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# Heads Up for the 2018 Proxy Season:

# ISS Proposes Changes to Proxy Voting Policies and Refines QualityScore Factors

By Lyuba Goltser and Kaitlin Descovich

ISS has released its key draft proposed proxy voting policy changes for the 2018 proxy season and is seeking comments by 5:00 p.m. EDT on November 9, 2017. ISS's proposed policy changes, questions for comment and details around how to participate in the comment process are available here. ISS's final 2018 policies are expected to be released during the second week of November, and will apply to meetings held on or after February 1, 2018.

ISS also announced changes to its QualityScore product in order to create greater comparability of core governance practices and risks across global markets. ISS increased the number of uniform global factors from 6 to 21, including 4 new factors related to independent board and key committee composition. ISS signaled that more changes are forthcoming, including rewarding companies for having a higher number and percent of women on their boards. ISS's press release is available here.

Further to the results of ISS's Policy Application Survey, which we blogged about here, ISS is proposing the following policy changes, which are discussed below.

**Proposed Changes to ISS Voting Policies for 2018 Proxy Season**

*Proposed changes for U.S. companies would:*

- Provide more specificity around factors ISS considers when evaluating gender pay gap disclosure shareholder proposals
- Result in a negative recommendation for compensation committee members when there is a pattern of excessive non-employee director compensation
- Result in negative recommendations for all board members at companies with poison pills that have not been approved by shareholders – currently 140 companies

*Proposed changes for companies incorporated in Continental Europe (including U.S- listed companies) would:*

- Tighten thresholds for general share issuance requests to 10% (from 20%) without preemptive rights and to 50% (from 100%) with preemptive rights

## ISS Specifies Criteria for Evaluation of Gender Pay Gap Disclosure Proposals – *REVISED*

Over the past three years, shareholders have increasingly submitted shareholder proposals requesting reports on company policies and goals to reduce the gender pay equity gap. ISS is proposing to add more specificity around how it will evaluate these proposals. Thus far, proponents have targeted technology, financial services, insurance, healthcare and telecommunications companies – industries in which shareholder proponents assert women are underrepresented.

ISS's current policy groups gender pay gap proposals with other social/environmental issues and provides that it will evaluate proposals on a case-by-case basis. While the proposed new policy continues to provide that gender pay equity proposals will be evaluated on a case-by-case basis, it highlights the factors that will be considered:

- The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy and fair and equitable compensation practices;
- Whether the company has been the subject of recent controversy or litigation related to gender pay gap issues; and
- Whether the company's reporting regarding gender pay gap policies or initiatives is lagging its peers.

To date, ISS has supported almost 20% of gender pay equity proposals. The analyses accompanying ISS's voting recommendations indicate that, as part of its case-by-case assessment, ISS reviews (a) whether the company lags its peers in addressing gender pay disparity, which would put the company at a competitive disadvantage, as well as (b) its compensation program and existing diversity and inclusion programs. The revised policy is expected to provide more clarity on ISS's approach as shareholder interest in this subject grows; however, ultimately is not expected to impact on ISS's voting recommendations.

None of the gender pay equity proposals that have been submitted to a shareholder vote to date have passed – although Ebay notably received support from 51% of the votes cast (a majority of the outstanding shares was required for the vote to pass). Some companies have been able to negotiate the withdrawal of these proposals by demonstrating a commitment to gender pay equity through public reports and other analysis of pay practices along gender lines. We expect that these proposals will continue to grow in number and perhaps support this season.

## ISS Targets Outliers for Patterns of Excessive Director Pay; May Lead to Negative Recommendations – *NEW*

Consistent with the results of the Policy Application Survey, ISS has recommended a change to its policy on how it evaluates Non-Employee Director ("NED") compensation. ISS's proposed policy change is focused on patterns of extreme director pay. ISS expects that there would be no impact on its recommendations for director elections in 2018 and minimal impact when ISS begins looking at trends in 2019.

The new policy would explicitly provide for adverse vote recommendations for members of the board of directors who are responsible for setting NED compensation (e.g., the compensation committee) when there is a pattern (i.e., two or more consecutive years) of "excessive NED pay magnitude" without a compelling rationale or other mitigating factors.

Although ISS does not define what amount would be "excessive," noting NED pay magnitude varies by company size and industry, it cites the trend demonstrated in the 2017 Board Practices Study, available for download here, which indicates that median NED pay at S&P 500 companies has steadily increased every year since 2012 to approximately $211,000 in 2016.

