating committee, as an agent for the shareholders, is responsible and accountable for selection of objective and competent board members. We will recommend voting against the following nomination committee members under these circumstances:⁴⁰

³⁹ If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered or due to a by-election, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of a remuneration committee, we will recommend voting against the chairman of the board.

⁴⁰ Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will simply express our concern with regard to the committee chair. In the absence of a nominating committee, we will recommend voting against the chairman of the board.

- **The nominating committee chair:** (i) if the nominating committee did not meet during the year, but should have (i.e., because new directors were nominated); (ii) when the board is not sufficiently independent; or (iii) when there are less than three members on key board committees.⁴¹
- **All members of the nominating committee** (that served during the relevant time period) when the committee nominated or re-nominated an individual who had significant conflicts of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.

However, as previously noted, Israeli companies are not required to have nominating and/or governance committees.

ELECTION PROCEDURES

CLASSIFIED/STAGGERED BOARDS AND TERM LIMITS

Pursuant to the Companies Law, a director's term ends at the end of the annual meeting that follows his/her appointment. Directors will be reelected annually by law, unless the company's articles dictate otherwise.⁴² As an exception, external directors serve a three-year term by law and may be reelected no more than twice.⁴³ However, external directors serving at companies whose shares are traded on a foreign exchange may be reelected for more than three three-year terms, as long as the reasons why the company's audit committee and board view such a re-election as benefiting the company are placed before shareholders beforehand.⁴⁴

However, we believe staggered boards, or boards with lengthy terms of office, are less accountable to shareholders than boards that are elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on shareholder interests. Moreover, empirical studies have shown: (i) companies with staggered boards reduce a firm's value; and (ii) in the context of hostile takeovers, staggered boards operate as a takeover defense, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.⁴⁵

In light of the empirical evidence suggesting staggered boards reduce a company's value and the increasing shareholder opposition to such a structure, Glass Lewis supports the declassification of boards and the annual election of directors. Further, we believe the election of a director to an unlimited term, such that, once elected, the director would never be placed before shareholders for re-election, is an egregious action that limits shareholder rights. In such cases, we will recommend voting against the nominee on this basis alone.

In some cases, companies may propose amendments to their articles to explicitly instate staggered or classified board elections. If there is no current provision in the company's articles regarding the schedule for the election of directors and directors are not elected annually in practice, we will support the amendment if it is in line with market practice and if it introduces more regular elections than existing election cycles. Whenever a proposed amendment to an existing election schedule would cause a board to become classified, we will support it only if it reduces the term lengths for directors or introduces more regular elections for than the previous election schedule.

ELECTION OF DIRECTORS AS A SLATE

Glass Lewis believes that the practice of electing directors as a slate is contrary to principles of good corporate governance, as slate elections make it more difficult for shareholders to hold individual members of the

⁴¹ In the case of compensation and nominating committees, this will not apply to companies with small, sufficiently independent boards.

⁴² Article 222, Companies Law.

⁴³ Article 245, Companies Law.

⁴⁴ Companies Regulations (Leniencies for Public Companies Whose Shares are Listed for Trade on an Exchange Outside of Israel), 5760-2000: Article 5(τ).

⁴⁵ Lucian Bebchuk, Alma Cohen, "The Costs of Entrenched Boards" (2004) and Lucian Bebchuk, Alma Cohen and Charles C.Y. Wang, "Staggered Boards and the Wealth of Shareholders: Evidence from a Natural Experiment," SSRN: <http://ssrn.com/abstract=1706806> (2010), p. 26.

supervisory board accountable for their actions. As such, we recommend voting against proposals whereby a company clearly states that it intends to elect the board as a slate in a market such as Israel's where individual elections are common.

In some cases, shareholders voting at general meetings vote on board nominees individually; however, shareholders voting by proxy may only be given the choice of electing directors as a slate. In such cases, we will typically recommend that shareholders voting by proxy vote for the slate of nominees, unless we have very serious concerns about the composition or acts of the board in which case we will recommend voting against the entire slate. Whether voting for the board as a slate or individually, we will note our concerns with individual directors in our analysis of the board.

RATIFICATION OF THE CO-OPTION OF BOARD MEMBERS

In certain instances, board members are appointed directly by the board to serve as directors. Shareholders are then asked to ratify the co-opted board member and formally appoint him/her for a new term. We apply the same standards for such proposals as we do when analyzing a standard election of directors' proposal.

MANDATORY DIRECTOR RETIREMENT PROVISIONS

Glass Lewis believes that age limits are not in shareholders' best interests. Academic literature suggests that there is no evidence of a correlation between age and director performance. Like term limits, age limits are a crutch for boards that are unwilling to police their membership and decide when turnover is appropriate.

While we understand some institutions' support for age limits as a way to force change where boards are unwilling to make changes on their own, the long-term impact of age limits is to restrict experienced and potentially valuable board members from service through an arbitrary cut-off date. Further, age limits unfairly imply that older (or in rare cases, younger) directors cannot contribute to company oversight. A director's experience can be valuable to shareholders because directors navigate complex and critical issues when serving on a board.

We believe that shareholders are better off monitoring the board's approach to corporate governance and the board's stewardship of company performance rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders. As such, we will generally recommend voting for any proposal that seeks to repeal or increase age limits.

LACK OF ADEQUATE DIRECTOR DISCLOSURE

In some cases, where we believe shareholders have not been provided with sufficient information in order to make an informed decision regarding the election of a director, we recommend that shareholders abstain from voting on the candidate. We will recommend that shareholders abstain from voting on a candidate for election to the board when any of the following applies: (i) the name of the nominee has not been disclosed; (ii) no biographical details for the nominee have been disclosed; or (iii) the name of a natural person representing a legal person or entity, which is otherwise entitled to serve on the board, has not been disclosed.

In addition, we generally recommend that shareholders abstain from voting on a board nominee when a company's disclosure of biographical information for the nominee falls below market practice. Information that Glass Lewis considers particularly critical for shareholder review when evaluating a candidate for election include the following: (i) the independence of the nominee; (ii) the nature of any relationships between the nominee and the company, its directors and executives, major shareholders and any other related parties; (iii) the current occupation and external directorships held by a nominee; and (iv) the relevant experience and skills possessed by a nominee. When any of this information has not been disclosed, Glass Lewis may recommend that shareholders abstain from voting on the nominee.

EXCEPTIONS FOR RECENT IPOS

We believe that companies that have recently completed an initial public offering (“IPO”) should be allowed adequate time to fully comply with marketplace listing requirements as well as to meet basic corporate governance standards. We typically believe that a one-year grace period immediately following the date of a company’s IPO is sufficient time for most companies to comply with all relevant regulatory requirements and to meet such corporate governance standards. Except in egregious cases, Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices (e.g., board independence, committee membership and structure, meeting attendance, etc.) during the one-year period following an IPO.

