



November 20, 2015

U.S. Market Update: 2016 Benchmark Policy Update

On November 20, 2015, Institutional Shareholder Services Inc. (“ISS”) released their 2016 Benchmark Policy Updates following the Benchmark Policy Consultation period announced previously. These voting policies will be **applied for shareholder meetings taking place on or after February 1, 2016**. The updates are currently bundled in [ISS’ 2016 Americas Policy Updates](#) for the U.S., Canadian and Brazilian markets and the actual restated policy documents for each of these regions will likely be made available sometime in December. In our experience, there may be changes to other areas when ISS publishes its full policies.

For the U.S. market, ISS finalized three changes previously announced: (i) “overboarding” guidelines, (ii) evaluation of unilateral amendments to by-laws or charters to classify the board or establish supermajority vote requirements, and (iii) evaluation of compensation at externally managed issuers. New changes were also introduced, including: (i) an updated framework to evaluate shareholder proposals related to executive holding requirements of equity, (ii) evaluation of proxy access nominees, and (iii) clarification for evaluating several environment related shareholder proposals.

1. Overboarding Guidelines

Currently, ISS considers: (i) CEOs of public companies who sit on the boards of more than two public companies besides their own, or (ii) a director (not a CEO) who sits on more than 6 public company boards in total as “overboarded”. Withhold recommendations for “overboarded” CEOs will only apply to their outside boards.

Beginning **February 1, 2017**, directors will be considered “overboarded” if he/she is a CEO of a public company who sits on more than two outside public company boards in addition to the company of which he/she is CEO. For directors (not a CEO), five boards, including the board under consideration, will be the maximum threshold.

***Kingsdale Commentary:** ISS has opted to allow non-CEO directors to sit on up to five boards after considering thresholds of four or five boards in their Benchmark Consultation Period. Given the one year grace-period, we anticipate that issuers may have enough time to adapt to the new policy thresholds under the revised policy.*

2. Unilateral Amendments to By-laws or Charters

Currently, ISS evaluates unilateral by-law and charter amendments (that diminish shareholder rights) under the “board accountability” framework pursuant to an amendment made in 2014 under ISS’ U.S. benchmark policy guidelines.

As mentioned in our previous note, ISS has updated its guidelines such that certain provisions adopted unilaterally by the board to either classify the board or establish supermajority vote requirements, regardless of pre- or post-IPO adoption, if not sufficiently addressed, can form the basis for continued adverse recommendations for director nominees in subsequent years.

Specifically, ISS clarified that:

- Unless the adverse amendment is reversed or submitted to a binding shareholder vote, in subsequent years vote case-by-case on director nominees. ISS will generally recommend voting **AGAINST** (except new nominees, who should be considered case-by-case) if the directors:
 - Classified the board;
 - Adopted supermajority vote requirements to amend the by-laws or charter; or
 - Eliminated shareholders' ability to amend by-laws.
- For new public companies, ISS will generally recommend voting **AGAINST** or **WITHHOLD** from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopts by-law or charter provisions adverse to shareholders' rights, considering the following factors:
 - The level of impairment of shareholders' rights caused by the provision;
 - The company's or the board's rationale for adopting the provision;
 - The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholder right to amend the by-laws or charter, or supermajority vote requirements to amend the by-laws or charter);
 - The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and
 - A public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering.

Kingsdale Commentary: *ISS' update serves to provide further clarity on the specific circumstances when this policy will be triggered. ISS has clarified that director nominees will be voted on a case-by-case basis in the following years if the adverse provision has not been reversed/submitted for a vote. New nominees will be evaluated on a case-by-case basis but may not escape a negative recommendation. Interestingly, for companies in the pre-IPO phase, a public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering may serve to be an appropriate course of action (in consideration of other factors as well, of course).*

3. Compensation at Externally-Managed Issuers

ISS notes that “externally-managed issuers” (“EMIs”) typically do not directly compensate their executives and instead, executives are compensated by the external manager, which is reimbursed by the EMI through a management fee. Typically, compensation arrangements for EMIs are not disclosed in sufficient detail and without sufficient disclosure to the arrangements and payments made to executives, shareholders cannot assess pay programs and their linkage to company performance.

ISS' updated guidelines include insufficient executive compensation disclosure for EMIs as a “Problematic Pay Practice” and will issue **AGAINST** recommendations for the “Say on Pay” proposal where comprehensive pay analysis is impossible due to insufficient compensation-related disclosure by EMIs.