## ISS Revises Poison Pill Policy: Cites Warning to 140 Companies -- *REVISED*

ISS is proposing several policy changes to how it evaluates a company's poison pill. For companies that have adopted a long-term poison pill (greater than 1 year) that has not been approved by shareholders, ISS is proposing to adopt the following policy changes:

- ISS will now recommend against all board nominees every year, rather than once every three years, at companies with annual director elections.
- Commitments to put a long-term pill to a shareholder vote in the year following adoption would no longer be considered a mitigating factor in director voting recommendations.
- Boards with the 10-year poison pills that were grandfathered when ISS adopted related policy changes in 2009 would no longer be exempt from negative voting recommendations in director elections.
- With the proposed removal of grandfathering, ISS no longer believes there is a need to have an explicit policy regarding so called "deadhand' or "slowhand" features, which make it difficult to redeem a pill if a majority of the board does not consist of continuing directors or their nominees. ISS indicates that the five remaining publicly-traded companies that have deadhand/slowhand poison pills in effect not approved by shareholders and would be covered under the proposed policy change.

Short-term poison pills (a year or less) that have not been approved by shareholders would continue to be assessed on a case-by-case basis, but the proposed policy update would focus more closely on the rationale for the adoption of the pill, rather than on the company's governance practices and track record as is the current policy. ISS will continue its current policy for renewals or extensions of short-term pills, under which all directors will receive adverse vote recommendations.

ISS indicates that directors at about 140 companies will be impacted by the revised policy: directors at 90 companies with 10-year pills adopted or renewed in 2008 and 2009 will now receive negative recommendations, and directors at 50 companies with annually elected boards that adopted or renewed pills after 2008 will now receive negative recommendations every year, rather than every three years.

## ISS Tightens Potential Dilution Limits for General Share Issuance Requests for Companies Incorporated in Continental Europe; May Affect U.S. Listed Companies – *REVISED*

Companies incorporated in Continental European countries are required by home country rules to seek approval for any share issuance. Even if the company is subject to the same disclosure and listing standards as U.S. incorporated companies, these home country proposals may be evaluated under the local policy. As a result, ISS's proposed policy change relating to share issuances will be particularly relevant for U.S.-listed companies that are incorporated in France, Germany, Switzerland, The Netherlands and other such countries.[1]

ISS is proposing to tighten guidelines on general share issuance requests (i.e., those for which the company has not disclosed a specific purpose, but for which shareholder approval is required) in order to limit dilution of preemptive voting rights. ISS believes that in order to protect shareholders from potentially excessive dilution, best practice for authorizations is that they should be limited to a fixed number of shares or a percentage of capital at the time of issuance.

Currently, ISS generally recommends in favor of the general issuance of up to 20% of a company's share capital for shares where preemptive rights are not provided or up to 100% of a company's share capital for shares where preemptive rights are provided. Beginning in February 2019, ISS would revise potential dilution limits for general share issuance requests to 10% without preemptive rights, and to 50% with preemptive rights.

ISS's policy on specific share issuance requests (i.e. those requests with a specific disclosed purpose) would remain unchanged: they would continue to be assessed on a case-by-case basis. We note that ISS's analysis may continue to take into account whether the applicable stock exchange listing rules provide adequate safeguards when determining the acceptability of share issuance requests.

The proposed change follows the tightening of voting guidelines by many institutional investors as a growing number only support general share issuances if the maximum dilution is 10% without preemptive rights or 50% with preemptive rights. ISS notes that investors in larger European markets like the UK, France, or Germany already follow this stricter approach, and many other European investors follow this trend as well.

### What to Do Now

- Consider providing comments to ISS on the proposed policy changes before the deadline on November 9, 2017. Comments can be submitted to ISS via email to policy@issgovernance.com.
- Companies that have received a gender pay equity proposal in the past, or may expect to receive such a proposal, should consider the company's policy in that regard in order to understand how it would respond to shareholders on this issue.
- Management and the committee charged with oversight of non-employee director compensation should take a critical year-over-year review of NED compensation in relation to the company's peers (including ISS selected peers).
- Boards of directors at companies that have a poison pill in place that has not been approved by shareholders should be educated on ISS's new policy. Management and the board should consider whether to maintain the poison pill or whether shareholder approval is feasible.
- Companies that are incorporated in continental European countries should understand the limits above which ISS may take issue with requests for increasing share capital without preemptive voting rights with respect to all future share issuances.

## ENDNOTES

[1] ISS' European Policy applies to companies incorporated in the following territories: Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Cyprus, Denmark, Estonia, the Faroe Islands, Finland, France, Germany, Greece, Greenland, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, Romania, Spain, Slovakia, Slovenia, Sweden, and Switzerland.

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