ISS 2018 U.S. POLICY UPDATES

On November 16, ISS released its 2018 policy updates which will be applicable to all meetings held on or after February 1, 2018. The policy updates applicable to companies in the United States are relatively limited in scope, and were generally addressed in the surveys and/or the draft policy updates released by ISS in October. The policy updates relate to some perennial issues, including say-on-pay votes, pay for performance, and poison pills. Companies should note, however, that certain topical governance and social issues are addressed as well. These include gender pay disparity proposals, non-employee director pay and lack of board gender diversity. A discussion of the key 2018 policy updates follows. The updated ISS policies are available on the ISS Policy Gateway.

Summary of ISS Policy Updates

Shareholder Engagement Following Low Say-on-Pay Votes. Companies should be prepared to provide detailed disclosure regarding investor engagement efforts if their prior year’s say-on-pay vote received less than 70% support. ISS has codified the advice that it has been providing relating to this disclosure to include the timing and frequency of engagements, whether independent directors participated, and disclosure of specific concerns raised by dissenting shareholders that led to say-on-pay opposition, in addition to other factors under ISS’s existing guidelines. When planning for shareholder outreach and discussion, the companies should take into account these disclosure considerations. Many companies that received low say-on-pay support in 2017 have already undertaken shareholder outreach efforts during the off season so the key will be clearly communicating those efforts in the company’s proxy statement.

Pay for Performance. ISS has moved from the qualitative section to the quantitative section of its compensation evaluation framework a test which ranks CEO total pay and company financial performance, within a peer group, over a three-year period. The other tests in this quantitative section include: (a) the degree of alignment between the company’s annualized TSR rank and the CEO’s annualized total pay rank within a peer group, measured over a three-year period, and, (b) the multiple of the CEO’s total pay relative to the peer group median in the most recent fiscal year. According to ISS’ preliminary compensation FAQs,
this Financial Performance Assessment (FPA) test will be added as a secondary measure after the current three screens (Multiple of Median, Relative Degree of Alignment, and Pay-TSR Alignment) have been calculated. ISS plans to provide additional details about this analysis in a subsequent publication.

**Non-Employee Director (NED) Pay.** ISS will make adverse vote recommendations, beginning in 2019, for board/committee members who approve or set NED compensation when there is a recurring pattern of excessive NED pay without a compelling rationale or other mitigating factors. ISS defines “recurring” as two or more consecutive years. Companies should be prepared to benchmark their director pay to peers and consider additional disclosure to the extent their pay may raise concerns.

**Executive or Director Share Pledging.** ISS has codified as a policy its current approach in cases when a company executive or director pledges a quantum of company stock significant enough to raise concerns. ISS may recommend against all members of the committee that oversee share pledging, or the full board, considering: (a) the presence of an anti-pledging policy, disclosed in the proxy statement, that prohibits future pledging activity; (b) the magnitude of aggregate pledged shares in terms of total common shares outstanding, market value, and trading volume; (c) disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time; and (d) disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock.

**Gender Pay Gap Proposals.** Given the expected increase in proposal volume, ISS has added a new policy to provide more clarity to its current approach to gender pay gap shareholder proposals. ISS will make case-by-case recommendations on requests for reports on a company’s pay data by gender, or a report on a company’s policies and goals to reduce any gender pay gap. ISS will consider the following circumstances in its analysis: (a) the company’s current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy and fair and equitable compensation practices; (b) whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender pay gap issues; and (c) whether the company’s reporting regarding gender pay gap policies or initiatives is lagging its peers.
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Climate Change Risk Proposals. ISS has broadened the circumstances under which it will recommend in favor of shareholder proposals requesting a company disclose information on operational and investment risk related to climate change. The changes to its policy align closely with the recommendations made by the Task Force on Climate-Related Financial Disclosures (TCFD).

Poison Pills. ISS will now recommend against all board nominees, every year, at a company that maintains a “long-term” (defined as greater than one year) poison pill that has not been approved by shareholders. Commitments to put a long-term pill to a vote the following year will no longer be considered a mitigating factor and boards with 10-year pills currently grandfathered from 2009 will no longer be exempt. Short-term pill adoptions would continue to be assessed on a case-by-case basis, with ISS analysis focusing primarily on the rationale for the unilateral adoption.

ISS Categorization of Directors

Directors will now be categorized as Executive Director, Non-Independent Non-Executive Director and Independent Director (respectively replacing Inside Director, Affiliated Outside Director and Outside Director).

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