September 21, 2018

ISS Publishes 2018 Governance Principles Survey Results

Results Include Support for ISS to Consider Director Controversies on Other Company Boards and Provide Adjusted Voting Results for Dual-Class Companies

On September 18, 2018, Institutional Shareholder Services (ISS) released the results of the first half of its Annual Policy Survey. The Annual Policy Survey is designed to gather feedback from stakeholders, including institutional investors, companies, corporate directors and other market constituents, to provide ISS guidance on where to set policy in emerging or shifting corporate governance and compensation areas.

As in 2017, this year's survey has been conducted in two parts. The recently released results are from the high-level ISS Governance Principles Survey. The results for the second part of the survey, the ISS Policy Application Survey, containing more detailed questions on specific voting issues that are broken down by region, are still forthcoming.

In total, ISS received 669 responses to this year's Governance Principles Survey, including 111 investor respondents and 558 non-investor respondents (consisting mostly of responses from companies and a smaller number of directors and consultants). The survey topics and key findings are summarized below:

- **Director Accountability and Track Records**

  Survey Topic: Whether ISS should, when it evaluates a director who sits on other company boards, consider the director's controversies on such other boards and, if so, what types of shortfalls should be relevant and what would an appropriate look-back period be. ISS does not currently consider aspects of a director's tenure on other public company boards when making voting recommendations.

Survey Results: A significant majority (84 percent) of investor respondents answered that they would consider it useful for ISS to incorporate in its proxy research any oversight shortfalls by a director at other boards on which he or she serves. Non-investor respondents were evenly split, with 41 percent responding that considering such controversies on other boards would be useful, 40 percent responding it would not, and 20 percent responding that it would depend upon the nature of the controversy.

As a follow up question, the survey asked respondents to select the types of controversies that would be most relevant. Both investor and non-investor respondents showed the most support for risk oversight failures relating to fraud or other forms of corporate malfeasance, as well as for oversight failures related to protection of shareholder rights or shareholder value.

The survey also asked respondents what they would consider an appropriate look-back period. A significant portion of investor respondents favored a longer timeframe, with 39 percent choosing no time limit and 30 percent choosing five years, while non-investor respondents favored a shorter timeframe, with 44 percent choosing three years and 22 percent choosing five years.

- **Gender Diversity on Boards**

  Survey Topic: 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. Last year's survey had the same topic, and ISS was seeking to identify whether respondents' views on these issues have changed.

  Survey Results: Compared to last year, both investors and non-investors responded at higher percentages that a lack of gender diversity would indicate a problem. More than 80 percent of investors responded it would be problematic, up from 69 percent in 2017, and more than 60 percent of non-investors responded it would be problematic, up from 54 percent in 2017.

  Of the respondents who indicated that the lack of female directors is or could be problematic, the top three potential responses were (1) engagement with the board or management, (2) consider supporting a shareholder proposal aimed at increasing diversity and (3) consider voting against the chair of the nominating and governance committee. These were similar responses to last year.

- **One-Share, One-Vote Principle for Dual-Class Companies**

  Survey Topic: For companies with multi-class capital structures with unequal voting rights, (1) whether ISS should provide 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.

  Survey Results: A significant majority of respondents favored receiving information showing what the vote results would have been if all votes were counted equally, with 92 percent of investors and 59 percent of non-investors responding in favor.

  Regarding whether ISS should use such adjusted vote results to determine the need for board responsiveness to shareholder vote results in the following year, 72 percent of investors were in favor while only 42 percent of non-investors were.

  When asked about the appropriate timeframe for sunset provisions on unequal voting rights structures, 46 percent of both investors and non-investors picked either "one to three years" or "four to six years" as their responses. A significant portion of respondents replied instead that the timeframe depended on the situation, such as the level of involvement of the family or original founders, the share structure and difference in voting rights, the maturity of the company, the industry, company size and corporate governance practices.

- **Auditor Independence and Audit Committee**

  Survey Topic: What factors (in addition to non-audit services and fees as a percentage of total fees) could be considered in assessing external auditor independence and performance and what factors do respondents consider important in assessing the effectiveness of a company's audit committee.

  Survey Results: The top responses for what factors to consider in evaluating external auditor independence and performance were (1) regulatory fines or other penalties on the auditor for weaknesses or errors in audit practices (ranked most important for investor respondents and third most important for non-investors), (2) significant audit controversies (ranked second for investors and fourth for non-investors), (3) the identity of the audit partner and any links he or she has to the company or its management (ranked third for investors and first for non-investors) and (4) regulatory fines or other penalties related to financial disclosure practices or weaknesses not identified in the audit report (ranked fourth for investors and second for non-investors).

  The top responses for what factors to consider in assessing the effectiveness of a company's audit committee were (1) skills and experience of audit committee members (ranked most important for both investor and non-investor respondents), (2) significant financial reporting or audit controversies (ranked second for investors and third for non-investors) and (3) quality of the company's financial reporting, such as the number and nature of restatements (ranked third for investors and second for non-investors).

For a summary of the topics that will be covered in the forthcoming results to the ISS Policy Application Survey, see our previous publication, dated July 31, 2018, entitled "ISS Launches Annual Policy Formulation Process". More generally, for a review of the results of the 2018 U.S. annual meeting proxy season, including our analysis of ISS negative recommendations against directors and Rule 14a-8 shareholder proposals, see our publication, dated July 12, 2018, entitled "2018 Proxy Season Review".

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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	cohena@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	eitelm@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
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
Richard A. Pollack	+1-212-558-3497	pollackr@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Melissa Sawyer	+1-212-558-4243	sawyerm@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
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	millersc@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 Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Richard A. Pollack	+44-20-7959-8404	pollackr@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Melbourne		
Robert Chu	+61-3-9635-1506	chur@sullcrom.com
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
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