COMPANIES WITH U.S. LISTINGS

A number of Israeli companies are listed in the United States and may qualify as foreign private issuers under the Securities and Exchange Act Rules.⁴⁶ Israeli companies qualifying as foreign private issuers in the United States may avail of exemptions to certain corporate governance requirements and instead follow local market practice and Israeli Companies Law.⁴⁷ Foreign private issuers availing of such exemptions are required to disclose a concise summary of the significant differences between local market practice and the standards applicable to other listed U.S. companies in their annual report. We may consider factors such as a company’s trading position in the United States and a company’s board structure when deciding which market and exchange specific voting policies to apply.

Recent amendments to Israeli Companies Law Regulations reduce duplicative compliance requirements for Israeli companies without controlling shareholders which trade on certain U.S. exchanges including the NASDAQ and the NYSE.⁴⁸ Pursuant to the amendments, qualifying Israeli companies will be exempt from certain board and committee composition requirements under the Companies Law. Specifically, these companies will be exempt from the requirement to appoint external directors, the requirement to appoint these directors to the audit and compensation committees and the requirement that an external director serve as chairman of the audit and compensation committees; provided, however, that such companies instead comply with the listing rules and regulations applicable to U.S. companies traded on U.S. exchanges.⁴⁹

For non-controlled Israeli companies adopting board and committee composition structures which reflect U.S. corporate governance standards and applicable listing requirements, we will consider applying U.S. specific voting policies which we may deem more suitable in such instances including, but not limited to: (i) the requirement that audit, compensation and nominating/corporate governance committees are comprised entirely of independent directors; (ii) the requirement that boards be comprised of two-third independent directors; and (iii) the requirement to appoint a financial expert to serve on the Company’s audit committee. For the purposes of applying these standards we will generally defer to U.S. independence classification criteria which may differ from Israeli market practices, for example, with respect to affiliations based on board tenure and significant beneficial ownership.⁵⁰

46 A foreign private issuer under SEC regulations is defined as a foreign (non-U.S.) issuer, other than a foreign government, except for an issuer meeting the following conditions: (i) on the last business day of its most recently completed second fiscal quarter more than 50% of its outstanding voting securities are directly or indirectly held of record by residents of the United States; (ii) the majority of the executive officers or directors are citizens of the United States; (iii) more than 50% of the assets of the issuer are located in the United States; or (iv) the business of the issuer is administered principally in the United States.

47 NASDAQ Listing Rule 5615(a) and NYSE Listing Manual Section 303A.

48 U.S. exchanges qualifying for such exemptions are: (i) the New York Stock Exchange (NYSE); (ii) the American Stock Exchange; (iii) the National Association of Securities Dealers Automated Quotation (NASDAQ) – Global Select Market; (iv) the NASDAQ Global Market; and (v) the NASDAQ Capital Market.

49 Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000: Article 5D.

50 Under SEC rules and NASDAQ/NYSE listing requirements directors may continue to be considered independent after serving nine consecutive years on the board. Furthermore, the beneficial ownership threshold for determining whether directors will be considered independent under SEC and NASDAQ/NYSE listing rules is 20% of a company’s share capital or voting rights (or if such director has a material relationship with a 20% beneficial owner).

II. Transparency and Integrity in Financial Reporting

ACCOUNTS AND REPORTS

As a routine matter, Israeli company law requires that shareholders receive and consider the company's annual financial statements and the report of the board of directors.⁵¹ Most often this is a non-voting proposal in Israel.

In cases where the approval of the financial statements is required, we will recommend voting for this proposal, unless there are concerns about the integrity of the statements/report. We will generally recommend voting for proposals seeking to acknowledge the receipt of a company's accounts and reports provided they are available to shareholders.

However, in the event that the audited financial statements have not been made available, we do not believe shareholders have sufficient information to make an informed judgment regarding these matters. As such, we will recommend that shareholders abstain from voting on the relevant agenda items.

ALLOCATION OF PROFITS/DIVIDENDS

In Israel companies may submit the allocation of profits for shareholder approval. We will generally recommend voting for such a proposal. In accordance with Israel company law, shareholders have the right to a dividend or bonus shares if the company passes such a resolution.⁵²

With respect to dividends, we generally support the board's proposed dividend (or the absence thereof). However, we will give particular scrutiny to cases where a company's dividend payout ratio, based on consolidated earnings, has decreased to an exceptionally low level (i.e., less than 10%) from a more reasonable payout ratio (i.e., over 10%), or where a company has eliminated dividend payments altogether without explanation. We will also scrutinize dividend payouts that are consistently excessively high relative to peers (i.e., over 100%) without satisfactory explanation. In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend to shareholders. As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases.

APPOINTMENT OF AUDITOR AND AUTHORITY TO SET FEES

The auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and to do a thorough analysis of a company's books to ensure that the information provided to shareholders is complete, accurate, fair, and that it is a reasonable representation of a company's financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

Shareholders should demand the services of objective and well-qualified auditors at every company in which they hold an interest. Similar to directors, auditors should be free from conflicts of interest and should assiduously avoid situations that require them to make choices between their own interests and those of the shareholders they serve.

⁵¹ Article 60, Companies Law.

⁵² Article 306 of the Israeli Companies Law.

VOTING RECOMMENDATIONS ON AUDITOR APPOINTMENT

We generally support a company's choice of auditor except when we believe the auditor's independence or audit integrity has been compromised. When there have been material restatements of annual financial statements or material weaknesses in internal controls, we usually recommend voting against the auditor. We do not hold a company's auditor responsible for the company's failure to comply with reporting obligations or a lack thereof.

Reasons why we may not recommend support of the appointment of an auditor include:

- When audit and audit-related fees total less than one-half of the total fees billed by the auditor, unless a specific justification is provided.
- Recent material restatements of annual financial statements, including those resulting in the reporting of material weaknesses in internal controls and including late filings by the company where the auditor bears some responsibility for the restatement or late filing.⁵³
- When the company has aggressive accounting policies evidenced by restatements or other financial reporting problems.
- When the company has poor disclosure or lacks transparency in its financial statements.
- We also look for other relationships or concerns with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.

We note that in Israel, however, companies often disclose the amount paid to the auditor(s) for audit and tax services combined. Although we strongly prefer that companies disclose tax and audit fees separately, given that it is common practice in Israel for these fees to be disclosed as a lump sum in accordance with Israeli accounting standards, if the fees paid for other services appear reasonable, we do not believe this issue alone merits voting against such proposals.