Kingsdale Commentary: *While the previous Benchmark Policy Consultation referenced potential **AGAINST** recommendations on the chair or members of the compensation committee as well as the entire board in addition to the “Say on Pay” vote, this section appears to have removed. It remains to be seen whether or not ISS will hold directors accountable in this instance.*

4. Shareholder Proposals for Holding Equity Past Retirement or a Significant Period of Time

Currently, ISS will recommend on a case-by-case basis the voting on shareholder proposals that seek the adoption of policies requiring senior executive officers to retain all or a significant portion of the shares acquired through compensation plans.

The current version of the policies regarding this area is broken into shareholder proposals of two distinct categories:

- For shares acquired: (i) while employed and/or for two years following the termination of their employment, (ii) or for a substantial period following the lapse of all other vesting requirements for the award (“lock-up period”), with ratable release of a portion of the shares annually during the lock-up period; and
- Requiring Named Executive Officers to retain 75% of the shares acquired through compensation plans: (i) while employed, and/or (ii) for two years following the termination of their employment and (iii) to report to shareholders regarding this policy.

The case-by-case analysis framework for both scenarios mentioned above considered the same factors, as excerpted from ISS:

- Whether the company has any holding period, retention ratio, or officer ownership requirements in place, including:
 - Rigorous stock ownership guidelines (should be at least 10 times base salary for the CEO and declining multiples for other executives);
 - A holding period requirement coupled with a significant long-term ownership requirement; or
 - A meaningful retention ratio (should constitute at least 50% of the stock received on a net proceed basis held on a long-term basis (e.g. tenure or a couple of years after departure)
- Actual officer stock ownership and the degree to which it meets or exceeds the proponent’s suggested holding period/retention ratio or the company’s own stock ownership or retention requirements;
- Post-termination holding requirement policies or any policies aimed at mitigating risk taking by senior executives;
- Problematic pay practices (current and past) which may promote a short-term versus a long-term focus.

While the policy was applied on a case-by-case basis, ISS generally recommended and will continue to recommend voting **AGAINST** shareholder proposals seeking to mandate a minimum amount of stock that directors must own in order to qualify as a director or to remain on the board.

The new benchmark policy in this area streamlines the policy into one unified approach for all types of shareholder proposals under this branch. On a case-by-case basis, ISS will evaluate:

- The percentage/ratio of net shares required to be retained;
- The time period required to retain the shares;

- Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
- Whether the company has any other policies aimed at mitigating risk-taking by executives;
- Executives' actual stock ownership and the degree to which it meets or exceeds the proponent's suggested holding period/retention ratio or the company's existing requirements; and
- Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus

Kingsdale Commentary: *We are beginning to see issuers facing increasing scrutiny for compensation and certain design elements like equity holding periods will continue to be pushed by shareholders and governance groups. This policy streamlines ISS' approach to evaluating shareholder proposals in this area and the retention ratio is now considered for all proposals of this type.*

5. Proxy Access in Relation to Proxy Contests

Currently, ISS' framework for evaluating proxy contests considers several factors including:

- Long-term financial performance of the target company relative to its industry;
- Management's track record;
- Background to the proxy contest;
- Nominee qualifications and any compensatory arrangements;
- Strategic plan of dissident slate and quality of critique against management;
- Likelihood that the proposed goals and objectives can be achieved (both slates);
- Stock ownership positions.

ISS previously stated that they apply the same case-by-case factors listed above for proxy access nominees.

Under the new policy, ISS further clarified that for proxy access, additional factors may be evaluated, including factors that are specific (i) to the company (ii) to the nominee(s) and/or (iii) to the nature of the election (such as whether or not there are more candidates than board seats).

Kingsdale Commentary: *This clarification sets the stage for evaluating proxy access nominees in the future, providing a broadened scope for such circumstances. It is unlikely that proxy access nominees will materialize for the upcoming proxy season but it remains to be seen how ISS may assess the additional factors and/or if ISS will look at any additional factors beyond what is stated.*

6. Environment-Related Shareholder Proposals

ISS provided updates to its evaluation of shareholder proposals in three key categories: (i) Animal Welfare; Pharmaceutical Pricing, (ii) Access to Medicines and Prescription Drug Reimportation; and (iii) Climate Change/Greenhouse Gas Emissions Proposals. These updates serve to clarify ISS' existing proposals rather than entire proposal overhauls. Interested clients can view these changes via ISS' Americas Policy Update document.

If you have any questions about this update, please feel free to contact Victor Li or Jackie Cheung directly to discuss.

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