Securities Alert: ISS Issues 2018 Proxy Voting Guidelines Updates

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On November 16, 2017, Institutional Shareholder Services Inc. (ISS) released updates to its proxy voting guidelines for 2018 (2018 Updates). The 2018 Updates are effective for shareholder meetings on or after February 1, 2018. This alert summarizes the highlights of the 2018 Updates.

Poison Pills

Under the 2018 Updates, ISS will recommend a vote against/withhold from all director nominees if the company has a "long-term pill" (*i.e.*, a poison pill with a term longer than 12 months) that was not approved by the shareholders. ISS will now issue this recommendation every year for annually elected boards instead of only once every three years as was the case under the previous guidance. This policy will apply to companies that have existing non-shareholder approved long-term pills that were grandfathered from receiving against/withhold recommendations under the previous guidance.

However, if the board adopts a "short-term pill" (*i.e.*, a poison pill with a term of one year or less) without a shareholder vote, ISS will conduct a case-by-case analysis with special emphasis on the board's disclosed rationale for adopting the plan without a shareholder vote. Under the previous guidance, ISS also considered the company's governance structure and practices and track record of accountability to shareholders. ISS acknowledged that a commitment by the board to put the short-term pill to a shareholder vote in the event of its extension or renewal would provide reassurance to investors that their interests are being considered.

Excessive Non-Employee Director Compensation

ISS will generally recommend a vote against/withhold from the members of the board committee responsible for determining non-employee director compensation if there is a pattern (*i.e.*, two or more years) of the committee awarding excessive compensation to the company's non-employee directors without disclosing a compelling rationale or other mitigating factors. This new policy will not impact

vote recommendation in 2018 as it will only be triggered after excessive non-employee director compensation is identified in consecutive years. The ISS guidance suggests that it will identify excessive non-employee compensation by reference to peers and the broader market.

Problematic Pledging of Company Stock by Executives and Directors

ISS will recommend a vote against/withhold from the board committee responsible for the oversight of pledging of stock, or the full board, where a significant level of pledged stock by executives or directors raises concerns. ISS will consider the following factors in making its recommendation:

- the presence of an anti-pledging policy, disclosed in the proxy statement, that prohibits future pledging activity;
- the magnitude of aggregate pledged shares in terms of total common shares outstanding, market value, and trading volume;
- disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
- disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- any other relevant factors.

ISS has been recommending against the committee responsible for risk oversight since 2013 for a significant level of pledging of company stock and this update is intended to establish an explicit policy on the issue.

Lack of Say-On-Pay Ballot Items

ISS will recommend a vote against/withhold from the compensation committee if the company does not include a “say-on-pay” ballot item or a “say-on-pay frequency” ballot item when required by SEC rules. ISS will not issue an adverse vote recommendation if a company failed to timely present a “say-on-pay frequency” proposal but maintained an annual frequency.

Shareholder Proposals on Gender Pay Gap

ISS implemented a new policy governing shareholder proposals seeking company reports on a company’s pay data by gender, or a report on a company’s policies and goals to reduce any gender pay gap. ISS reported that shareholders have been requesting such reports for the past three years and have sought information as to any specific measures being taken to eliminate any gender pay gap. ISS will make a case-by-case recommendation on such shareholder requests and will consider:

- 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, litigation, or regulatory actions related to gender pay gap issues; and
- whether the company’s reporting regarding gender pay gap policies or initiatives is lagging its peers.

Board Responsiveness to Say-on-Pay

The 2018 Updates revise the factors that ISS will take into account when assessing a company's response to a "say-on-pay" proposal that received less than 70% support of votes cast to include:

- disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support (including the timing and frequency of engagements and whether independent directors participated);
- disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition;
- disclosure of specific and meaningful actions taken to address shareholders' concerns; and
- other recent compensation actions taken by the company.

Pay-for-Performance Evaluation

The 2018 Updates incorporate the Relative Financial Performance Assessment into the quantitative pay-for-performance evaluation methodology for companies in the Russell 3000 and Russell 3000E indices. The Relative Financial Performance Assessment compares the company's rankings to a peer group with respect to (1) CEO pay and (2) financial performance in three or four metrics (which will vary depending on industry), in each case as measured over three years. ISS will provide specific details around the mechanics of the updated quantitative screening methodology in an updated white paper. The 2018 Updates also clarify that a measurement period of one year applies to the CEO pay multiple assessment.

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