We are also mindful of fees for one-time corporate finance transactions and due diligence work related to mergers, acquisitions or disposals, and we may grant one-time exceptions when these fees make up a significant portion of the year's non-audit work. While we are generally opposed to a company's independent auditor providing a significant amount of services unrelated to the audit, given the auditor's intimate knowledge of the companies that they audit and the importance of these types of transactions, we consider their assistance in these matters to be acceptable, so long as their provision of such services does not persist.

Finally, in cases where the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g., the name of the auditor), we will recommend an abstain vote.

⁵³ An auditor does not audit all interim financial statements. Thus, we generally do not believe that an auditor should be opposed due to a restatement of interim financial statements unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

III. The Link Between Compensation and Performance

Glass Lewis carefully reviews the compensation awarded to senior executives, as we believe that this is an important area in which the board's priorities are revealed. Glass Lewis strongly believes executive compensation should be linked directly with the performance of the business the executive is charged with managing. We typically look for compensation arrangements that provide for a mix of performance-based short- and long-term incentives in addition to base salary.

VOTE ON EXECUTIVE COMPENSATION ("SAY ON PAY")

We define any vote involving executive compensation, other than long-term incentive plans, as a "say on pay" vote. Public companies incorporated in Israel are now required to formulate compensation policies for executives and directors and submit this policy for approval by the compensation committee, the board, and the majority of non-controlling and non-interested shareholders before implementation.⁵⁴ In a company with three or more tiers of a pyramidal structure,⁵⁵ the vote of these non-controlling and non-interested shareholders is binding. In all other cases shareholders' approval is advisory.⁵⁶ If a compensation policy remains in effect longer than three years, this approval process is required every three years.⁵⁷ In addition to full compensation policies applicable to senior executives generally, public companies are required to receive shareholder approval of specific compensation-related decisions from time to time. These decisions include pay arrangements for certain executives including the CEO, pay arrangement for individuals who are related to company insiders, and awards or other decisions which exceed the limits of a previously-approved compensation policy.

Some of the information companies must provide in the compensation policy include the following: (i) comparisons between the employment costs of directors and executives with those of the company's other employees and contractors; (ii) the relationship between fixed and variable components and an explanation of how the variable compensation is primarily based on long-term, measurable performance goals; (iii) caps on variable compensation, as well as on retirement bonuses; and (iv) clawback provisions.

Given the complexity of most companies' compensation programs, Glass Lewis applies a highly nuanced approach when analyzing votes on executive compensation. We review each vote on a case-by-case basis, with the belief that each company must be examined in the context of industry, size, financial condition, its historic pay-for-performance practices ownership structure and any other relevant internal or external factors.

We believe that each company should design and apply specific compensation policies and practices that are appropriate to the circumstances of the company and, in particular, will attract and retain competent executives and other staff, while motivating them to grow the company's long-term shareholder value.

Where we find those specific policies and practices serve to reasonably align compensation with performance, and such practices are adequately disclosed, Glass Lewis will recommend supporting the company's approach. If, however, those specific policies and practices fail to demonstrably link compensation with performance, Glass Lewis will generally recommend voting against the say on pay proposal.

⁵⁴ This requirement began with the passage of Amendment 20 to the Companies Law. Amendment 20 took effect December 12, 2012, with significant updates on July 31, 2013.

⁵⁵ Such as a public company that is controlled by another public company, that is itself held by a public company, all of which are controlled by a controlling shareholder.

⁵⁶ Article 267ג(ק), Companies Law. See also Licht, Talmore, and Sachs. "Israel's Executive Compensation Reform." *Harvard Law School Forum on Corporate Governance and Financial Regulation*. January 7, 2013.

⁵⁷ Article 267ט(ק), Companies Law.

Glass Lewis focuses on four main areas when reviewing say-on-pay proposals:

- The overall design and structure of the executive compensation program;
- The quality and content of disclosure;
- The quantum paid to executives; and
- The link between compensation and performance as indicated by the company's current and past performance.

We also review any significant changes or modifications, and rationale for such changes, made to a company's compensation structure or award amounts, including base salaries.

COMPENSATION POLICIES OF INSTITUTIONAL ENTITIES

As of August 2015, Israeli banks' compensation policies must comply with the requirements laid out in the Companies Law, with the following additional requirements:⁵⁸

- (i) Variable compensation must be 100% based on the achievement of pre-determined goals.⁵⁹
- (ii) Generally, variable compensation may not exceed 100% of fixed compensation.⁶⁰
- (iii) At least 50% of all variable compensation for each calendar year, including retirement bonus, must be deferred for at least three years.⁶¹
- (iv) Termination shall not trigger accelerated payment of deferrals.
- (v) At least 50% of the variable compensation awarded to an executive for a given year must consist of shares and/or share-based instruments that vest over multiple years based on performance conditions.
- (vi) There must be a provision for the clawback/recoupment in exceptional circumstances of variable compensation, effective for a period of five years following the grant date.⁶²
- (vii) All directors, including chairmen, may receive fixed compensation only, which must be determined in relation to the fixed compensation of external directors.

On October 7, 2015, the commissioner on the capital market, insurance, and savings published an updated circular that effected additional requirements to which institutional entities, such as pension funds and insurance companies, must adhere when formulating their compensation policies, beyond the requirements applicable to all public companies under Amendment 20 of the Companies Law.

⁵⁸ Updates to 301A of the Proper Conduct of Banking Business, Circular, August 13, 2015.

⁵⁹ The only exception to this rule is the grant of a signing bonus in an employee's first year.

⁶⁰ However, in certain circumstances, banks may set variable compensation equal to up to 200% if they provide a rationale and submit the proposal for approval by shareholders.

⁶¹ If variable compensation awarded for a given year is not above 1/6 of the fixed compensation, no deferral is required.

⁶² Clawback period for a variable component paid out to an officer as defined in Companies Law, shall be extended by two further years, if in the course of the clawback period the following circumstances materialize: (1) an investigation (internal or external) is opened; (2) the banking corporation is convinced that the investigation will find that the criteria warranting a clawback is met; and (3) a designated and authorized organ within the corporation determines that the necessary clawback criteria exists.

The variable compensation of “central position holders”,⁶³ other than bonuses that apply only in the first year of employment such as signing bonuses, must be tied to pre-established criteria and be bound by the following:

- (i) More than 50% of variable compensation must be granted based on measurable, financial, market, and accounting performance indicators. Nonetheless, an “insignificant portion” of variable compensation may be granted based on immeasurable criteria, taking into account the officer’s contribution to the company and to the management of the savings under its control.
- (ii) The pre-determined criteria must include goals related to the unit in which the officer is employed and the company as a whole, including the savings under its control.
- (iii) There must be a provision for the clawback / recoupment in exceptional circumstances of variable compensation, effective for a period of five years following the grant date.⁶⁴
- (iv) All directors, including chairmen, may receive fixed compensation only, which must be determined in relation to the fixed compensation of external directors. (For all, except chairman, this must be identical to the compensation of external directors. The chairman’s shall be determined according to a multiplier ratio (pegged to external directors’ compensation) set by the Compensation Committee).

