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Alert
SEC Disclosure and Corporate Governance

Heads Up for the 2016 Proxy Season:

ISS and Glass Lewis Update Their Voting Policies

ISS and Glass Lewis have released updates to their proxy voting policies for the 2016 proxy season.[1] ISS has also modified its QuickScore 3.0 Technical Document and Equity Plan Scorecard.[2] In this Alert we provide guidance for U.S. public companies on addressing these developments.

Key Developments
(see page 2 for highlights)

Overlapping ISS and Glass Lewis Developments

- Director "overboarding"

ISS Developments

- Vote on proxy access nominees (but no other guidance expected until December 2015 ISS FAQs)
- Unilateral board actions (new policy for IPO companies)
- Insufficient compensation disclosure by externally-managed issuers
- Shareholder proposals seeking environmental and social disclosure
- QuickScore 3.0 modifications
- Equity Plan Scorecard modifications

Glass Lewis Developments

- Conflicting management and shareholder proposals
- Performance failures associated with board composition or environmental or social risk oversight
- Exclusive forum bylaws for IPO companies

Highlights of the ISS and Glass Lewis Updates

- **Overboarding.** Citing an "explosion" in the time commitment needed for board service, both ISS and Glass Lewis have lowered from 6 to 5 the maximum number of directorships a director (other than the CEO) may have before being considered "overboarded." For the CEO, ISS has kept the ceiling at 3 (counting subsidiary boards separately); Glass Lewis has lowered it to 2. In 2016, overboarding will result in cautionary language in the proxy voting report; in 2017, a negative recommendation. However, in the case of overboarded CEOs, ISS will recommend against the CEO only for election to outside boards.
- **Proxy Access.** Neither ISS nor Glass Lewis has provided any new insight on how they will evaluate shareholder proposals on proxy access, or which proxy access bylaw provisions will be considered so restrictive as to call into question a board's responsiveness to a majority-supported shareholder proposal. ISS promised more information in FAQs to be released in mid-December. ISS did provide a framework, similar to that used to evaluate candidates in a contested election, to evaluate candidates nominated by proxy access. ISS also added proxy access as a "zero weight" factor for QuickScore 3.0 (likely presaging a weighting next year).
- **Unilateral Board Actions.** Directors of IPO companies are for the first time expressly susceptible to negative recommendations if, prior to or in connection with the IPO, the company's board adopted charter or bylaw amendments that ISS believes materially diminish shareholder rights. In addition, amendments by post-IPO companies to (1) classify the board, (2) establish supermajority vote requirements or (3) eliminate shareholders' ability to amend bylaws will result in a negative recommendation against directors *until such time as the rights are restored or the unilateral action is ratified by a shareholder vote*.
- **Insufficient Compensation Disclosure by Externally-Managed Issuers (EMIs).** ISS will now generally recommend against say-on-pay where insufficient compensation disclosure (e.g., disclosure of only the aggregate management fee) precludes a reasonable assessment of pay programs and practices applicable to the EMI's named executive officers. Many REITs are EMIs.
- **Shareholder Proposals Seeking Environmental and Social Disclosure.** ISS has clarified and somewhat broadened the criteria it will consider in evaluating shareholder proposals seeking company reports on (1) animal welfare, (2) pharmaceutical pricing and related matters and (3) climate change/greenhouse gas emissions. In the case of animal welfare, the criteria will now include practices in the supply chain.
- **Conflicting Management and Shareholder Proposals.** Glass Lewis now specifies the factors it will consider in assessing conflicting shareholder and management proposals. This is of increasing importance in light of the SEC's recent indication that it will strictly construe whether a shareholder proposal is truly "conflicting" and therefore qualifies for exclusion under Rule 14a-8(i)(9).
- **Performance Failures Associated with Board Composition or Environmental or Social Risk Oversight.** Glass Lewis "may consider" recommending against the nominating committee chair where it believes a board's failure to ensure that it has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to the company's "poor performance." (Glass Lewis did not indicate how it will establish that board composition has contributed to "poor performance" or how it will define such performance.) Glass Lewis also has indicated that, where the board or management has failed to sufficiently identify and manage a material environmental or social risk that either did – or could – negatively impact shareholder value, it will recommend against directors responsible for risk oversight.
- **Exclusive Forum Bylaws for IPO Companies.** For newly public companies, Glass Lewis will no longer automatically recommend against the nominating committee chair due to the presence of an exclusive forum bylaw at the time of the IPO. Instead, Glass Lewis will consider such provision in the context of a company's overall shareholder rights profile.

Contents of this Alert

Overview of ISS Policy Changes

For the most part, the following ISS policies will become effective for meetings on or after February 1, 2016.

1. Director "Overboarding" Policy Amendments

ISS and Glass Lewis Policies – REVISED

Both ISS and Glass Lewis lowered the maximum number of directorships a director nominee other than the company's sitting CEO may have before being considered "overboarded." Departing from its policy draft, ISS did not lower its ceiling for CEOs, while Glass Lewis did so for CEOs and other executive officers. ISS and Glass Lewis both provide a one-year transition period: for the 2016 proxy season, they will only include cautionary language about the overboarded director in the proxy voting recommendation report. Not until meetings commencing in 2017 (February 2017 for ISS) will overboarding under the new limits result in a negative recommendation.

Under ISS' guidelines, all subsidiary boards on which a CEO sits will be counted as separate boards. ISS will not recommend a withhold vote from the CEO of a parent company board or any of the controlled (>50% ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50% controlled and boards outside the parent/subsidiary relationship. However, in the case of overboarded CEOs, ISS will recommend against the CEO only for election to outside boards.

