MORROW SODALI

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PROXY UPDATE

ISS POLICY UPDATES 2020

ISS recently released its policy updates that will go into effect for meetings on or after February 1, 2020. The policy updates can be viewed **here**. As a whole, we view the impact of these updates to be relatively minor. Newly public companies with a multi-class stock structure and unequal voting rights should be aware of the policy revisions related to that type of capital structure. Last year, ISS introduced a policy to be implemented in 2020 concerning board gender diversity; companies without a woman on the board are at risk of receiving an against recommendation on the nominating committee chair. We discuss all the policy changes in greater detail below.

Newly Public Companies - Problematic Governance Structure

ISS notes that it is fairly common among newly public companies (over 10% in the last four years) to have a multi-class stock structure with one class having superior voting rights on a per share basis. ISS has updated its current policy regarding problematic governance practices at newly public companies and will now generally recommend against the entire board if a newly public company, as part of the IPO, had a multi-class stock structure with unequal voting rights. However, a reasonable sunset provision to the multi-class structure may be a mitigating factor that might help garner ISS support. ISS will review the company's lifespan, post IPO ownership structure and the board's rationale for the sunset timeframe that was chosen in making their determination if the sunset provision is reasonable. ISS declared that no sunset provision greater than 7 years from the IPO will be deemed reasonable.

Shareholder Proposal - Independent Board Chair

ISS codified its existing approach to independent board chair proposals. The policy was updated to explicitly detail the factors that will generally lead to a favorable recommendation. ISS noted that the policy changes are based on feedback from its clients and the section of the new policy that was added reads as such:

The following factors will increase the likelihood of a for recommendation for the shareholder proposal:

- A majority non-independent board and/or the presence of non-independent directors on key board committees;
- A weak or poorly defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role;
- The presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair, and/or departure from a structure with an independent chair;
- Evidence that the board has failed to oversee and address material risks facing the company;

- A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights; or
- Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

Share Repurchase Program Proposals

ISS has codified and updated its approach to proposals seeking approval of share repurchases. Most companies are not required to obtain shareholder approval to green light a share repurchase program, but there are some financial institutions that must have a buyback program approved by shareholders due to government regulators. In addition, U.S. listed companies incorporated in another country may be required to have shareholders approve any buyback program.

ISS has updated the policy to ensure that it safeguards against the use of targeted buybacks for the purposes of:
- greenmail,
- a reward for executives by purchasing their shares at a higher price than an open market transaction,
- using the buyback to boost EPS or other performance metrics to increase compensation payouts to executives,
- or a program that appears to threaten the company's long-term health and viability.

ISS will generally support buyback programs that do not have these abusive practices present.

"New Nominees" – Problematic Governance Issues

ISS clarified that only new nominees that have been on the board for less than a year may be exempt from responsibility for problematic governance issues.

"New Nominees" - Attendance

ISS removed the term "new nominee" from their director attendance policy. It noted that the policy relates to whether the director served for the entire fiscal year under review and not whether the director had been elected by shareholders previously.

Board Gender Diversity

In 2018 ISS approved a policy to recommend against the nominating committee chair at companies with no women on the board. It gave companies a one-year grace period to rectify the situation and that grace period has now passed. For 2020 ISS will recommend against the nominating committee chair at companies without a woman on the board. ISS also clarified its policy noting that companies that make a commitment to add a woman to the board will only be a mitigating factor in its decision-making process for 2020 but not future meetings beyond that. In addition, having a woman on the board at the preceding annual meeting will no longer alone be a mitigating factor for companies that currently do not have a woman on the board; in these cases, the company would also need to make a firm commitment to appoint a woman to the board within the next year.

Restriction of shareholder rights

A number of companies have submitted proposals seeking to approve requirements for shareholder proposals that are more stringent than those in SEC Rule 14a-8. For companies that do not provide shareholders with an unfettered ability to amend bylaws, ISS will recommend against the members of the governance committee until that situation is rectified or the board puts forth a proposal providing such right for shareholder approval.

Equity Plans

ISS will now include whether an equity plan includes an evergreen feature as an overriding factor in its equity plan scorecard analysis. This means that if an equity plan includes an evergreen feature it will receive an automatic against recommendation from ISS even if the plan is in alignment with the rest of ISS' equity plan scorecard methodology. ISS noted that since the 2017 Tax Cut and Jobs Act was implemented, plans no longer needed to be approved for 162(m) purposes because the Act repealed the performance-based pay exemption which required plans to be approved at least every 5 years to qualify for the performance-based exemption. This has led to a significant decrease in the number of equity plans that have gone to a vote in the last two years. ISS believes that because of this, the evergreen feature may help perpetuate plans with shareholder unfriendly features.

Shareholder Proposal – Labor-force Pay Gap

ISS added "race or ethnicity" to its policy relating to shareholder proposals requesting disclosure of a company's pay data by employee category. ISS implemented this change to better align with the various types of requests made by shareholder proposals filed on this topic.

In addition to the policy updates discussed above, ISS announced that in December it will issue a white-paper that will detail its updated Pay-for-Performance evaluation which will now include Economic Value Added (EVA) into its Financial Performance Assessment, which is a secondary screen within ISS' Pay-for-Performance modeling.

We will monitor how the new ISS guidelines impact voting in 2020
and update our clients to any significant developments.

In the meantime, please contact your Morrow Sodali representative if you have any questions.