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ISS Proposes 2015 Policy Updates

No Proposal on Unilateral Bylaw Amendments; U.S. Policy Changes Would Introduce Uncertainty for Independent Chair Shareholder Proposals and Implement a Scorecard for Equity Plan Proposals

SUMMARY

Yesterday, Institutional Shareholder Services, the proxy advisory firm, published proposed changes to its proxy voting guidelines for the 2015 proxy season. The proposals applicable to U.S. companies are limited and do not include any proposed change relating to unilateral bylaw amendments. ISS had recently surveyed institutional investors and public companies and reported receiving strong responses from investors against boards that unilaterally adopt bylaw amendments that reduce shareholder rights.

As U.S. issuers plan for the 2015 proxy season, they should take into account the proposed changes to ISS's voting policies on independent chair and equity plan proposals. Comments on the proposed changes are due by October 29, 2014.

ISS 2015 PROPOSED POLICY UPDATES

For U.S. issuers, the 2015 proposals would modify the corporate governance criteria that guide recommendations on shareholder proposals to separate the CEO and chair roles and would introduce a "more nuanced" scorecard for assessing equity plan proposals.

Independent Chair Shareholder Proposals

Currently ISS supports shareholder proposals to separate the CEO and chair roles unless six specific criteria are all satisfied, including the presence of a lead independent director with specified authority and other governance and performance criteria. ISS is proposing to modify this policy to provide for a more "holistic review" of relevant factors, such that any single factor that may have previously resulted in a "for"

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or “against” recommendation may be mitigated by other positive or negative factors, and to add the following new factors that are to be considered:

- the absence/presence of an executive chair;
- recent board and executive leadership transitions;
- director/CEO tenure; and
- a five-year total shareholder return (or TSR) period (increased from three years).

The proposal will result in more uncertainty with respect to independent chair proposals, and ISS notes that, in backtesting, the new methodology resulted in a higher level of support for such shareholder proposals.¹

Equity Plan Scorecard

The second proposed change for U.S. issuers relates to equity plan proposals. As a substitute for ISS’s current approach in determining when an equity incentive plan proposal warrants an “against” recommendation, ISS proposes to implement an “Equity Plan Scorecard.” This Scorecard will consider a range of factors under three main categories—cost, plan features, and grant practices, as follows:

- Shareholder Value Transfer relative to industry/market capitalization peers under a dual cost measurement approach
- equity plan features such as minimum vesting periods, discretionary vesting authority, share recycling and single trigger change-in-control
- historical grant practices

The factors will be weighted based on company size and status, with companies keyed to one of the following: the S&P 500, Russell 3000 (excluding S&P 500), Non-Russell 3000, or Recent IPO/Bankruptcy Emergent companies. Although ISS will generally continue to consider a range of factors in evaluating equity plan proposals, some equity plan features, such as the authority to reprice options without shareholder approval and excessive equity grants, will automatically trigger “against” recommendations.

Importantly, a company’s burn rate would be considered as part of the Scorecard evaluation and would be measured against the company’s respective group. As a result, this would eliminate the potential for burn rate commitments to mitigate historic grant levels.

The proposed policy is not designed to increase or decrease the number of proposals that would receive adverse vote recommendations although ISS notes that, in the current environment, investors may be

¹ As discussed in our firm’s 2014 Proxy Season Review, ISS’s recommendation on these proposals appears to have a significant impact on the voting results, though ultimately relatively few of these proposals tend to receive majority support. Our 2014 Proxy Season Review, dated June 25, 2014, is available at <http://www.sullcrom.com/2014-proxy-season-review>.

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more critical of equity transfers to management, particularly in the absence of shareholder-friendly plan features and grant practices

Comment Deadline

Comments on the proposed changes are due by October 29, 2014. The proposals are available at <http://www.issgovernance.com/policy-gateway/2015-benchmark-policy-consultation/>, as are instructions for providing comments.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Robert Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Jay Clayton	+1-212-558-3445	claytonwj@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohen@suillcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@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
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
James C. Morphy	+1-212-558-3988	morphyj@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com

SULLIVAN & CROMWELL LLP

Washington, D.C.

Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@sullcrom.com
Eric J. Kadel Jr.	+1-202-956-7640	kadelj@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

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
Richard C. Morrissey	+44-20-7959-8520	morriseyr@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
George H. White III	+44-20-7959-8570	whiteg@sullcrom.com

Paris

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

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
David Rockwell	+49-69-4272-5533	rockwelld@sullcrom.com

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
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Tokyo

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

Hong Kong

William Y. Chua	+852-2826-8632	chuaw@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
John D. Young Jr.	+852-2826-8668	youngj@sullcrom.com

Beijing

Garth W. Bray	+86-10-5923-5958	brayg@sullcrom.com
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