The ISS and Glass Lewis changes are reflected in the following table:

	Current ISS and Glass Lewis Policy Annual Meetings in 2016	Revised ISS and Glass Lewis Policy Annual Meetings in 2017
All directors (other than CEO/Executive Officer*)	6 or more public company boards including their own	5 or more public company boards including their own
CEO/Executive Officer* directors	3 public company boards including their own	No change for ISS 2 public company boards including their own for Glass Lewis

* ISS considers this threshold for CEO-directors only; Glass Lewis applies this threshold to all executive officers who serve as directors on other boards.

What To Do Now?

- Evaluate whether your company's directors, including the company's CEO or other executive officers, could be at risk of receiving a public caution from ISS or Glass Lewis and, subsequently, a negative recommendation under the revised overboarding policies.
- Ensure that directors and executive officers update their annual questionnaires to provide current biographies, including all other boards on which they serve (both public and private). Companies should have a policy requiring prompt notice of changes in employment or directorships and directors and executive officers should be periodically refreshed about this policy. Directors and executive officers should be particularly mindful about potential overboarding that may arise from board service on private companies that anticipate an IPO.

2. Candidates Nominated by Proxy Access – *NEW*

ISS has added an analytical framework for evaluating candidates nominated by proxy access. ISS will make voting recommendations on a case-by-case basis, considering the same factors currently used to evaluate nominees in a proxy contest,[3] "or additional factors which may be relevant." ISS did not provide specific guidance on "additional relevant factors" other than to state they may be specific to the company, to the nominee(s), and/or to the nature of the election (such as whether or not there are more candidates than board seats).

Spotlight on Proxy Access – No New Guidance from ISS or Glass Lewis

Much to the disappointment of companies awaiting further guidance on proxy access, ISS and Glass Lewis did not provide any new insight on how they will evaluate shareholder proposals on proxy access, or which proxy access bylaw provisions will be so restrictive as to call into question the board's responsiveness to a majority-supported shareholder proxy access proposal and, therefore, attract a negative recommendation for director nominees. ISS has, however, indicated that FAQs to be released in mid-December 2015 will provide more information on which proxy access provisions it will consider "overly restrictive." As the deadlines for shareholder proposals at calendar year companies rapidly approach, this timing is less than ideal for boards currently considering whether and, if so, on what terms, to adopt proxy access.[4]

What To Do Now?

- It remains to be seen how proxy access will be used by shareholders of those companies that adopt it in time for the 2016 proxy season and, if used, how proxy access candidates will be evaluated by ISS.
- Companies should stay informed on proxy access issues and developments. We provide a strategic roadmap for decision-making about proxy access in our Alert available here.

3. Unilateral Board Actions – *REVISED*

Last year, ISS adopted a new stand-alone policy under which it will generally issue a negative recommendation against director nominees (except new nominees, whom it considers case-by-case), if the board amends the company's bylaws or charter without shareholder approval or ratification in a manner that ISS believes materially diminishes shareholders' rights or could adversely impact shareholders. The policy listed factors that ISS considered when formulating its recommendation, but did not specify for how many years it would issue negative recommendations or what types of amendments it would view as materially diminishing shareholder rights. Moreover, the policy did not make a distinction between newly public companies and those that have been public for some period of time. For a summary of the 2015 voting policy updates, see our Alert available here.

ISS amended its policy to explicitly state that, beginning for the 2016 proxy season, charter and bylaw amendments made by post-IPO companies to (1) classify the board, (2) establish supermajority vote requirements or (3) eliminate shareholders' ability to amend bylaws will result in a negative recommendation for director nominees ***until such time as the shareholders' rights are restored or the unilateral action is ratified by a shareholder vote***.

In addition, for the 2016 proxy season, ISS has established separate methodologies to evaluate bylaw or charter provisions adopted prior to or in connection with a company's IPO and unilateral board amendments made to the bylaws or charter following an IPO.

Spotlight on IPO Companies

While newly public companies have generally faced less scrutiny from ISS, the proxy advisor may now issue a negative recommendation against director nominees at annual meetings subsequent to the IPO, if the company has bylaw or charter provisions adverse to shareholders' rights that are in place prior to the IPO or adopted in connection with the IPO. Under this new stand-alone policy, ISS will consider the following factors in formulating its voting recommendation:

- The level of impairment of shareholders' rights caused by the amendment
- The rationale for adopting the amendment without shareholder approval
- The impact of the amendment on shareholders' ability to change the governance structure in the future (such as imposing supermajority vote requirements to amend the bylaws or charter)
- Whether the company has an annual election or classified board structure
- Whether the company has made a public commitment to put the adverse provision to a shareholder vote ***within three years*** of the date of the IPO

ISS will vote case-by-case on director nominees in subsequent years, unless the adverse provision is reversed or submitted to a shareholder vote.

It is unclear whether ISS will distinguish between directors who served on the board pre-IPO and directors appointed upon the completion of the IPO who did not approve such adverse shareholder provisions.

What To Do Now?

- Companies, including those preparing for an IPO, that are considering whether to amend their charter or bylaws in a manner that could be viewed by ISS to adversely impact shareholders should carefully consider the impact of such amendments on director elections but should continue to make decisions in the best interest of the company, especially during the IPO transition period.

