

October 26, 2015

## ISS Proposes 2016 Policy Updates

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### **No Proposal on Proxy Access or Responsiveness; U.S. Policy Changes Would Lower the Acceptable Number of Board Positions Held by a Director, Provide for Ongoing Negative Director Recommendations After Certain Unilateral Governance Changes, and Heighten Compensation Disclosure Requirements for Externally-Managed Issuers**

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#### **SUMMARY**

Today, Institutional Shareholder Services, the proxy advisory firm, published proposed draft policy changes for the 2016 proxy season. The proposals applicable to U.S. companies include a reduction in the acceptable number of total board seats held by directors (with a one-year grace period for implementation), an updated policy regarding negative director recommendations following unilateral action to classify the board or introduce supermajority voting provisions (or following an IPO of a company with such provisions), and a recommendation against say-on-pay proposals for externally-managed issuers (EMIs) who fail to provide the disclosure necessary to allow a comprehensive assessment of pay-for-performance. There were no published proposals relating to proxy access or board responsiveness.

As U.S. issuers plan for the 2016 proxy season, they should take into account these proposed changes. Comments on the proposed changes are due by November 9, 2015, with the final policy changes expected to be released on November 18.

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#### **ISS 2016 PROPOSED POLICY UPDATES**

For U.S. issuers, the 2016 proposals are as follows:

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### Director Overboarding

The first proposal relates to overboarding – that is, ISS concerns with directors who sit on an excessive number of boards. In the ISS 2015 Policy survey, investors, companies, and other market participants were queried regarding their views on acceptable limits for the total number of board seats held by U.S. company directors. Based on the feedback received, ISS proposes to lower the acceptable number of board positions as follows:

- For directors who are public company CEOs, a limit of one other public company directorship (down from two in the current policy) besides their own, with the negative recommendation being made at the outside board only.
- For other directors, ISS is considering lowering the acceptable number of total public boards from the current six (the board under consideration plus five others) to either five (the board under consideration plus four others) or four (the board under consideration plus three others), and solicits feedback on which is more appropriate.

It is important to note that there would be a proposed one-year grace period until 2017 for both changes. In 2016, ISS would include cautionary language in their research reports but would not issue a negative vote recommendation solely because a director was overboarded under the revised policy.

### Unilateral or Pre-IPO Action to Classify the Board or Introduce Supermajority Voting Requirements

The second proposal relates to unilateral charter or bylaw amendments, or amendments in connection with an IPO that aim to classify the board or establish supermajority voting requirements.

In particular, ISS proposes to:

- Generally issue adverse vote recommendations for director nominees if the board unilaterally amends the company bylaws or charter to either classify the board or establish supermajority vote requirements in any period after the completion of a company's initial public offering. These recommendations will continue until the unilateral action is either reversed or ratified by a shareholder vote. Note that in most states, including Delaware, classifying the board and adding a supermajority provision for a charter amendment could not be done without shareholder approval anyway.
- Generally issue adverse vote recommendations for director nominees at subsequent annual meetings following completion of the IPO if a board amends the bylaws or charter prior to or in connection with the IPO to classify the board or establish supermajority vote requirements to amend the bylaws or charter.

The proposal will not affect the way ISS evaluates and determines initial vote recommendations on directors with respect to unilateral bylaw and charter amendments. The proposal solicits comments on whether there are other types of unilateral board actions that materially impair shareholder rights, such that they should be included in this policy.

### Compensation at Externally-Managed Issuers

Externally-managed issuers (EMIs) are companies that do not directly compensate their executives, leaving compensation to an external manager who is reimbursed by the EMI through a management fee. ISS's proposal raises the concern that EMIs typically do not disclose their compensation arrangements

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and payments in sufficient detail, making it impossible for shareholders to assess pay programs and how they connect to company performance. Additionally, ISS is concerned with potential conflicts of interest in the compensation arrangements and aims to increase transparency surrounding executive compensation arrangements.

The proposal updates ISS's pay-for-performance analysis policy with respect to EMIs, and provides that it will recommend against say-on-pay proposals (or compensation committee members, the compensation committee chair, or the entire board, as appropriate, in the absence of a say-on-pay proposal on ballot) for EMIs with insufficient disclosure. Disclosure will be considered insufficient if comprehensive pay analysis is impossible with the information given about compensation practices and payments.

ISS states that most of the externally-managed issuers in the U.S. would have received an "Against" recommendation under the revised policy.

### **Comment Deadline**

Comments on the proposed changes are due by November 9, 2015. The proposals are available at <http://www.issgovernance.com/policy-gateway/2016-benchmark-policy-consultation/>, as are instructions for providing comments.

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