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# Client Alert

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## Proxy Voting: ISS Updates Its Proxy Voting Guidelines for 2018 Shareholder Meetings

On November 16, 2017, Institutional Shareholder Services ("ISS") released updates to its 2018 benchmark proxy voting policies, which will go into effect for shareholder meetings on or after February 1, 2018. The US-specific updates include new guidance on director elections related to non-employee director pay and poison pills and a new policy on shareholder proposals related to gender pay gaps. ISS has also refined its guidance on how it analyzes certain compensation practices and climate change proposals.

**Key Take-Aways**

- ISS will provide adverse vote recommendations for board or committee members responsible for approving non-employee director compensation when there is a recurring pattern of excessive pay without a compelling rationale.
- ISS will recommend against all board nominees, every year, at any company that maintains a long-term poison pill that has not been approved by shareholders without any applicable exemptions.
- ISS provided specific factors by which it will evaluate on a case-by-case basis shareholder proposals related to gender pay gaps.
- For companies that received less than 70% support for their say-on-pay proposal, ISS will look for various details about the company's efforts to engage with its shareholders.

**Non-Employee Director Compensation**

ISS will now recommend against any director responsible for setting or approving non-employee director compensation when there is a recurring pattern of excessive pay magnitude without a compelling rationale or other mitigating factors. The updated guidance defines a "recurring pattern" as two or more consecutive years, emphasizing that negative recommendations will only be triggered by consecutive years of excessive pay. Without explicitly defining "excessive pay," ISS suggests it has already identified certain "extreme outliers" that, as compared to their peer companies, pay directors substantially more without disclosing a clear justification for the difference.

This new policy will not impact ISS vote recommendations in 2018 and it will only recommend against directors after at least two years of observed excessive pay. This means negative recommendations triggered by non-employee director compensation will not begin until the 2019 proxy season.

**Poison Pills**

In what is described as an attempt to "simplify" its position on poison pills, ISS will now recommend against all director nominees for companies with poison pills that have not been approved by shareholders and with terms longer than one year. Poison pills with terms shorter than one year will continue to be analyzed on a case-by-case basis.

Previously, ISS maintained a bifurcated position on poison pills depending on whether a company's board was classified. Historically, ISS recommended against classified board nominees every year and annually elected board nominees once every three years, with an exemption for companies with newly adopted poison pills that committed to a binding shareholder proposal to approve the pill at the next annual meeting. Now all boards at companies that have a poison pill with a term greater than one year will be treated the same with annual negative vote recommendations.

Further tightening its position, ISS will no longer treat poison pills adopted prior to 2009 as grandfathered in under the current policy.

**Gender Pay Gaps**

In response to its anticipated increase in shareholder proposals related to gender pay gaps, ISS introduced a new policy to address such shareholder proposals. Specifically intended to evaluate shareholder proposals requesting reports on a company's pay data by gender, or a report on a company's policies and goals to reduce any existing gender pay gaps, ISS will take into account the following factors on a case-by-case basis:

- the company's current policies and disclosures related to both its diversity and inclusion policies and practices;
- the company's compensation philosophy and use of fair and equitable compensation practices;
- whether the company has been the subject of recent controversies, 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.

ISS has previously not provided specific guidance on gender pay gap proposals.

**Gender Diversity on Board**

ISS will now highlight boards of directors with no female directors, but it will not issue adverse vote recommendations due to a lack of gender diversity.

**Pledging**

ISS formalized its existing policy to vote against the members of a board committee that oversees risks related to pledging, or the full board, where a significant level of pledged company stock by executives or directors raises concerns. The policy explains that the following factors will be considered:

- 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 the total 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.

**Shareholder Engagement Disclosure on Compensation Practices**

For companies that received less than 70% of the votes cast on a say-on-pay proposal, ISS provided new guidance on how it will review the company's response in deciding whether to recommend against compensation committee members or how to vote on other ballot items related to executive compensation. In particular, ISS indicates that it will consider the detail of the disclosures with respect to timing and frequency of engagements, whether independent directors participated in the engagements, disclosure of the specific concerns voiced by dissenting shareholders and “specific and meaningful” action taken by the company to address the shareholders’ concerns.

In considering whether to recommend against compensation committee members of companies whose say-on-pay proposals received less than 70% of votes cast, ISS considers the company’s disclosure regarding shareholder engagement efforts.

**Pay-for-Performance Evaluation**

ISS added to its existing policy governing its annual pay-for-performance analysis of companies. ISS will now consider, among other things, the rankings of CEO total pay and company financial performance within a peer group measured over a three-year period. It will also limit its analysis of the multiple of the CEO’s pay relative to the company’s peer group to the most recent fiscal year.

**Climate Change Proposals**

ISS made certain changes to its policy on climate change proposals, which is to generally vote for proposals requesting a company to disclose information on “the financial, physical, or regulatory risks” confronting the company or “how the company identifies, measures, and manages such risks.” ISS said the update “better aligns” its policy with the recommendations of The Task Force on Climate-Related Financial Disclosures, “which explicitly seek transparency around the board and management’s role in assessing and managing climate-related risks and opportunities.”

**Conclusion**

As proxy season approaches, boards should take stock of how their current practices may trigger negative recommendations by ISS under its updated policies and the extent to which their shareholder base will follow those recommendations. As always, compensation practices are a key focal point of ISS. Companies should also not be surprised to see an increase in the number of shareholder proposals related to gender pay gaps, as ISS’s new guidance may trigger such shareholder proposals inasmuch as it is in response to such proposals.

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