- Companies that recently became public or are preparing for an IPO should note what may be a suggestion from ISS that disclosure of a public commitment to put any adverse shareholder provisions to a shareholder vote within three years of the IPO date may result in a period of "grace" during the company's formative years in the public domain.

4. Insufficient Compensation Disclosure at Externally-Managed Issuers – Now a "Problematic Pay Practice" – *NEW*

ISS has adopted a new voting policy under which it will generally recommend against say-on-pay when the EMI fails to provide sufficient compensation disclosure to allow investors to make a reasonable assessment of pay programs and practices for the EMI's named executive officers.

ISS expressed concern over the lack of transparency in the compensation disclosure made by EMIs, as well as potential conflicts of interest underpinning such compensation arrangements. EMIs pay fees to an external management firm in exchange for management services and, in most cases, executives of the EMIs are compensated by the external manager. Disclosure is often limited to the aggregate management fees paid by the EMI to the manager. In ISS' view, EMIs typically do not disclose the compensation arrangements and payments made to the

EMI executives by the external manager in sufficient detail to enable shareholders to make an informed pay-for-performance evaluation. ISS further notes that a small number of EMIs disclose detailed compensation information, which ISS uses to support its conclusion that such information can be made available within the constraints of company agreements with external managers.

Spotlight on REITs

In its 2016 benchmark policy consultation,[5] ISS said it is aware of 60 U.S. EMIs, typically REITs, and that in most cases they provide limited or no disclosure on NEO compensation arrangements with their external managers. Under ISS' new policy, these companies should expect to receive a recommendation against their say-on-pay advisory vote unless they significantly enhance their executive compensation disclosure.

What To Do Now?

- The compensation committee of an EMI should review prior proxy statement disclosure on compensation of its NEOs by the external manager and consider whether expansion is warranted this year in light of ISS' new policy.

5. Voting Recommendations on Certain Shareholder Proposals

Equity Holding Periods for Executives – *REVISED*

ISS has streamlined its policy with respect to shareholder proposals asking companies to adopt policies requiring executive officers to retain all or a significant portion of net shares acquired through compensation plans. These proposals typically include retention periods of up to two years after termination of employment or during a lock-up period after vesting.

The revisions broaden ISS' policy to encompass equity retention proposals more generally, eliminating the need for a separate policy tied to a specific retention ratio (e.g., 75% of net shares). The revised policy clarifies that the suggested retention ratio and the required duration remain two factors that ISS will strongly consider. In addition, the revised policy applies to *executive officers*, rather than the previously bifurcated policy for *named executive officers* and *senior executive officers*.

Under the revised policy, ISS will recommend case-by-case on shareholder proposals seeking the adoption of share retention policies for executive officers, taking into account:

- The percentage/ratio of net shares required to be retained
- Time period required to retain the shares
- Whether the company has equity retention, holding periods, or stock ownership requirements and the robustness of such requirements
- Compensation policies aimed a mitigating executive risk taking
- Executives' actual stock ownership and the degree it meets or exceeds the thresholds in the proposal
- Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.

Proposals on Environmental and Social Issue Disclosure – *REVISED*

- **Animal Welfare**. ISS revised its voting policy recommendation relating to proposals seeking a report on a company's animal welfare policy to also cover reports on animal welfare-related risks (not just animal welfare standards). Under the revised policy, ISS will generally vote "for" proposals seeking such reports unless: (1) the company has already published a set of animal welfare standards and monitors compliance; (2) the company's standards are comparable to industry peers; and (3) there are no recent, significant fines, litigation, or controversies related to the company's and/or its suppliers' treatment of animals. The revised policy added animal treatment "controversies" and *"suppliers' treatment"* of animals to the list of evaluated criteria.
- **Pharmaceutical Pricing, Access to Medicines, and Prescription Drug Reimportation**. Generally ISS will recommend case-by-case on shareholder proposals requesting that a company report on its product pricing or access to medicine policies after considering certain factors. ISS added to its list of criteria: (1) recent significant controversies, litigation, or fines at the company and (2) the potential for "regulatory" risk exposure.
- **Climate Change / Greenhouse Gas (GHG) Emissions**: ISS will generally support shareholder proposals asking that a company disclose information on risks related to climate change on its operations and investments. ISS has clarified the types of climate change risks for which it will support disclosure to include financial, physical, and regulatory risks.

What To Do Now?

- Companies receiving shareholder proposals on these matters should consult ISS' new policy. This policy reflects the growing interest of investors and other stakeholders in corporate social responsibility matters and a trend toward voluntary disclosure by larger U.S. public companies.

Overview of Glass Lewis Policy Changes

1. Conflicting Management and Shareholder Proposals – *NEW*

Against the backdrop of dueling shareholder and management proposals on proxy access during the 2015 proxy season, and recent guidance in SEC Staff Legal Bulletin No. 14H indicating that the SEC will strictly construe whether a shareholder proposal truly conflicts with a management proposal and therefore qualifies for exclusion,[6] Glass Lewis has clarified how it will evaluate conflicting proposals during the 2016 proxy season. Glass Lewis will consider the following factors when reviewing conflicting management and shareholder proposals:

- Nature of the underlying issue
- Benefit to shareholders by implementing the proposal
- Materiality of the differences between the terms of the shareholder and management proposal
- Appropriateness of the provisions considering the company's shareholder base, corporate structure, and other relevant circumstances
- The company's overall governance profile, specifically including its responsiveness to shareholders evidenced by the company's response to previous shareholder proposals and its adoption of progressive shareholder rights provisions.

What To Do Now?

