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ISS Releases Draft Policy Updates for 2020; Executive Compensation is Notably Absent

ISS is proposing changes to its U.S. policies on problematic governance structures, independent board chair proposals and share buybacks. Here's a summary of potential implications.

ISS has released proposed voting policy changes for the 2020 proxy season. In contrast to previous years, the draft policy updates applicable to U.S. companies do not address compensation-related policies nor certain topics included in the 2019 ISS policy survey circulated in July — specifically director overboarding, gender diversity and climate risks. There was also no mention of the potential use of Economic Value Added (EVA) metrics as the pay for performance secondary quantitative filter for companies with elevated scoring or borderline "cautionary low" or "medium" scoring to replace Generally Accepted Accounting Principles (GAAP) financial metrics. However, these topics may be included when the final policy update is released in the first half of November. The final policy updates will also include previously announced changes regarding board gender diversity and excessive non-employee director compensation.

Key proposed policy updates are summarized below.

Problematic Governance Structure for Newly Public Companies

ISS clarified its policy by creating two distinct polices for newly public companies: 1) problematic governance structure and 2) problematic capital structure.

Problematic Governance Structure: ISS will continue to oppose all nominee directors (except new nominees) if, prior to a company's IPO, the company's adopted charter or bylaw provisions are materially adverse to shareholder rights. The updated policy now explicitly lists the following materially adverse factors:

- Supermajority vote requirements to amend the bylaws or charter;
- A classified board structure; or
- Other egregious provisions.

Problematic Capital Structure*:* ISS moved this issue into a separate policy and will continue to oppose the re-election of the entire board if the company has implemented a multi-class capital structure where the classes have unequal voting rights without making it subject to a reasonable time-based sunset provision. A sunset period

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of more than seven years will not be considered reasonable. Based on the survey results ISS released in September, 55% of investors consider a seven-year sunset provision as appropriate. Consistent with the previous policy, ISS will continue to recommend against directors in subsequent years unless these problematic features are removed.

Impact of Proposed Policy: This updated policy formalizes the approach and views of ISS and many institutional investors — which is an opposition to unlimited multiclass structures, classified boards and supermajority provisions. It offers a way for companies to obtain ISS support for directors by avoiding or sunsetting these types of provisions. We do not expect the proposed policy update to result in a significant change to the percentage of negative vote recommendations ISS issues for director reelections.

Share Buybacks

ISS currently supports management proposals for share repurchases if all shareholders may participate on equal terms. The updated policy would recommend votes against the buybacks if ISS believes that there is:

- Greenmail;
- A plan to use the buyback to inappropriately manipulate incentive compensation metrics;
- A threat to the company's long-term viability; or
- Other company-specific factors as warranted.

ISS also updated the policy to make voting recommendations on a case-by-case basis for proposals that seek to repurchase shares from specific insiders.

Impact of Proposed Policy: ISS rarely makes adverse recommendations on share buyback proposals, and this proposed policy update would codify existing practice. Shareholders also generally support buybacks.

Independent Board Chair Shareholder Proposals

ISS' current policy generally recommends supporting shareholder proposals requesting the split of the chair and CEO roles. The proposed policy update lists specific factors that would increase the likelihood of ISS supporting these recommendations, including:

- A weak or poorly defined lead independent director role;
- The presence of an executive or non-independent chair in addition to the CEO or recent changes in the structure;
- Evidence that the board has failed to oversee and address material risks facing the company,
- A material governance failure (failure to address shareholder concern or material diminution of shareholder rights); or
- Evidence that the board has failed to intervene when management's interests are contrary to shareholder interests.

Impact of Proposed Policy: ISS usually takes a holistic approach and supports shareholder proposals seeking an independent board chair, but these proposals typically do not receive significant vote support from investors. The proposed update indicates factors that will weigh more heavily in ISS' evaluation of these proposals.

Next Steps

ISS requests feedback on its proposed policy updates. Interested parties may submit comments until Oct. 18, 2019. In recent years, participant feedback has not seemed to have a significant influence on final policy updates. ISS has indicated that it will release its final policy updates in the first half of November. In past years, ISS has announced other policy changes that were not circulated for review, and it would not be unexpected for that to happen again this year.

If you have any questions about these policy updates or want to speak to a member of our consulting team about related compensation and governance issues, please write to rewards-solutions@aon.com.

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