In addition, variable compensation of a central position holder may not exceed 100% of the officer’s fixed compensation in a given year. Nonetheless, the variable compensation of a central position holder other than the CEO or the chairman may exceed 100% and reach up to 200% of fixed compensation if the company’s compensation committee and board decide that extraordinary circumstances⁶⁵ warrant doing so. The value at the time of grant of any equity-based compensation granted to a central position holder also counts against the amount of variable compensation allowable. In addition, a ceiling must be placed on the value of equity-based compensation that may be realized at the time of exercise.

Should the institutional entity tie a portion of an employee’s variable compensation to outcomes related to management of the company’s investments or the financial savings under its control, the performance period related to these goals must be at least three years. In addition, all variable compensation must be subject to deferral provisions:

- (i) At least 50% of a central provision holder’s variable compensation for each calendar must be deferred and its grant must be spread out evenly over at least three years. Nonetheless, if the officer’s variable compensation for a given calendar year does not exceed 1/6th of the fixed compensation for the year, no deferral is required.
- (ii) The proportion of variable compensation that must be deferred must increase with seniority, the more the officer’s work bears on the risk profile of the institutional entity or the financial savings it manages, and the larger the weight and amount of the officer’s variable compensation.
- (iii) End of employment must not accelerate the payment of deferred variable compensation.

63 A central position holder at an institutional entity is defined as someone whose actions tend to have a material influence on the risk profile of the entity or the financial savings under its control. This designation includes the CEO and those who report to the CEO, as well as one who earned more than NIS 1.5 million each of the past two years or anyone who is involved in managing the investments of the entity or the financial savings under its control. In addition, others whose aggregate variable income may expose the entity or the financial savings under its control to significant risk should also be given this designation, unless (i) the employee’s terms are fully governed by a collective agreement, (ii) the employee’s compensation includes fixed compensation of no more than NIS 0.5 million per year and no variable compensation that is beyond what the majority of the company’s employees receive, or (iii) the employee’s variable compensation does not exceed 1/6 of the employee’s fixed compensation each year and the employee’s total compensation each of the previous two years equaled no more than NIS 0.5 million per year.

64 Nevertheless, the clawback period for a variable component paid out to an officer as defined in the Companies Law, shall be lengthened by two further years, if in the course of the clawback period the compensation committee determines that the circumstances warrant seeking a clawback, described as follows: (1) The institutional entity opened an internal enquiry regarding a fundamental failing; (2) If it comes to the attention of the institutional entity that a certified authority, including such an authority located outside of Israel, opens an administrative enquiry or a criminal investigation against the institutional entity or officers thereof.

65 Extraordinary circumstances are defined as those related to a one-time business event that does not recur every year and those that do not apply to a large category of central position holders.

When granting equity-based compensation, the grants must vest linearly over a period of at least three years and must be tied to performance during this period.

An institutional entity's compensation policy must forbid central position holders from creating private hedging arrangements meant to counteract the measures the company undertakes in trying to limit the risk to the company associated with its variable compensation policies.

Retirement grants⁶⁶ paid to the CEO and central position holders who report to the CEO are considered variable compensation and are subject to all the rules detailed above for variable compensation, including dependence on performance criteria and deferral over at least three years. Nonetheless, if the retirement grant does not exceed two months of fixed compensation, no deferral is required.

SAY ON PAY VOTING RECOMMENDATIONS

In cases where our analysis reveals a compensation structure or compensation disclosure in drastic need of reform, we will recommend that shareholders vote against the say-on-pay proposal. For compensation policies, we believe that shareholders should be provided with clear disclosure of an appropriate framework for managing executive compensation. While this framework will vary for each company, it should generally provide an explicit link to the Company's strategy, setting appropriate quantum limits along with structural safeguards to prevent excessive or inappropriate payments and particularly any reward for failure; whilst providing sufficient flexibility to allow boards to manage matters of recruitment, severance and professional development as they arise to avoid the necessity of seeking shareholder approval for policy amendments or special payments outside the policy.

For most companies we expect a compensation policy to:

- emphasise incentive pay in the form of equity, weighted towards performance- and/or holding-periods of three or more years;
- incentivise executives based on goals aligned with strategy while avoiding structures that encourage excessive risk-taking;
- set reasonable award limits for normal and exceptional circumstances;
- limit the application of discretion to clearly defined circumstances;
- include structural safeguards such as clawback/malus provisions as required, deferral, and extended holding periods;
- disclose a clear approach to recruitment, including reasonable award limits and delivery structures that align the interests of incoming executives with those of shareholders;
- disclose all relevant details of executive service contracts, limiting notice period entitlements to salary and benefits over

In the instance that a company has simply failed to provide sufficient disclosure of its policies, we may recommend shareholders vote against this proposal solely on this basis, regardless of the appropriateness of compensation levels.

When a company's compensation policy or a decision made outside of the policy deviates from these guidelines, we expect a clear and compelling rationale for why the proposed structure or practice is appropriate for the company.

⁶⁶ Retirement grants include any payment made at the end of employment beyond the standard end-of-employment payments given to all employees of the institutional entity.

Although not an exhaustive list, we believe the following practices are indications of problematic pay practices which may cause Glass Lewis to recommend against a say on pay vote:

- Egregious or excessive bonuses, equity awards or severance payments;
- Guaranteed bonuses;
- Bonus or long-term plan targets set at negative performance levels;
- Performance targets not sufficiently challenging, and/or providing for unreasonably high potential payouts;
- Lowered performance targets, without justification;
- Discretionary bonuses paid when short- or long-term incentive plan targets were not met;
- Executive pay that is high compared to the company's peers and is not correlated with outstanding company performance; and
- The terms of the long-term incentive plans are inappropriate and a separate vote on the long-term incentive plan(s) is not provided.

In the instance that a company has simply failed to provide sufficient disclosure of its policies, we may recommend shareholders vote against this proposal solely on this basis, regardless of the appropriateness of compensation levels.

On March 8, 2016, the Companies Law (First Addendum A, Part 2) was amended to allow a CEO to receive an amount equal to three months of base salary per year in variable compensation based on non-measurable criteria, while considering the CEO's contribution to the company. The law also was amended such that the bonuses of office holders who are subordinate to the CEO may be based entirely on non-measurable criteria.⁶⁷ We will generally oppose proposals whose main objective is to amend the compensation policy to allow for bonuses to be based purely on such discretionary criteria.