- Companies that anticipate having management and shareholder proposals on the same topic in their proxy statement should review the factors that Glass Lewis has enumerated, as well as the new SEC guidance. We provide a summary of the SEC's recent guidance in our Alert available here.

2. Nominating Committee Performance: Failures Associated with Board Composition – *REVISED*

Glass Lewis may now recommend against the nominating and governance committee chair "where the board's failure to ensure the board has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to a company's poor performance." The revised policy does not indicate how Glass Lewis determines when a director's experience contributed to poor company performance, nor does it define "poor performance." However, in another Glass Lewis voting guideline relating to company performance, Glass Lewis indicates that poor performance is "[in] the last three years . . . performance [that] has been in the bottom quartile of the [company's] sector."

What To Do Now?

- Ensure company disclosure contains thorough descriptions of the specific experience, qualifications, attributes or skills that led to the conclusion that each director should be nominated in light of the company's business and structure as required by Item 401(e) of Regulation S-K.
- Ensure that the company is conducting regular and robust board evaluations. Note that ISS QuickScore 3.0 has been revised to consider whether the board is conducting *individual* director assessments.

3. Environmental and Social Risk Oversight – *NEW*

Beginning in the 2016 proxy season, Glass Lewis will recommend against directors responsible for risk oversight in cases where the board or management failed to sufficiently identify and manage a "material environmental or social risk" that did or could negatively impact shareholder value. Glass Lewis reasoned that the identification, mitigation and management of environmental and social risks are integral components when evaluating a company's overall risk exposure. While the policy does not define environment or social risk, the Glass Lewis Shareholder Initiatives Guidelines indicate that examples of environmental risks include oil or gas spills, contamination, hazardous leakages, explosions, or reduced water and air quality; social risks include non-inclusive employment policies or inadequate human rights policies.

What To Do Now?

- Companies that have previously faced shareholder criticism, negative proxy advisory firm recommendations or shareholder proposals relating to environmental or social issues should consider enhancing disclosure regarding the board's oversight process specifically in these areas.

4. Exclusive Forum Bylaws for IPO Companies – *REVISED*

For the 2015 proxy season, Glass Lewis amended its voting policy to automatically recommend a vote against the nominating and governance committee chair (or the entire committee) if the board adopted an exclusive forum bylaw pre-IPO. Under Glass Lewis' relaxed policy, if a company adopts an exclusive forum bylaw provision pre-IPO, Glass Lewis will no longer automatically make such negative recommendation. Instead, Glass Lewis will weigh the presence of an exclusive forum provision in a newly-public company's bylaws in light of other provisions that may limit shareholder rights, such as supermajority vote requirements, a classified board, or a fee-shifting bylaw.

Glass Lewis has not changed its policy to automatically recommend against the nominating and governance committee chair (or the entire committee) when a company adopts an exclusive forum provision without shareholder approval outside of the spin-off, merger or IPO context. ISS, on the other hand, does not recommend voting against directors based on the unilateral adoption of an exclusive forum bylaw provision and reviews exclusive forum bylaws on a case-by-case basis.

What To Do Now?

- Newly public companies and those preparing for an IPO should consider their shareholder rights profile in its entirety in evaluating whether to implement an exclusive forum provision.

- Remember that Glass Lewis will continue to recommend against the chair or the entire committee when a company adopts a fee-shifting bylaw pre-IPO, if such provision is not subject to a shareholder vote following the IPO.

5. Compensation Policy Updates – *REVISED*

Glass Lewis has updated the following disclosure and compensation policies:

- *Long-Term Incentives* – Glass Lewis will look to see whether a company has disclosed actual performance and vesting levels for previous grants earned during the fiscal year.
- *Transitional Awards* – While acknowledging that there are costs associated with transitions at the executive level, Glass Lewis believes that sign-on arrangements should be clearly disclosed and accompanied by meaningful explanation of the payments and process for determining the payment amounts, including any "make-whole" payments.
- *Equity Compensation Plans* – Glass Lewis analyzes equity-based compensation plans based on quantitative and qualitative factors. The revised policy clarifies that additional qualitative factors include the choice of, use of, and difficulty in meeting award metrics and targets (if any). Other factors, such as the company's size and operating environment, may be relevant in assessing the concerns or benefits of certain changes to equity compensation plans. Glass Lewis may also consider a company's overall executive compensation practices when evaluating certain equity compensation plans.

What To Do Now?

- In preparing their CD&As, companies should take into account Glass Lewis' updated expectations about disclosure of long-term incentives, transitional awards and equity compensation plans, as applicable.

QuickScore 3.0 Updates

ISS has revised its QuickScore 3.0 Technical Document. A copy of the revised QuickScore 3.0 technical document is available for download at http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore/. ISS has added one new "zero weight" factor regarding proxy access and modified existing factors applicable to U.S. public companies. New company QuickScores will be published will begin to appear in ISS research reports on November 23, 2015.

1. New Zero-Weight Factor – Proxy Access (Q346)

- QuickScore will now track whether companies provide proxy access and, if so, the following specifics: (1) the ownership threshold and holding period required to exercise the proxy access right, (2) the number of shareholders permitted to aggregate their holdings, and (3) the number or percentage of board seats available for proxy access nominees. For 2016, this will be a zero-weight factor, meaning the factor will be noted on the QuickScore report but will not impact the numerical QuickScore. We expect this to be weighted in 2017.

