November 2019

ISS Opens Peer Group Submission Window and Finalizes 2020 Policy Guideline Updates

Issuers can submit their peer groups to ISS for consideration until December 6. Peer group selection influences the firm's pay-for-performance analysis for purposes of the say-on-pay vote.

Institutional Shareholder Services (ISS) has opened its annual peer submission window until December 6, 2019. This applies to companies with annual meetings between February 1 and September 15, 2020, or through January 31, 2020, for European companies.

The peer submission process allows public companies to submit their current or updated peer groups to ISS (used for 2019 pay decisions), prior to their disclosure in the proxy statement. The intent is that ISS will take into account the company's own peer selection in developing ISS' influential pay-for-performance peer group.

When companies submit their own peer group it does not guarantee they will be included in ISS' peer group. However, submission of proxy peers can lead to at least some of the peers being included in the final ISS peer group. This can be especially important if a company has had a significant change in market cap (or assets, for financial firms) in the past year or significantly changed their peer group.

ISS Finalizes 2020 Policy Voting Updates

Separately, ISS has finalized its policy voting guidelines for 2020 for U.S.-based companies; the final guidelines mostly followed the firm's draft guidelines we covered in this article. Final policy voting updates are as follows:

- **Pay-for-Performance Evaluation** – ISS has confirmed enhancements to its quantitative pay-for-performance methodology by incorporating the use of Economic Value Added (EVA) metrics in the model's secondary Financial Performance Assessment (FPA) screen. If a company receives a "cautionary low" or "medium" score on its primary quantitative pay-for-performance screen (which is currently unchanged), ISS' assessment of the company's EVA metrics will determine if a qualitative review of compensation is triggered. This was an expected development, as ISS already displays EVA metrics in their research reports.

- **Dual Class Companies** – ISS policy already considers dual class capital structures with unequal voting rights to be problematic and can result in negative voting recommendations against newly public companies unless the company commits to sunsetting the provision. However, in the past, ISS has been unclear on what it would consider acceptable sunsetting. A sunset period of *no more than* seven years from the date of the IPO will be considered to be reasonable under this updated policy. In evaluating a

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dual class structure that sunsets in no more than seven years, ISS will also consider the company's justification for its timeline as well as the company's lifespan, its post-IPO ownership structure and whether there are any other governance provisions ISS disfavors, such as staggered board or a poison pill.

- **Board Diversity** – ISS will recommend against the chair of the nominating committee (or other directors as appropriate) if the board lacks a female director unless there are mitigating factors. Additionally, having board gender diversity the previous year but not in the current year will not alone prevent an against recommendation. In such cases, the company will need to acknowledge the current lack of a gender-diverse board and provide a firm commitment to re-achieving board gender diversity by the following year. Mitigating factors include:
    - A firm commitment in the proxy statement to appoint at least one woman to the board within a year;
    - The presence of a woman on the board at the preceding annual meeting and a firm commitment to appoint at least one woman to the board within a year; or
    - Other relevant factors as applicable.

- **Independent Board Chair Shareholder Proposals** – In considering shareholder proposals to require an independent board chair, ISS has now added the following to the list of its considerations as to whether to recommend in favor of such a shareholder proposal-- whether the subject company has:
    - A majority non-independent board or non-independent directors on key board committees;
    - A weak or poorly-defined lead independent director role (ISS will likely review the responsibilities of the lead director for evidence that the role has executory powers, including the ability to call meetings and set or approve agendas);
    - An executive or non-independent chair in addition to the CEO;
    - A recent departure from a structure with an independent chair;
    - Failed to oversee and address material risks facing the company (ISS will likely look for evidence of controversies of the type that might land companies in the news, which introduces a high amount of subjectivity as to what news is "material");
    - A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights; or
    - Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

- **Share Repurchase Programs** – For U.S. companies (and foreign-incorporated U.S. domestic issuers) that request shareholder approval to initiate share buyback programs, ISS has adopted a policy that would approve such programs provided that the following factors are not present. In the absence of these abusive practices, ISS will generally support a grant of authority to the board to engage in a buyback, subject to the following considerations:
    - The use of targeted share buybacks as greenmail or to reward company insiders by purchasing their shares at a price higher than they could receive in an open market sale;
    - The use of buybacks to boost EPS or other compensation metrics to increase payouts to executives or other insiders; and
    - Repurchases that threaten a company's long-term viability (or a bank's capitalization level).

- **Equity Plans (Evergreen Provisions)** – ISS is adding automatic replenishment features (evergreen provisions) to its list of "overriding factors" to their U.S. Equity Plan Scorecard analysis that will generally lead to a vote against the proposal. This is a minor change, as plans with evergreen provisions have rarely gained ISS support in the past.

- **Diversity (Gender Pay Gap)** – ISS is adding “race or ethnicity” to better align with the types of shareholder proposals getting filed that are seeking a report on a company’s pay data by gender, race or ethnicity.

Next Steps

As in previous years, ISS expects to issue further clarification and other resources in advance of when the updates go into effective on February 1, 2020. Key milestones in early to mid-December include:

- White paper on ISS pay-for-performance methodology (including the addition of Economic Value Added or EVA into its Financial Performance Assessment) for the U.S. and Canadian markets
- Publication of updated FAQs (ISS released *preliminary* FAQs this month, available here, which we will further comment on when they are final)

Clients can contact us to can submit peers to ISS on their behalf. If you have any questions about these developments, please reach out to one of the authors or write to rewards-solutions@aon.com.

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