STRUCTURE OF COMPENSATION POLICY

In addition to the general guidelines noted above, we believe that several specific features are important in well-designed compensation policies. Compensation policies should include an appropriate balance of fixed and variable pay. To minimize the incentives for excessive risk-taking, the fixed component should represent a sufficiently high proportion of total compensation. Moreover, companies should set explicit limits in their policies on variable components in relation to fixed salary.

With respect to variable compensation, we believe that pay should be demonstrably tied to performance. For short-term bonuses or incentives ("STI"), we believe a mix of corporate and individual performance measures is appropriate. We normally expect to see an emphasis on internal financial measures and non-financial factors, although other arrangements are acceptable if they are tied to a company's business drivers. Further, when a company includes provisions for awards in the event of poor performance, we believe that a clear discussion on the circumstances for such payments should be provided. Additionally, any such award should be subject to disclosed limits. Lastly, we believe that the best-designed STI plans provide for mandatory deferral of a portion of payments over a multiyear period and include malus provisions.

With respect to long-term incentive ("LTI"), Glass Lewis recognizes the value of these arrangements. When used appropriately, they can provide a vehicle for linking an executive's pay to company performance, thereby aligning their interests with those of shareholders. Well-designed LTI arrangements include a mixture of

⁶⁷ Companies Directive (Change to First Addendum A), 5776-2016) https://www.nevo.co.il/law_word/Law06/tak-7639.pdf.

service-based awards which vest over at least three years as well as awards which only vest upon achievement of performance conditions beyond implicit share-price hurdles. In Glass Lewis' view, long-term performance is best measured by a mixture of performance metrics which include absolute measures and relative goals measured against a relevant peer group or index. However, we recognize that such robust performance-based long-term incentive plans are somewhat rare in Israel. As such, we generally accept the practice of granting non-performance based awards to senior executives, so long as such grants are reasonable and part of a compensation program that demonstrates a well-structured pay-for-performance link.

CHANGES TO COMPENSATION POLICY

Where a company has proposed significant improvements to its compensation policy, we will take this into account when making voting recommendations. Moreover, in Israel, shareholders may be asked to approve specific changes to the compensation policy. In such cases, where the proposed policy represents an improvement over the existing policy, we will recommend voting for the proposal, even when the existing policy contains notable deficiencies.

OTHER COMPENSATION-RELATED PROPOSALS

Glass Lewis analyzes proposals on specific aspects of compensation, such as executive employment agreements or additional bonus awards which require shareholder approval, on a case-by-case basis. If a proposal is in line with a company's shareholder-approved compensation policy, we will consider the appropriateness of the previously proposed policy and, if there are any significant concerns with the policy, whether the proposed structure or practice exhibits any of the same issues. In addition, we will consider whether there are any additional factors which may impact our recommendation on the proposal.

If a company indicates that a proposal is not congruous with a company's current compensation policy, we expect a clear and compelling rationale for why the deviation from the shareholder-approved arrangements is necessary. If such a structure or practices is not sufficiently justified, does not appear to be reasonable relative to market practice or is otherwise not in shareholders' interests, we may recommend that shareholders vote against such a proposal.

For proposals which include equity grants, we may consider a company's broader equity award practices in developing our recommendation, particularly if the company does not regularly afford shareholders an opportunity to vote on its these broader practices. For more information on our treatment of equity as a component of compensation, please refer to the "Equity-Based Compensation Plan Proposals" on page 24.

COMPENSATION RELATIVE TO PEERS

Glass Lewis' analysis of compensation policies examines a company's compensation disclosure and structure as compared to peer practices, based on relevant stock market indices, market capitalization, industry and/or liquidity. As a result, we generally apply higher standards to compensation policies and disclosure of the largest companies in a given market, as these multinational companies compete with international companies in similar industries for talented executives. In particular, we expect companies on blue-chip indices to provide relatively better compensation-related disclosure than other companies in a market. We also expect these companies to apply compensation practices that meet at least a majority of local key recommendations for best practice, and align with international standards for best practice. In contrast, we might recommend support of a say on pay vote at a smaller company where the compensation policy generally aligns with key best practice recommendations in the relevant market and with the policy and disclosure of its peers, but does not meet more stringent standards for international best practice.

COMPENSATION RELATIVE TO OWNERSHIP STRUCTURE

Glass Lewis recognizes that differences in the ownership structure of listed firms necessarily affect the incentive structure for executives. In particular, where a company is controlled and managed by a family, we believe the

use of equity incentives for representatives of the family are inappropriate and may serve to further entrench the controlling shareholders' stake. Similarly, we question equity grants to executives who have, or represent a shareholder who has, a significant equity stake in the company.

EQUITY-BASED COMPENSATION PLAN PROPOSALS

While companies listed only in Israel are not required to receive shareholder approval for their equity compensation plans, companies listed in the U.S generally are required to do so. We believe that equity compensation awards are useful, when not abused, for retaining employees and providing an incentive for them to act in a way that will improve company performance.

Equity-based compensation programs have important differences from cash compensation plans and bonus programs. Accordingly, our analysis takes into account factors such as plan administration, the method and terms of exercise, and express or implied rights to re-price.

Our analysis of both equity compensation plans and individual grants is both quantitative and qualitative. In our evaluation, we examine the potential dilution to shareholders, the company's grant history and compliance with best practice recommendations.

We evaluate equity-based incentive plans based on the following principles:

- Total potential voting power dilution to current shareholders should be reasonable and in line with a company's peers. We will consider annual grant limits to all plan participants and individual senior executives when making this assessment, and particularly whether such limits have been set and disclosed.
- Companies should have a demonstrated history of reasonable equity incentive grants.
- Awards should be granted at fair market value, unless a discount is sufficiently justified and explained.
- Plans should not permit re-pricing of stock options without shareholder approval.
- Plans should not allow for automatic accelerated vesting in the event of a change in control of the company.

We will consider whether the award and exercise of stock options or restricted stock is conditional on the achievement of detailed and challenging performance targets to adequately align management interests with those of shareholders. Successful plans and acceptable grants will generally include long-term (at least three-year) performance targets, in addition to any share price hurdles, which aim to reward executives who foster company growth while limiting excessive risk-taking. We feel that executives should be compensated with equity only when their performance and the company's performance warrant such rewards.

OPTION REPRICING

Glass Lewis views option repricing with great skepticism. Shareholders have substantial risk in owning stock and we believe that the employees and officers who receive stock options should be similarly situated to align their interests with shareholder interests.