2. Modified Factors and Other Changes

ISS has modified certain factors applicable to U.S. public companies:

- *Policy requiring annual performance evaluation of the board (Q41)* – ISS QuickScore considers whether the company has disclosed a policy requiring an annual performance evaluation of the board. ISS has clarified that, for U.S. companies, a "robust" policy exists when the company discloses an annual board performance evaluation policy that includes (1) *individual* director assessments and (2) an *external evaluation* performed at least every three years. This revised interpretation is likely to affect a company's QuickScore given that many companies conduct evaluations at the board and committee level rather than at the individual director level, and typically through a company-managed process.

- *Proportion of non-executive directors on the board with a lengthy tenure (Q13)* – ISS clarified that a "small number" of long-tenured directors (i.e., those on the board longer than 9 years) does not negatively impact the company's QuickScore governance rating. QuickScore does not quantify the term "small number." To date, we have generally found that companies receive a QuickScore "red flag" when long-tenured directors represent more than one-third of the board.
- *Board and committee meeting attendance (Q45)* – ISS clarified that for U.S. companies, this question applies to all board and committee meetings "as set forth under SEC disclosure requirements," indicating the ISS attendance policy applies to *all* committees of the board, and not exclusively the audit, compensation, and nominating/governance committees.[7]
- *Majority voting policy (Q52)* – ISS clarified that a director resignation policy (typically found in the company's corporate governance guidelines) is not considered to be the same as a "majority voting standard" located in the company's certificate of incorporation or bylaws.
- *Adverse auditor opinions (Q2)* – QuickScore has added an "emphasis of matter" disclosure in the audit report to its evaluation of whether a company received an adverse opinion from its auditor. It is not clear if an "emphasis of matter" disclosure will result in a QuickScore "red flag."
- *Enforcement action against a director or officer of the company in the past two years (Q200)* – ISS clarified that any penalty against a director or officer is considered to be "material" when it considers whether an officer or director was subject to an enforcement action by a regulator within the past two years, and if the investigation was resolved with a material penalty.
- *Regulatory investigations (Q201)* – QuickScore evaluates whether the company, directors, or officers are under a regulatory investigation, which is categorized either as "routine" or "non-routine." ISS has clarified that FCPA-related investigations and Wells Notices are generally considered to be non-routine investigations, unless the company states the outcome is not expected to have a material adverse effect on the company. Accounting investigations are considered "routine," unless tied to a restatement.

What To Do Now?

- Once issued, review your QuickScore and continue provide feedback via the ISS data verification website. Feedback should reference public filings, where appropriate. It is important to provide feedback as soon as possible because data verification is not available during the period between the filing of a company's proxy statement and the publication of ISS' proxy analysis for the company's annual meeting. Information about verifying data, how to obtain log-in information and a link to the data verification website is available at http://www.isscorporatesolutions.com/quickscore-dataverification.
- Where appropriate, enhance discussion in the company's upcoming proxy statement relating to elements of QuickScore that have been newly modified as summarized above.
- Remember that companies that have adopted many of the best practices advocated by ISS may nevertheless find themselves with QuickScores that are in the middle of the pack or below average, as each QuickScore will reflect a company's relative rank. Directors and management should continue to make governance decisions in the best interests of the company, depending on the company's particular circumstances, rather than be driven by a desire to increase QuickScores in line with rigid one-size-fits-all prescriptions.

Equity Plan Scorecard Updates

For the 2015 proxy season, ISS adopted a new Equity Plan Scorecard (EPSC) for evaluating equity compensation plans by considering a range of positive and negative factors, rather than a series of "pass" or "fail" tests. Positive and negative factors can counterbalance each other. The Scorecard factors fall under three enumerated "pillars" weighted by reference to company size and status. For S&P 500 and Russell 3000 companies these pillars and weighting are as follows: Plan Cost – 45%, Plan Features – 20% and Grant Practices – 35%. Additional information about the EPSC is provided in our Alert available here. Generally, the EPSC policy has not changed for S&P 500 and Russell 3000 companies.

ISS has amended the EPSC FAQs for company meetings beginning on or after February 1, 2016, available at http://www.issgovernance.com/file/policy/faq-on-iss-us-equity-plan-scorecard-methodology.pdf, as follows:

- ISS has created a new "Special Cases – Russell 3000 / S&P 500." This includes companies that have recently become public or emerged from bankruptcy. Maximum pillar scores for this new category are as follows: Plan Cost – 50%; Plan Features – 35%, and Grant Practices – 35%. For these companies, the Grant Practices pillar will not include burn rate and duration.
- For all companies, the Plan Features factor called "Automatic Single-Trigger Vesting" is renamed to "CIC Vesting," with the following scoring levels:
  - Full points if plan provides (1) for time-based awards: no acceleration or accelerated vesting only if awards are not assumed/converted and (2) for performance-based awards: forfeited, terminated, paid pro-rata and/or based on actual performance.
  - No points if plan provides for automatic acceleration of time-based equity or above-target vesting of performance awards.
  - Half points if plan provides for any other vesting terms related to a CIC.
- For the "Post-Vesting/Exercise Holding Period" Plan Features, the period required for full points has been revised to 36 months (up from 12 months) or until employment termination. Half points will accrue for a 12 month holding period.
- The maximum of 100 total points and the threshold of 53 points for a favorable recommendation remain unchanged.

What To Do Now?

- Companies planning to include an equity compensation plan on the ballot for the next annual meeting should register to gain access to the ISS Equity Plan Data Verification Portal and review the data points about the company that ISS will consider as part of its scorecard.

