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ISS Launches Annual Policy Formulation Process

Policy Survey Questions Include (1) Whether ISS Should Consider Director Records at Other Companies, (2) How ISS Should Evaluate Audit-Related Matters, (3) Whether to Adjust Reported Voting Results of Dual-Class Companies and (4) What Factors to Evaluate in Independent Chair Proposals

Yesterday, Institutional Shareholder Services (ISS) launched its global policy formulation process by posting its Annual Policy Survey. The survey is designed to gather feedback from stakeholders to give ISS guidance on where to set policy in areas that are shifting or emerging. Institutional investors, companies, corporate directors and other market constituents are all invited to respond.

As in 2017, this year's survey is being conducted in two parts. The high-level [ISS Governance Principles Survey](#) covers the following global high-profile governance topics:

- **Director Accountability and Track Records:** when evaluating a director who sits on multiple boards, whether a director's controversies on other boards are relevant and, if so, what types of shortfalls would be relevant and what an appropriate look-back period would be. ISS does not currently consider aspects of a director's tenure on other public company boards when making voting recommendations.
- **Auditor Independence and Audit Committee:** what factors (in addition to non-audit services and fees as a percentage of total fees) respondents consider important in assessing external auditor independence and what factors respondents consider important in assessing the effectiveness of a company's audit committee. Under current ISS policies, it will generally recommend against members of the audit committee if non-audit fees are excessive, the company receives an adverse opinion on its financial statements from its auditor, or the audit committee entered into an agreement with its auditor that would limit the ability of the company or shareholders to pursue legitimate legal recourse against the audit firm. ISS will vote on a case-by-case basis against members of the audit committee if poor accounting practices rise to the level of serious concern, such as fraud, misapplication of GAAP, or material weaknesses identified in Section 404 disclosures. ISS recommendations on these bases tend to have

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significant effects on voting results, with directors receiving negative recommendations on these bases gaining only 70% shareholder support on average this proxy season.

- **One-Share, One-Vote Principle:** (1) whether ISS should provide, for companies with multi-class capital structures with unequal voting rights, an analysis of shareholder vote results that has been adjusted to apply the “one-share, one-vote” principle, (2) whether ISS should use such adjusted vote results to determine the need for board responsiveness to shareholder vote results in the following year and (3) what time frame respondents consider appropriate for sunset provisions on unequal voting rights. In last year’s survey, ISS asked whether unequal voting rights were appropriate for public companies, with a majority of investors responding that unequal voting rights can be appropriate in some circumstances and half of non-investors responding that companies should be able to choose whatever capital structure they see fit. Between 2017 and 2018, major stock index compilers, such as the S&P Dow Jones Indices and FTSE Russell, have made policy changes that impact the eligibility of dual class companies for inclusion on their indices, and policy-makers also have issued several high-profile statements on the potential harms of dual class companies and the possibility of further regulatory scrutiny.
- **Gender Diversity on Boards:** whether it is problematic if there are zero female directors on a public company board and what actions may be appropriate for shareholders to take regarding a company whose board lacks gender diversity. These are the same questions from last year’s survey regarding gender diversity on boards, where 69 percent of respondents found that the absence of female directors on a public company board would be problematic, 43 percent of respondents found that such an absence could indicate problems in the board recruitment process and 26 percent of respondents found their concerns may be mitigated if there is a disclosed policy that describes the considerations taken into account by the board or the nominating committee to increase the board’s gender diversity. ISS is seeking to identify whether respondents’ views on these issues have changed.