We are concerned that option grantees who believe they will be "rescued" from underwater options will be more inclined to take unjustifiable risks. Moreover, a predictable pattern of repricing substantially alters a stock option's value because options that will practically never expire deeply out of the money are worth far more than options that carry a risk of expiration.

In short, repricings change the bargain between shareholders and employees after the bargain has been struck. Re-pricing is tantamount to re-trading.

There is one circumstance in which a repricing is acceptable: if macroeconomic or industry trends cause a stock's value to decline dramatically, rather than specific company issues, and repricing is necessary to motivate and retain employees. In this circumstance, we think it fair to conclude that option grantees may be suffering from a risk that was not foreseeable when the original "bargain" was struck. In such a circumstance, we will support a repricing only if the following conditions are true:

- Officers and board members do not participate in the program;
- The stock decline mirrors the market or industry price decline in terms of timing and approximates the decline in magnitude;
- The exchange is value-neutral or value-creative to shareholders with very conservative assumptions and with a recognition of the adverse selection problems inherent in voluntary programs; and
- Management and the board make a cogent case for needing to motivate and retain existing employees, such as being in a competitive employment market.

SEVERANCE PAYMENTS

In general, we believe that severance payments should be limited to two years fixed salary and should not be paid in the event of inadequate performance or voluntary departure. Furthermore, Glass Lewis is generally skeptical of proposals which would provide additional compensation or benefits to departing executives beyond those which are included in the relevant compensation policy or employment agreement. However, we will apply local best practice standards when analyzing severance payments.

COMPENSATION PLANS FOR BOARD MEMBERS

Glass Lewis believes that non-employee board members should receive compensation for the time and effort they spend serving on the board and its committees. Board fees should be competitive in order to retain and attract qualified individuals but should generally not be performance based. Excessive fees represent a financial cost to the company and, along with performance-based compensation, threaten to compromise the objectivity and independence of non-employee board members. We generally recommend voting against stock option grants when excessive, deeply discounted, or granted on the same terms as executives and performance-based equity grants for non-executive directors.

In Israel, shareholders may decide the amount of fees to be paid to directors as compensation for their services as a member of the board. It should also be noted that at times, proposals regarding director compensation qualify as related-party transactions, and in these cases shareholder approval is required by law.⁶⁸ We also note that it is common in Israel for companies to include a separate proposal for the approval of a bonus payment to be granted to the chairman. We prefer that all directors, including the chairman, receive only fixed compensation. Given the market practice of granting variable pay to chairmen of Israeli companies, however, we will generally accept a small amount of variable pay offered to chairmen who devote a significant amount of their time to their duties.

Companies often set the compensation of their directors other than the chairman to be equal to that of their external directors. The Companies Regulations (Rules Regarding Compensation and Expenses of an External Directors), 5760-2000, provides companies two options on the cash compensation payable to external directors:

Option 1: A fixed amount

According to this option, the range of cash compensation that a company may pay its external directors is slotted according to the company's equity, as it appears in its audited financial statements for the

⁶⁸ Article 270, Companies Law.

previous year. For a company that is considered an institutional entity, the cash compensation is slotted based on the company's equity plus the value of the assets the company manages on behalf of others. The acceptable ranges are adjusted semi-annually to account for changes in the consumer price index. The annual and per-meeting compensation of each "expert external director"⁶⁹ must be identical, and the annual and per-meeting compensation of each external director not classified as an expert must be identical.

The Companies Regulations breaks down all companies into five levels based on their equity⁷⁰ and presents an acceptable range for annual compensation for each level. Between the minimum and maximum amount for each level, a so-called "set amount" also is presented. For example, for Israel's largest companies, those whose equity exceeds approximately NIS 1.17 billion, the minimum annual compensation for an external director is currently NIS 68,490, the maximum is NIS 111,345, and the set amount is NIS 89,920. For expert external directors, however, the maximum is NIS 148,575. Compensating external directors between the minimum and the set amount requires shareholder approval, while compensating external directors between the set amount and the maximum does not.

Companies also are required to pay an external director a fee for each meeting attended. For Israel's largest companies, the minimum per-meeting fee is currently NIS 2,410, the maximum is NIS 4,285, and the set amount is NIS 3,350. For expert external directors, however, the maximum is NIS 5,715. If the director participates in a meeting remotely, the company must pay the external director 60% of the standard fee, and if the board makes a decision without meeting, when all directors who would have the right to vote on the matter have agreed to make the decision without meeting, the company must pay the external director 50% of the standard fee. Note that at companies listed on foreign exchanges, under which external directors have additional obligations due to their being classified as independent, the maximum annual and per-meetings are slightly higher (Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trade on an Exchange Outside of Israel, 5760-2000).

These fees are meant to cover all expenses an external director may incur that are tied to the director's participation in meetings held in the director's geographical area. If the director participates in a meeting outside of the director's area, the company must reimburse expenses directly tied to participation in the meeting. The company may also pay for an external director's continuing education, as well as for the director to obtain expert advice on the company's account, if such advice has been approved by the board or the court.

Option 2: Relative compensation

In lieu of Option 1, a company may choose relative compensation by compensating its external directors relative to its other directors. In this case, "other directors" refers to directors who are none of the following: external directors; controlling shareholders; directors who regularly provide additional services to the company, to its controlling shareholder, or to a company controlled by its controlling shareholder; and directors who receive no cash compensation from the company. According to this option, external director fees may be set at no less than the legal minimum amount for external directors mentioned above and no less than the amount the other directors receive. The external directors' fees may be set at no more than the average amount the other directors receive, except that expert external director fees may be set at up to 33% above said average amount. The compensation of each expert external director must be identical, and the compensation of each external director not classified as an expert must be identical. Note that the relative compensation option is available only when a company has at least two other directors.

69 The law defines an expert external director as someone who (i) brings accounting and financial expertise, or (ii) has education, experience, and skills that give the director a high level of skill and a deep understanding in the area of the company's main line of business. The determination of this expertise is carried out by the board, after the director has provided supporting documentation.

70 For companies that are considered institutional entities, the amount of the company's total assets plus all the assets the company manages is used instead of the company's equity alone (the circular from the commissioner on the capital market, insurance, and savings titled "Compensation of External Directors at Institutional Entities," published March 9, 2009).

Relative compensation requires the approval of the compensation committee, the board, and the majority of shareholders voting in a meeting. However, if relative compensation amounts to more than 50% above the legal maximum amount for external directors discussed above, the approval of a majority of shareholders who have no personal interest in the matter resulting from ties to the controlling shareholder(s) or the absence of the dissent of 2% of such shareholders is required. Note that the cash compensation amount may not change over the external director's three-year term.