Engaging with ISS

In the ordinary course, it is difficult for many companies to meet directly with ISS. Rather, ISS encourages engagement indirectly by complying with the following procedures:

- **Update Company Compensation Peer Group.** Companies in the Russell 3000 or Russell Microcap Index with annual meetings taking place between February 1, 2016 and September 15, 2016 should notify ISS of any updates to their self-selected compensation benchmarking peers. The submission window opens at 9 a.m. ET on November 24, 2015 and closes 8 p.m. ET on December 11, 2015. For additional information, see our Alert available here.
- **Register for ISS Voting Recommendation Review Process (S&P 500 companies only)**. S&P 500 companies should ensure that they annually elect to participate in the voting recommendation preview process by registering details with ISS. Company contact information can be provided using the form available at this link: http://www.issgovernance.com/iss-draft-review-process-u-s-issuers/
  - S&P 500 companies that have registered with ISS will receive a draft report reflecting ISS' voting recommendations in advance of the annual meeting of stockholders. They will then have a very narrow time window (48 hours) in which to respond to ISS with any updates, or engage with ISS if possible.
  - Companies should carefully review their proxy voting reports (whether pursuant to the "preview" process discussed above or otherwise) – with input from outside counsel and compensation consultants, as appropriate – and notify the relevant proxy advisory firm of any errors as soon as possible.
- **QuickScore Reports Become Available for Verification on November 23, 2015.** Companies may verify data verification points at any time, except between the company's proxy filing and shareholder meeting.
- **Register with ISS for Equity Compensation Scorecard.** Companies planning to seek shareholder approval of an equity compensation plan at the next annual meeting should register to gain access to the ISS Equity Plan Data Verification Portal and review the data points about the company that ISS will consider as part of its scorecard approach.
- **Understand Vulnerabilities and Potential for Negative ISS Voting Recommendations.** We encourage all companies to become familiar with the more than 45 circumstances in which ISS may recommended a negative vote regarding director elections (set forth on the Appendix), or on other proposals that may be included in their proxy statement.
  - ISS is expected to release its voting policy FAQs and full set of proxy voting summary guidelines in mid-December 2015.
- **Review and Enhance Proxy Statement Disclosure.** Companies should review last year's compensation and governance disclosure and consider any investor feedback with an eye toward further improvements. Clear, complete and concise proxy statement disclosure that highlights developments and explains the board's rationale can be a company's best tool for making its case to the proxy advisors and shareholders generally.

ENDNOTES

[1] ISS, "2016 Americas Policy Updates" (November 20, 2015), *available at* http://www.issgovernance.com/file/policy/2016-americas-policy-updates.pdf; Glass Lewis, "Proxy Paper Guidelines, 2016 Proxy Season" (2016), *available at* http://www.glasslewis.com/assets/uploads/2015/11/GUIDELINES_United_States_20161.pdf. Changes to non-U.S. policies were also announced.

[2] ISS, "Governance QuickScore 3.0" (October 2015), *available at* http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore-downloads/.

[3] Factors currently considered by ISS in evaluating director candidates in a proxy contest are: the long-term performance of the company relative to its industry; management's track record; background to the contested election; nominee qualifications and any compensatory arrangements; strategic plan of dissident slate and qualify of critique against management; likelihood that the proposed goals and objectives can be achieved (both slates); and stock ownership positions.

[4] ISS current voting guidelines provide that ISS will generally recommend in favor of management and shareholder proposals on proxy access that have the following provisions: (i) an ownership threshold of not more than three percent (3%); (ii) a holding period no longer than three continuous years; (iii) minimal or no limits on the number of shareholders permitted to form a nominating group; and (iv) a cap on the number of proxy access nominee seats at no less than 25% of the board.

Glass Lewis' current voting guidelines indicate that it generally supports proxy access as a means to ensure that significant shareholders have an ability to nominate candidates to the board; however, it considers each proposal on a case-by-case basis. Specifically, Glass Lewis considers specified minimum ownership and holding period requirements, as well as company size, board independence and diversity, company performance, existence of anti-takeover protections, board responsiveness to shareholders, and opportunities for shareholder action (e.g., ability to act by written consent or right to call a special meeting).

[5] ISS benchmark policy consultation and proposed policy changes are available at http://www.issgovernance.com/policy-gateway/2016-benchmark-policy-consultation/.

[6] Rule 14a-8(i)(9) traditionally provided companies an avenue to exclude shareholder proposals by submitting a conflicting, and often more company-friendly, management proposals. On October 23, 2015, the SEC staff issued guidance that will make it more difficult for companies to seek exclusion for conflicting proposals. For a discussion regarding Staff Legal Bulletin No. 14H, see our Alert, "SEC Staff Updates its Guidance on Rule 14a-8 Shareholder Proposals," available here.

[7] Item 407(b) of Regulation S-K requires disclosure of directors attending less than 75% of (i) the total number of meetings of the board of directors and (ii) the total number of meetings held by all committees of the board.

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If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of Weil's Public Company Advisory Group:

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We thank our colleague Reid Powell for his contribution to this alert.

Appendix

Circumstances that can Lead to ISS Negative Recommendations for Directors

ISS has identified more than 45 circumstances that may support a negative vote recommendation in uncontested director elections. These circumstances are outlined below. Changes from ISS' 2015 policies are noted *in italics*.

