

October 26, 2017

## ISS 2018 Benchmark Policy Consultation

On October 26, 2017, Institutional Shareholder Services Inc. (“ISS”) released its 2018 Benchmark Policy Consultation requesting feedback from interested market constituents on new or potential changes to their voting policies. Comments are **due by 5pm ET on November 9, 2017** and will be taken into consideration as ISS formulates updates to its voting policies **to be applied for shareholder meetings taking place on or after February 1, 2018**. ISS anticipates that the final benchmark voting guidelines will be released in the second half of November. It is our experience that there may be other significant policy changes that are adopted in ISS’ final benchmark guidelines without consultation. Kingsdale will continue to monitor the situation and provide any updates as necessary.

For the U.S. market, ISS is currently proposing three changes-- two related to director elections and one related to gender pay gap shareholder proposals: (i) adverse vote recommendation on directors responsible for excessive non-employee director pay; (ii) adverse vote recommendation on directors every year at companies with poison pills not approved by shareholders; and (iii) a case-by-case approach with more clarity on gender pay gap shareholder proposals.

### Non-Employee Director (NED) Compensation

ISS’ current benchmark guidelines only broadly address NED compensation by stating that companies should avoid inappropriate pay for NEDs.

The proposed policy would explicitly provide for adverse vote recommendations for board committee members who are responsible for approving/setting NED compensation when there is a pattern (i.e. two or more consecutive years) of excessive NED pay magnitude without a compelling rationale or other mitigating factors.

ISS is currently soliciting feedback on the circumstances for which large NED pay would still merit support on an exceptional basis. They are also looking for input on circumstances where it is not clear which board committee is responsible for setting NED pay, and whether NED board chairs, lead directors or other directors who received outsized pay should be excluded in calculating average/median pay.

**Kingsdale Insight:** Investors have shown a growing interest in NED pay as the magnitude has steadily increased. The proposed ISS policy is still vague on what is considered “excessive” NED pay and only results in adverse recommendations when there is a pattern over multiple years. Consequently, there would be no impact on vote recommendations in 2018. Based on the feedback ISS is seeking, it appears that ISS may screen outliers using average/median NED pay. Accordingly, issuers should self-assess.

## Director Elections – Poison Pills

ISS' current policy on director elections where the company adopted or renewed a pill that was not approved by shareholders has several focuses:

- If the pill has a “deadhand” or “slowhand” feature: These features make it difficult to redeem a pill if a majority of the board does not consist of continuing directors or their nominees. Once quite common, ISS is now only tracking five such pills among publicly-traded companies. ISS recommends in these cases against the full slate of directors every year;
- For long-term pills (term >1 year): Adverse recommendations depend on whether the board is annually-elected or classified. ISS recommends against all nominees every year if the board is classified, but, if the board is annually elected, only once every 3 years. Companies who had newly adopted a pill could be exempt from adverse vote recommendations by making a commitment to put the pill to a binding shareholder vote at the next year's AGM;
- The policy above was put into place Nov 19, 2009. Boards that adopted pills prior to that date were grandfathered from the policy and do not receive adverse vote recommendations; and
- Lastly, the adoption (not the renewal) of a short-term pill is considered on a case-by-case basis and generally does not cause an against recommendation on the board if there was a compelling rationale for its adoption and the company has a generally good governance track record.

ISS is proposing to update the policies outlined above, and recommend against all board nominees, every year, at companies who maintain a long-term poison pill that has not been approved by shareholders. Therefore, annually-elected boards would receive adverse recommendations on an annual basis, rather than every 3 years. Commitments to put a long-term pill to a vote the following year would no longer be considered a mitigating factor. The boards with the 10-year pills currently grandfathered from 2009 would no longer be exempt and would receive against recommendations. With the proposed removal of grandfathering, there will also be no need to have an explicit policy regarding deadhand or slowhand features, as the few remaining deadhand/slowhand pills are not approved by shareholders and would be covered under the proposed policy.

Short-term pill adoptions would continue to be assessed on a case-by-case basis, but the proposed policy update would focus more on the rationale for their adoption than on the company's governance and track record. Renewals or extensions though, as with the current policy, will not receive the case-by-case assessment.

**Kingsdale Insight:** As most US companies do not have an active pill, the impact of the above policy update may not be seen as significant as, according to ISS, about only 140 companies will be affected (about 90 companies with 10-year pills adopted or renewed in 2008 and 2009 and about 50 companies with annually elected boards who adopted/renewed pills since 2009). In our view, the proposed tightened policy changes strengthen ISS' principle that poison pills should be approved by shareholders. The fact that ISS continues to assess short-term pill adoption on a case-by-case basis with more emphasis on rationale may be reflective of ISS' balanced approach that shorter term pills are generally less onerous as a takeover defense when compared to longer term pills, and may in some cases provide the board with a valuable tool to maximize shareholder value in the event of an opportunistic offer. Notwithstanding, when considering adoption of a pill, issuers should simultaneously contemplate a commitment or policy that puts a newly-adopted pill to a binding shareholder vote.

## Gender Pay Gap Shareholder Proposals

To date, ISS has applied a general global approach on environmental, social and governance issues when analyzing the gender pay gap shareholder proposals. The proposed new policy is not a major shift in what ISS is currently doing but specifies the following three considerations:

- The company's current policies and disclosure related to: i) its diversity and inclusion policies and practices, and ii) its compensation philosophy and fair and equitable compensation practices;
- Whether the company has been the subject of recent controversy or litigation related to gender pay gap issues; and
- Whether the company's reporting regarding gender pay gap policies or initiatives is lagging its peers.

ISS is asking whether there are other factors to be considered.

**Kingsdale Insight:** Over the past few years, unsatisfied by the gender pay gap, shareholders have increasingly filed proposals at companies in the technology, financial services, insurance, healthcare and telecom industries, requesting that companies report whether a gender pay gap exists, and if so, what measures will be taken to address the gap. It appears such campaigns will continue. With the proposed ISS policy, issuers now have better visibility to ISS' approach which can help self-assessment of internal policies and practices. Keeping with peers' disclosure in this regard will also fend off such proposals.

*This client advisory has been prepared by the Governance Advisory and Special Situations team at Kingsdale Advisors.*

If you have any questions about this update, please feel free to contact:

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