Apart from cash compensation, a company may grant external directors equity-based compensation, as long as:

- (i) The equity is granted under an equity plan that includes all "other directors," as well as additional officers;
- (ii) The grants, including their number, conditions, exercise price, vesting periods, etc., follow rules similar to the relative compensation rules above for cash compensation;
- (iii) The amounts do not change over the external director's three-year term.

As of August 13, 2015, the compensation of directors serving on boards of banks is subject to the following additional rules;

- (i) All directors, including chairmen, may receive fixed compensation only. A bank may continue, however, to provide its chairman with benefits and associated expenses, similar to those it pays its other office holders. In addition, an office holder at a bank who also serves as chairman at a subsidiary may still receive variable compensation for his or her role at the parent bank; and
- (ii) the compensation of all directors other than the chairman must be set according to the rules for setting external director pay.⁷¹

Taking into account the substantial regulations for directors fees described above, Glass Lewis will generally recommend supporting fees that align with the allowable amounts under Israeli law. However, absent a compelling rationale, Glass Lewis may recommend voting against proposals to compensate any director other than the chairman significantly above the legal maximum amount for external directors discussed above.

⁷¹ The Bank of Israel's supervisor of banks enacted these updates to the section of the Proper Conduct of Banking Business dealing with compensation policies at banking corporations (Section 301A). See <http://www.boi.org.il/en/BankingSupervision/LettersAndCircularsSupervisorOfBanks/Circulars/h2484-en.pdf>.

IV. Governance Structure and the Shareholder Franchise

AMENDMENTS TO THE ARTICLES OF ASSOCIATION

We will evaluate proposed amendments to a company's articles of association on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from reviewing each amendment on its own merit. In such cases, we will analyze each change on its own. We will recommend voting for the proposal only when, on balance, we believe that the amendments are in the best interests of shareholders.

EXTERNAL DIRECTORS

In response to amended regulations promulgated under Israeli Companies Law, a number of companies whose shares are traded on certain United States stock exchanges are submitting proposals which seek to amend their Articles of Association in order to amend/remove references to external directors and committee composition requirements.⁷² Israeli companies without controlling shareholders listed on certain U.S. stock exchanges will no longer be required to appoint external directors provided that the Company complies with the corporate governance and listing requirements applicable to U.S. listed companies.

We will generally support a company's decision regarding whether to follow Israeli market practices or to defer to U.S. corporate governance principles, SEC regulations and listing requirements. Further, we do not believe that the adoption of U.S. corporate governance standards in lieu of Israeli corporate governance standards will have a negative impact on shareholder rights.

RELATED PARTY TRANSACTIONS⁷³

We will evaluate related party transactions on a case-by-case basis. We generally recommend approval of any transaction which falls within the company's regular course of business, so long as the terms of the transaction have been verified to be fair and reasonable by an independent auditor or independent board committee, in accordance with prevailing market practice.

In Israel, shareholders are generally requested to approve any agreement to be entered into, directly or indirectly, between the company and its directors, officers, controlling shareholders, and/or any party related to the controlling shareholder.⁷⁴ These agreements often include: (i) agreements between the company and interested parties, such as those listed above; (ii) insurance policies for directors or officers; and (iii) severance plans or employment agreements of employees who are related to the controlling shareholder(s). Such agreements must be reapproved by shareholders every three years.⁷⁵

LIABILITY INSURANCE AND INDEMNIFICATION

Under Israeli law, a company may enter into a contract to indemnify a director or officer of a company for debts or expenses imposed upon him/her pursuant to being a director or an officer if such a provision is provided in the company's articles of association.⁷⁶ In certain cases, shareholder approval is required not only for these article amendments but also for granting indemnification agreements or purchasing liability insurance plans.

⁷² Companies Regulations 5760-2000.

⁷³ Articles 270, 273 and 275, Companies Law.

⁷⁴ We note that if the controlling shareholder is a company, this would include the company that controls this shareholder as well.

⁷⁵ Article 275(1)(1x) of the Companies Law.

⁷⁶ Article 260, Companies Law.

While we strongly believe that directors and officers should be held to the highest standard when carrying out their duties to shareholders, some protection from liability is reasonable for directors and officers. As such, we find it reasonable for a company to enter into indemnification agreements with its directors and officers and/or to purchase liability insurance so long as the terms of such agreements are reasonable.

We note that, under the Companies Law as well as its Securities Law, directors and officers will continue to be held accountable in the case of: (i) a breach of fiduciary duty, unless the director or officer acted in good faith and had reasonable grounds to assume that the act would not cause the company harm; (ii) a breach of a duty of care committed intentionally or recklessly; (iii) acts done with the intent to make unlawful personal profit; (iv) a fine or forfeit imposed; and (v) any financial sanction, with the exception of payment to another party, or related to a legal proceeding with such party, involved in certain violations specified in the Israeli Securities law for amount of up to 20% of the sanction and as long as a provision stipulating this allowance is included in a company's articles of association. Specifically, the list of aforementioned violations imposed by an Israeli Securities Authority panel which may be partially indemnified, includes, but is not limited to, the following: (i) failure to make available or send to shareholders, if requested, a document regarding either a transaction with the controlling shareholder or the allotment of securities in a listed company which were not offered to the public; (ii) the inclusion or omission of an item in the publication of a notice or in any other report which would mislead a reasonable investor; (iii) sharing insider information with a person who the director or officer should have known would make use of insider information received; and (iv) offering securities to the public in a manner not authorized by the Israeli Securities Authority.⁷⁷

Although the extension of partial indemnification for the aforementioned list of violations is permitted by the Israeli Securities Law, if included in a company's articles of association, companies are not required to indemnify directors or officers for these violations.

While Glass Lewis believes that shareholders should not be involved in the approval and negotiation of individual liability insurance policies and that such matters should be left to the board, when the transaction requires shareholder approval and the policy does not extend beyond the legal boundaries discussed above, we will generally recommend supporting the proposal.

Although we generally recommend supporting liability and indemnification proposals, in accordance with best practice in Israel, in the event a company proposes to indemnify its directors/officers for an amount that exceeds 25% of the company's equity, we will oppose such proposals. Where the details of the proposed liability or indemnification proposal have not been provided, we will recommend that shareholders abstain from voting on the proposal. Finally, we recommend that shareholders vote against proposals to exempt directors or officers from liability for any reason.

ANTI-TAKEOVER DEVICES

Glass Lewis believes that authorities that are intended to prevent or thwart a potential takeover of a company are not conducive to good corporate governance and can reduce management accountability by substantially limiting opportunities for shareholders.