Entire Board

ISS will recommend a negative vote ("against" or "withhold") for the entire board (and possibly a board committee or individual directors) due to:

Governance failures

- Material failures of governance, stewardship, risk oversight (examples include bribery, large or serial fines or sanctions from regulatory bodies, significant adverse legal judgments or settlements, hedging of company stock, or significant pledging of company stock), or fiduciary responsibilities at the company
- Failure to replace management as appropriate
- Egregious actions related to service on other boards that raise substantial doubt about the director's ability to effectively oversee management and serve the best interests of shareholders at any company

Unilateral bylaw/charter amendments

- Board amendment of the company's bylaws or charter without shareholder approval/ratification in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors, as applicable:
  - The board's rationale for adopting the bylaw/charter amendment without shareholder approval or ratification
  - Disclosure by the company of any significant engagement with shareholders regarding the amendment
  - Level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter
  - The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions
  - The company's ownership structure and existing governance provisions
  - The timing of the board's amendment to the bylaws/charter in connection with a significant business development
  - *Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders*
- *Board amendment of the company's bylaws or charter without shareholder approval/ratification to establish a classified board*
- *Board amendment of the company's bylaws or charter without shareholder approval/ratification to adopt a supermajority vote requirement to amend the charter or bylaws*
- *Board amendment of the company's bylaws or charter without shareholder approval/ratification to eliminate shareholders' ability to amend bylaws*
- *If prior to or in connection with the initial company's public offering, the company adopts bylaw or charter provision adverse to shareholders' rights, considering the following factors:*
  - *The level of impairment of shareholders' rights caused by the provision*
  - *The company's or the board's rationale for adopting the provision*

- *The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholders' right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter)*
- *The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure*
- *A public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering*

ISS will consider vote recommendations on a case-by-case basis for the entire board (and possibly a board committee or individual directors) due to:

Board responsiveness

- The board failed to act on a shareholder proposal that received approval by a majority of votes cast in the previous year. Factors that will be considered are:
  - Disclosed outreach efforts by the board to shareholders in the wake of the vote
  - The board's rationale, as provided in the proxy statement, for the level of implementation of the proposal
  - Subject matter of the proposal
  - Level of support for and opposition to the proposal at past meetings
  - Board actions in response to the majority vote and its shareholder engagement
  - Continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals)
  - Other factors as appropriate
- At the previous board election, any director received more than 50 percent negative votes of the votes cast and the company failed to address the underlying issue(s) that caused these high negative votes
- The board failed to act on takeover offers where a majority of shareholders tendered their shares
- The board implemented an advisory vote on executive compensation on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency
- When no say-on-pay frequency received a majority and the board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received a plurality of the votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency, taking into account:
  - The board's rationale for selecting a frequency that is different from the frequency that received a plurality
  - The company's ownership structure and vote results
  - ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices

Individual Directors

In addition to the circumstances discussed above, ISS will recommend a negative vote ("against" or "withhold") for an individual director:

Attendance

- Who attends less than 75 percent of board and committee meetings for the period of service (or missed more than one meeting, if the director's total service was three or fewer meetings), unless the absence was due to medical issues or family emergencies, and the reason for such absence is disclosed in the proxy statement or other SEC filing
- If the proxy disclosure is unclear and insufficient to determine whether the director attended at least 75 percent of board and committee meetings during the period of service

"Overboarding"

- Who sits on more than six public company boards*; for meetings on or after February 1, 2017, who sits on more than five public company boards*, with boards of subsidiaries with publicly-traded stock counting as separate boards
- Who is CEO of a public company and sits on boards of more than three public companies in total, with boards of subsidiaries with publicly-traded stock counting as separate boards. Although all of a CEO's subsidiary boards will be counted as separate boards, ISS will not recommend a withhold vote from the CEO of a parent company board or any of the controlled (> 50% ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50% controlled and boards outside of the parent/subsidiary relationship.

Independence

- Who is an inside or affiliated outside director serving on the audit, compensation or nominating committee

Entire Board

In addition to the circumstances discussed above relating to the entire board, ISS will recommend a negative vote ("against" or "withhold") for all directors (except for new nominees, who will be considered on a case-by-case basis) if:

Problematic takeover defenses

- The board is classified and a continuing director responsible for a problematic governance issue at the board/committee level that would warrant a negative vote recommendation is not up for election (ISS may hold any or all appropriate nominees, except new nominees, accountable)
- The board lacks accountability and oversight, coupled with sustained poor performance of the company relative to peers measured by one-year and three-year total shareholder returns in the bottom half of a Russell 3000 company's four-digit Global Industry Classification Group (ISS will consider "problematic" the following governance practices -- a classified board structure, a supermajority vote requirement, a plurality vote standard in uncontested director elections or majority vote standard for director elections with no carve-out for contested elections, inability of shareholders to call special meetings or act by written consent, a dual-class capital structure, and/or a non-shareholder approved poison pill. ISS will also take into consideration the company's five-year total shareholder return and operational metrics)
- A poison pill has a dead-hand or modified dead-hand feature, in which case a negative vote recommendation will be made every year until the feature is removed

- The board adopts a poison pill with a term of more than 12 months or renews any existing pill including a pill with a term of 12 months or less without shareholder approval (a commitment or policy that puts a newly adopted pill to a binding shareholder vote may potentially offset a negative vote recommendation)
- The company maintains a poison pill that was not approved by shareholders (ISS will review annually for companies with classified boards and at least once every three years for companies with declassified boards)
- The board makes a "material adverse change" to an existing poison pill without shareholder approval
- On a case-by-case basis: the board adopts a poison pill with a term of 12 months or less without shareholder approval, taking into account the following factors:
  - The date of the pill's adoption relative to the date of the next meeting of shareholders (whether the company had time to put the pill on the ballot for shareholder ratification given the circumstances)
  - The company's rationale
  - The company's governance structure and practices
  - The company's track record of accountability to shareholders

