Our governance and executive compensation principles

Vanguard's duty to fund shareholders is to **maximize the long-term value of the investments held by our funds.** Consistent with that responsibility, we advocate effective policies regarding governance and executive compensation by the companies in which our funds invest. Our advocacy on these issues is an important way to enhance shareholder value.

Our views on corporate governance

The principles detailed below serve as the foundation for the guidelines we use to vote proxies on behalf of our funds. Importantly, they also represent a framework to shape our future discussions with portfolio companies on governance matters.

Independent oversight

We believe that a substantial majority of the board should be entirely independent of management. In those cases where the board chair is not independent, we believe that it is important for there to be an element of independent leadership on the board, in the form of a lead or presiding director. This director should ensure an appropriate balance between the powers of the CEO and those of the other independent directors, and should meet regularly with the independent directors without the CEO present.

Accountability

Corporate governance is, at its core, about the relationship among a company's owners (shareholders), managers, and directors. Ensuring that management is accountable to the board, and the board to shareholders, is an important incentive in the creation of value. To this end, among other things, directors should be subject to annual elections by majority vote and executive managers should see a substantial link between their compensation and company performance.

Engagement

We believe that it is important for company officials to communicate regularly with shareholders regarding areas of interest or concern. In addition, shareholders should be provided with channels through which they may communicate with the board. While boards get shareholder "feedback" through the proxy voting process, a "yes/no" vote provides only limited insight into shareholder views. We have found, through hundreds of meetings and discussions annually, that we can often accomplish more through dialogue than through the ballot.

Sensible compensation tied to performance

We believe that the majority of executive pay should depend on the creation of long-term shareholder value. An independent compensation committee should have sufficient latitude to structure pay arrangements that reward both long- and short-term achievements, but always with the focus on creating sustainable value.

We value stock ownership and retention requirements because they reinforce executives' "shareholder" mindset. Executive pay, no matter how it is designed to reward performance, should always be reasonable on an absolute basis and should not unduly dilute public shareholders' interests. With respect to severance, we believe executives should be paid well when they perform well, not when they're asked to leave. Finally, companies' required disclosures of their pay practices are more useful and create more accountability if they focus as much on "why" as they do on "how much."

Shareholder voting rights consistent with economic interests

We believe that shareholders' say in important matters should be proportional to their ownership interest in a company. A simple majority of shares outstanding should be sufficient to approve virtually any matter subject to shareholder approval. Companies should not create classes of stock that disproportionately give one class more votes per share than the common share class.

Minimal anti-takeover devices and annual director elections

We believe that shareholder value is generally maximized when the market for corporate control is permitted to function freely. Classified boards, poison pills, and other takeover defenses, particularly in combination with one another, are generally at odds with this perspective. While we appreciate that these measures may enhance the board's negotiating leverage in certain instances, we are concerned with their potential to reduce board accountability. Accordingly, we believe that these provisions should be minimized, and to the extent they are used—particularly poison pills—they should be subject to shareholder approval.

Our views on executive compensation

Sound compensation policies and practices are fundamental drivers of sustainable, long-term performance for shareholders. While we do not want to determine the policies of the companies in which we invest—a decision appropriately left to their boards and managements—we believe that the following principles are critical in linking compensation and shareowner value.

Pay for performance

Compensation should incent and reward the creation of value for the company's stakeholders. As such, we believe that a substantial portion of executive compensation should be tied to relevant financial and/or operational outcomes that (a) reflect the decisions and effort of those being compensated, and (b) contribute to the creation of value over the long term. Accordingly, incentives should be structured to reward relative outperformance, as opposed to a general rise in stock prices or other market-wide trends, over the course of a business or product cycle that is relevant to the company. (In the event that a company's financial results are subsequently restated, excess awards to individuals should be reclaimed by the company.) While compensation should ultimately reward long-term performance, incentives for shorter term (i.e., annual) performance objectives may be appropriate to the extent that the incentives support sustainable value creation.

Pay within reason

Compensation levels and performance targets should be sensible within the context of a company's peer group, taking into account differences in company size and complexity, as well as performance. While

comparative pay data may factor into the pay-setting process, the board should rationalize the selection of peer companies based on relevant business metrics, particularly when including firms in other industries.

Listen

We believe that it is important for board members and company officials to regularly seek input from shareholders regarding compensation. To that end, annual advisory votes provide shareholders with a consistent channel through which to provide directional input on compensation decisions. In addition to these "Say on Pay" votes, we will provide feedback to boards regarding the alignment between compensation and shareholder value creation through our votes on directors and equity compensation plan proposals. In many cases, we will supplement our voting with direct discussions to provide company officials with relevant and specific feedback regarding compensation programs.

Comply *and* communicate

While policies and practices will justifiably vary from firm to firm, each company should have a clearly articulated compensation philosophy that serves as the foundation for all of its pay programs and decisions. Disclosures should make clear the board's decision-making process, from the selection of peer groups and performance targets, through performance assessment and award determination. Communicating the rationale for decisions in addition to their outcomes will better enable shareholders to critically assess the board's process and approach as stewards of shareholders' assets.

Encourage stock ownership

We value stock ownership and retention requirements because we believe that they reinforce executives' "shareholder" mindset. Executives should be expected to maintain a substantial ownership interest for the duration of their employment. Companies should also impose holding-period requirements on shares acquired through option exercise. While we support the use of equity-based compensation as a means to align the interests of employees and other owners, such arrangements should not unduly dilute the value of stock held by public shareholders.

Minimize guarantees

We believe that, in general, senior executives should be engaged without employment contracts that guarantee certain salary or "bonus" payments, or that provide substantial severance payments upon termination (absent a change in control). Such "pay for pulse" or, even worse, "pay for failure" arrangements are at odds with the pay-for-performance philosophy we support. While we do not object to typical change-in-control arrangements, such payments should always be "double trigger" in nature.

Lead by example

Director compensation should be reasonably structured to reward the efforts of directors without compromising the independence necessary to protect shareholders' long-term interests. We believe that payment of a significant portion of directors' fees in stock that must be held for the duration of the director's service establishes alignment with the interests of other shareholders. In addition, those directors serving on key committees should have no relationship with the company outside their service as a director.

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