In particular, we note that under Israeli law, companies may create different classes of shares with different rights, including shares providing certain preferred or additional rights regarding voting, dividends and capital repayment, as well as other matters. Nevertheless, the authority to issue a new class of shares requires an amendment to the articles of association to be approved by the company's shareholders.⁷⁸

SUPERMAJORITY VOTING REQUIREMENTS

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example is in the takeover context, where supermajority

⁷⁷ Article 52QQ(a) and Seventh Schedule, Securities Law.

⁷⁸ Article 20, Companies Law.

vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business. While we recognize that supermajority voting requirements are imposed by national law for approval of certain proposals in most European markets, we will recommend voting against any proposal seeking to extend supermajority voting requirements to decisions where a supermajority requirement is not stipulated by law.

RIGHTS OF SHAREHOLDERS TO CALL A SPECIAL MEETING

Glass Lewis strongly supports the right of shareholders to call special meetings. However, in order to prevent abuse and waste of corporate resources by a very small minority of shareholders, we believe that only shareholders holding at least 5% of a company's share capital should be allowed to call a special meeting.⁷⁹ A lower threshold may leave companies subject to meetings whose effect might be the disruption of normal business operations in order to focus on the interests of only a small minority of owners.

⁷⁹ Article 63, Companies Law.

V. Capital Management

INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. Israeli companies are authorized to increase share capital through several methods that may or may not involve the issuance of shares.⁸⁰

ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

In general, issuing an excessive amount of additional shares and/or convertible securities can dilute existing holders. Further, the availability of additional shares, where the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that the company has not detailed a plan for use of the proposed shares, or where the number of shares far exceeds those needed to accomplish a detailed plan, we typically recommend against the authorization of additional shares.

While we believe that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management come to shareholders to justify their use of additional shares rather than providing a blank check in the form of a large pool of unallocated shares available for any purpose.

In Israel, shareholders are required to approve all proposals related to the increase of the registered share capital. According to Israeli law, the board may issue shares and other convertible securities up to the limit of the company's registered share capital.⁸¹

With or Without Preemptive Rights

In our view, any authorization to issue shares and/or convertible securities with preemptive rights should not exceed 100% of the company's total share capital and any authorization to issue shares and/or convertible securities without preemptive rights should not exceed 20% of the company's total share capital.

In our view, any general authorization to issue shares and/or convertible securities with preemptive rights should not exceed 100% of the company's total share capital and any general authorization to issue shares and/or convertible securities without preemptive rights should not exceed 20% of the company's total share capital. When information is available, in order to establish a broader context in which to consider a proposed increase, we may also take into account a company's existing authorities to issue shares and/or convertible securities in order to determine the total potential dilution to shareholders should the proposal be approved.

Rights Issues

When a company seeks shareholder approval of a specific plan to issue shares with preemptive rights, we will evaluate the plan on a case-by-case basis. We will generally approve rights issues, even in excess of 100% of a company's current issued share capital, when the following conditions are met: (i) the total number of shares to be issued, or intended proceeds of the issue, is disclosed; (ii) the price at which the shares will be issued is disclosed; and (iii) the intended uses of the proceeds from the issuance are sufficiently justified in light of the company's financial position and business strategy.

⁸⁰ Article 286, Companies Law.

⁸¹ Article 288, Companies Law.

Private Placements

We evaluate these proposals on a case-by-case basis. In general, we expect companies to provide a specific and detailed rationale for such proposals.

STOCK SPLIT

We typically consider two metrics when evaluating whether a proposed stock split is reasonable: (i) the historical pre-split stock price; and (ii) the current price relative to the company's average trading price over the past 52 weeks. In general, we recommend voting for these proposals when a company's historical share price is in a range where a stock split could facilitate trading, assuming the board has provided adequate justification for the proposed split.

ISSUANCE OF DEBT INSTRUMENTS

When companies seek shareholder approval to issue debt we evaluate the terms of the issuance, the requested amount and any convertible features, among other aspects. If the requested authority to issue debt is reasonable and we have no reason to believe that the increase in debt will weaken the company's financial position, we will usually recommend in favor of such proposals.

AUTHORITY TO REPURCHASE SHARES

A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, to distribute excess cash to shareholders or to provide shares for equity-based compensation plans for employees. In addition, a company might repurchase shares in order to offset dilution of earnings caused by the exercise of stock options.

We will recommend voting in favor of a proposal to repurchase company stock when the following conditions are met: (i) a maximum of 20% of the company's total shares may be repurchased, unless the company explicitly states that any shares repurchased above this 20% threshold will be held in treasury and cancelled; (ii) a maximum price which may be paid for each share (as a percentage of the market price) is set; and (iii) the share buyback may not be used as a takeover defense.

AUTHORITY TO CANCEL SHARES AND REDUCE SHARE CAPITAL

In conjunction with a share repurchase program, companies often proceed to cancel the repurchased shares. Under Israeli law, shareholders are allowed to cancel any un-allotted share capital provided that the company is under no obligation to issue these shares.⁸² We generally recommend that shareholders vote for such proposals.

⁸² Article 287, Companies Law.

VI. Environmental, Social and Governance (“ESG”) Issues and Shareholder Initiatives

Although uncommon in Israel, should a shareholder proposal arise, we will evaluate it on a case-by-case basis. Glass Lewis typically prefers to leave decisions regarding day-to-day management and policy decisions, including those related to social and social issues to management and the board, except when there is a clear link between the proposal and value enhancement or risk mitigation. We strongly feel that shareholders should not attempt to micromanage the company, its business or its executives through the shareholder initiative process. Rather, we believe shareholders should use their influence to push for governance structures that protect shareholders and promote director accountability. Shareholders should then put in place a board they can trust to make informed decisions that are in the best interests of the business and its owners, and then hold directors accountable through the election of directors.

To this end, we examine the circumstances at each company on a case-by-case basis. We thoroughly research each firm, using publicly available information, such as annual reports, sustainability reports, companies’ websites, NGO websites, and news sources. When we identify situations where shareholder value may be at risk, we will always note our concerns in the relevant section of the Proxy Paper analysis as well as in any applicable shareholder proposals. Though relatively rare in Europe, should a shareholder proposal seek action on a specific ESG issue, Glass Lewis will recommend voting “For” such a proposal when we believe its implementation will enhance or protect shareholder value. We will also recommend voting “For” a proposal if we believe supporting such proposal will promote disclosure of significant risk exposure. Only in extreme cases will we recommend shareholders vote against board members based on ESG concerns.

For a detailed review of how Glass Lewis approaches ESG issues and related shareholder initiatives, please refer to our comprehensive *Proxy Paper Guidelines on Shareholder Initiatives*.

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