Problematic compensation practices

- On a case-by-case basis: in exceptional circumstances, if the company's previous say-on-pay proposal received the support of less than 70 percent of votes cast (see below)
- In the absence of a say-on-pay vote or in egregious situations if:
  - There is a significant misalignment between CEO pay and company performance (see below)
  - The board exhibits a significant level of poor communication and responsiveness to shareholders
  - The company fails to submit one-time transfers of stock options to a shareholder vote
  - The company fails to fulfill the terms of a burn rate commitment made to shareholders
  - The company maintains significant "problematic pay practices" (see below)
- The company has recently practiced or approved problematic pay practices (see below)

Problematic audit-related practices

- On a case-by-case basis: poor accounting practices rising to a level of serious concern (such as fraud, misapplication of GAAP, and material weaknesses identified in Section 404 (internal control over financial reporting) disclosures) are identified, taking into consideration the practices' severity, breadth, chronological sequence and, duration, and the company's efforts at remediation or corrective actions

All Inside Directors and Affiliated Outside Directors

ISS will recommend a negative vote ("against" or "withhold") for all inside directors and affiliated outside directors when:

- The company lacks an audit, compensation, or nominating committee so that the full board functions as that committee
- The company lacks a formal nominating committee (even if the board attests that independent directors fulfill the functions of such a committee)
- The full board is less than majority independent

Audit Committee Members

In addition to the circumstances discussed above relating to committee members, ISS will recommend a negative vote (“against or withhold”) for audit committee members if:

- Non-audit fees paid to the auditor are excessive (e.g., non-audit fees are greater than audit fees plus audit-related fees plus tax compliance/preparation fees)
- The company receives an adverse opinion on its financial statements from its auditor
- There is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company or its shareholders to pursue legitimate legal recourse against the audit firm
- On a case-by-case basis: poor accounting practices, which rise to a level of serious concern (such as fraud, misapplication of GAAP, and material weaknesses identified in Section 404 disclosures) are identified, taking into consideration the practices’ severity, breadth, chronological sequence and, duration, and the company’s efforts at remediation or corrective actions

Compensation Committee Members

In addition to the circumstances discussed above relating to committee members, ISS will recommend a negative vote (“against” or “withhold”) for compensation committee members (and potentially the full board) if:

- On a case-by-case basis: the company’s previous say-on-pay proposal received the support of less than 70 percent of votes cast, taking into account:
  - The company’s response, including:
    - Disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support
    - Specific actions taken to address the issues that contributed to the low level of support
    - Other recent compensation actions taken by the company
  - Whether the issues raised are recurring or isolated
  - The company’s ownership structure
  - Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness
- In the absence of a say-on-pay vote, or in egregious situations, if:
  - There is a significant misalignment between CEO pay and company performance, considering:
    - Peer group alignment (total shareholder return and CEO’s total pay rank within a peer group as measured over one-year and three-year periods and considering the multiple of CEO total pay relative to the peer group median)
    - Absolute alignment (difference between the trend in annual CEO pay changes and the trend in annualized company total shareholder return over the prior five years)
    - Qualitative factors
  - The board exhibits a significant level of poor communication and responsiveness to shareholders
  - The company fails to submit one-time transfers of stock options to a shareholder vote
  - The company fails to fulfill the terms of a burn rate commitment made to shareholders

- The company maintains significant "problematic pay practices," such as:
  - Repricing or replacing of underwater stock options/SARS without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options)
  - Excessive perquisites or tax gross-ups, including any gross-up related to personal use of corporate aircraft, executive life insurance, bonus, a secular trust or restricted stock vesting
  - New or extended agreements that provide for:
    - Change in control payments exceeding three times base salary plus bonus
    - Change in control severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers)
    - Change in control payments with excise tax gross-ups (including "modified" gross-ups)

- In the absence of a say-on-pay vote, ISS may also consider if the company has recently practiced or approved "problematic pay practices," which include (in addition to those listed above):
  - Egregious employment contracts (contracts containing multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation)
  - Overly generous new-hire package for new CEO (excessive "make whole" provisions without sufficient rationale or any problematic pay practice)
  - Abnormally large bonus payouts without justifiable performance linkage or proper disclosure (includes performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance)
  - Egregious pension/supplemental executive retirement plan payouts (inclusion of additional years of service not worked that result in significant benefits provided in new arrangements or inclusion of performance-based equity or other long-term awards in the pension calculation)
  - Excessive perquisites, perquisites for former and/or retired executives (such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements) or extraordinary relocation benefits (including home buyouts)
  - Excessive severance and/or change in control provisions (change in control payment exceeding 3 times base salary, new or materially amended arrangements that provide for change-in-control payments without loss of job or substantial diminution of job duties)
  - Excessive income tax reimbursements on executive perquisites or other payments
  - Dividends or dividend equivalents paid on unvested performance shares or units
  - Internal pay disparity (excessive differential between CEO total pay and that of next highest-paid named executive officer)
  - Voluntary surrender of underwater options by executive officers (may be viewed as an indirect option repricing/exchange program especially if those cancelled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or the executives subsequently receive unscheduled grants in the future)
  - *Insufficient executive compensation disclosure by externally managed issuers (EMIs)*
  - Other pay practices deemed problematic but not covered in any of the above categories