This first part of the survey (the Governance Principles Survey) will close on **August 24, 2018, at 5:00 pm ET.**

The second part of the survey, which can be accessed at the end of the Governance Principles Survey and contains more expansive and detailed questions concerning specific voting issues broken down by region, is the ISS Policy Application Survey. The [Policy Application Survey for the Americas](#) covers the following topics relevant to U.S. issuers:

- **An Independent Chair Requirement:** ISS is currently reevaluating certain factors it considers in determining whether to recommend support for an independent chair proposal. The survey asks respondents to rank the relative significance of various factors when evaluating such a proposal. These proposals tend to receive significant shareholder support (generally 25% to 40%), but rarely pass. Only a handful each year managed to win majority support between 2012 and 2015, and none have passed since. Notwithstanding this background, ISS recommended in favor of about three-quarters of these proposals in 2017.
- **Minimum Stock Ownership Requirements for Bylaw Amendments:** The Securities and Exchange Commission’s shareholder proposal rule (Rule 14a-8) allows holders of \$2,000 of a company’s stock to file shareholder proposals. The survey asks whether respondents support companies setting a minimum stock ownership requirement in excess of the SEC’s minimum for shareholders to propose binding amendments to corporate bylaws and, if so, what an appropriate minimum ownership threshold should be and whether multiple shareholders should be able to aggregate their stock ownership to meet this threshold.
- **Quantitative Pay-for-Performance Screens:** ISS’ pay-for-performance quantitative screen (“P4P screen”) measures the alignment between CEO pay and company performance using both Total Shareholder Return and certain financial measures based on GAAP-reported data. ISS is

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considering supplementing or replacing the GAAP metrics with Economic Value Added (“EVA”)-based metrics to measure corporate economic performance in the Financial Performance Assessment portion of the P4P screen. ISS describes EVA as “a framework that applies a series of uniform, rules-based adjustments to financial statement accounting data, and aims to measure true underlying economic profit and capital productivity”. The survey asks whether respondents would support the use of EVA in the P4P screen or prefer to maintain the current GAAP-based framework.

- ***Non-Employee Director Pay:*** In response to last year’s survey results in which respondents favored addressing high or outlier compensation paid to non-executive directors, ISS began to identify non-employee director outliers in 2018, and in 2019 will begin to recommend against compensation committees where elevated pay persists over multiple years without compelling justification. This year’s survey asks for respondents’ views on what constitutes reasonable justifications for multiple consecutive years of outlier director pay.
- ***Board Qualifications Matrix:*** The New York City Pension Funds’ Boardroom Accountability Project 2.0 advocated for a director matrix to help shareholders assess an individual director’s skills and attributes. The survey asks about the level of disclosure regarding directors (such as a matrix, cumulative information, or short director biographies) that respondents consider most useful to shareholders.

ISS has also launched Policy Application Surveys specific to the [Asia-Pacific region](#) and [Europe, the Middle East and Africa](#). These Policy Application Surveys will close on **September 21, 2018, at 5:00 pm ET**.

More generally, for a discussion of the 2018 U.S. annual meeting proxy season, including Rule 14a-8 shareholder proposals and our analysis of ISS negative recommendations against directors, see our publication, dated July 12, 2018, entitled “[2018 Proxy Season Review](#)”.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohenad@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Heather L. Coleman	+1-212-558-4600	colemanh@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelms@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Matthew M. Friestedt	+1-212-558-3370	friestedtm@sullcrom.com
Joseph B. Frumkin	+1-212-558-4101	frumkinj@sullcrom.com
David B. Harms	+1-212-558-3882	harmsd@sullcrom.com
Alexandra D. Korry	+1-212-558-4370	korrya@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com

SULLIVAN & CROMWELL LLP

Melissa Sawyer	+1-212-558-4243	sawyer@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@sullcrom.com

Washington, D.C.

Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@sullcrom.com
Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Richard C. Morrissey	+1-202-956-7565	morriseyr@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com

Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

Palo Alto

Scott D. Miller	+1-650-461-5620	milleresc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

London

Nikolaos G. Andronikos	+44-20-7959-8470	andronikosn@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com

Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
----------------------	-----------------	--

Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
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Melbourne

Robert Chu	+61-3-9635-1506	chur@sullcrom.com
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Sydney

Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
--------------------	-----------------	--

Tokyo

Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com

SULLIVAN & CROMWELL LLP

Hong Kong

Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
