

MORROW SODALI

US PUBLICATION
NOVEMBER 2018
PROXY UPDATE

ISS RELEASES UPDATES TO 2019 BENCHMARK VOTING POLICIES

ISS recently released updates to its 2019 benchmark proxy voting policies for the Americas, EMEA, and Asia-Pacific regions. Policy changes will be effective for meetings taking place after February 1, 2019.

For U.S. companies, ISS is adding two new policies and codifying practices currently in use in several other policies (policy updates can be found in the **2019 Americas Proxy Voting Guidelines Updates**). The most significant changes are to the Board Composition policy which addresses the lack of gender diversity on boards, and to several policies which are intended to discourage the practice of management seeking to ratify existing shareholder rights in order to block a shareholder proposal seeking more favorable rights. Also, of note, ISS will not be incorporating Economic Value Added (EVA) data in its pay-for-performance model for 2019.

Board Composition - Diversity

ISS notes that the results of its 2018 policy survey show a preference among an increasing number of investors for gender diversity in the boardroom. ISS also notes that while both investors and issuers prefer engagement, there is a recognition that action at the ballot box is sometimes warranted. As such, ISS has updated its board composition policy to address boards with no gender diversity. This policy will apply to companies in the Russell 3000 and S&P 1500 indices and will go into effect on February 1, 2020; giving companies a one-year grace period.

Starting in 2020, in cases where there are no female directors on the board, ISS will recommend a vote against or withhold on the chair of the nominating committee, or other directors on a case-by-case basis.

Mitigating factors include a firm commitment (in the proxy statement) to appoint at least one female director in the “near term”, the presence on the board of a female director at the preceding annual meeting, and other factors ISS deems relevant.

Management Proposal to Ratify Existing Charter or Bylaw Provisions

ISS looks unfavorably on efforts by companies to exclude a shareholder proposal seeking more favorable shareholder rights by the inclusion of a management proposal seeking to ratify existing shareholder rights that are

more restrictive on shareholders. Noting an increase in the number of “conflicting” management proposals in 2018, ISS has added two new policies and updated one other.

There are two new policies for companies that seek shareholder approval to ratify existing charter or bylaw provisions. For both policies, ISS will consider a variety of factors, the first of which is whether there is a shareholder proposal on the agenda that addresses the same issue. ISS will also look at the board’s rationale, whether the adoption was in response to a shareholder proposal, and disclosure of shareholder engagement. Under its new Board Accountability policy, ISS will generally recommend against/withhold on members of the governance committee, individual directors or the full board depending on the circumstances. ISS has also added a new policy in Shareholder Rights & Defenses and will generally recommend against the “conflicting” management proposal, unless it aligns with “best practice.”

Under its Board Responsiveness policy, ISS has added a provision that could result in a recommendation to vote against/withhold on individual directors, committee members or the entire board. The new provision would be triggered if a board failed to act on a management proposal which was seeking to ratify existing charter or bylaw and the proposal received a majority of the shares cast against the proposal in the previous year.

Board Composition - Attendance

In the past, ISS would generally recommend against/withhold on a director who attended less than 75% of aggregate board and committee meetings in the prior year without providing an acceptable reason for the absences (i.e., medical issues and family emergencies).

In the case of “chronic poor attendance” (defined as a director attending less than 75% of aggregate board and committee meetings for three or more consecutive years without providing an acceptable reason for the absences), in addition to recommending against/withhold on the director with poor attendance, ISS would, on a case-by-case basis, recommend against/withhold on appropriate members of the nominating/governance committees or the full board.

Under its updated policy, ISS has codified its case-by-case approach on “chronic poor attendance” and will generally recommend against/withhold on other board members as follows:

- After three years of poor attendance – chair of nominating or governance committee;
- After four years – full nominating or governance committee;
- After five years – all nominees.

Reverse Stock Splits

ISS is codifying its approach on reverse stock splits for companies not listed on major stock exchanges. It is also broadening its policy to include consideration of additional critical factors for all companies, both exchange-listed and non-exchange listed, where a substantial risk exists, especially in the case where there is disclosure of substantial doubt of a company’s ability to continue without additional financing.

Environmental and Social Issues

ISS is codifying its policy on environmental and social shareholder (E&S) proposals. The policy update makes it explicit that ISS will consider whether there are “significant controversies, fines, penalties or litigation” associated with the company’s E&S practices in its case-by-case evaluation of E&S proposals.

Pay-for-Performance Model

ISS has been assessing the use of Economic Value Added (EVA) data in its pay-for-performance model. The purpose of utilizing EVA factors would be to add additional insight into company performance that goes beyond just market performance (TSR) and accounting performance (GAAP). In policy surveys and roundtable discussions, while investors expressed agreement with the direction that ISS has taken in looking at EVA factors, the investors wanted more time to understand EVA methodology. To that end, ISS will begin adding EVA metrics to reports in 2019 on a phased-in basis, but for informational purposes only.

Upcoming Key Dates

December 7:

ISS benchmark policies (proxy voting guidelines) will be posted on the ISS website.

December 31:

ISS will post updated FAQ’s regarding its policies.

January:

ISS will evaluate new U.S. shareholder proposals and update its U.S. Guidelines as needed.

February 1:

New policies go effective.

Morrow Sodali will monitor these policies and keep our clients and subscribers updated on any new developments.