

ISS Policy Updates for 2017

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Right on the heels of the Glass Lewis policy updates, ISS has also issued [its updates](#) that will apply to meetings held on or after February 1, 2017. Similar to Glass Lewis, the ISS policy updates are generally not significant for existing public companies. However, there are several new and revised policy changes related to equity plans, including on director compensation. These policy updates are quite technical in their details, and warrant a careful examination and thoughtful disclosure to ensure that the plans are appropriately evaluated within the correct policy framework.

Overboarding. Similar to Glass Lewis, ISS also deferred its new overboarding policy until this season. ISS will recommend against directors who (a) sit on more than five public company boards or (b) are CEOs of public companies who sit on the boards of more than two public companies besides their own.

Unilateral Bylaw/Charter Amendments and Problematic Capital Structures – IPO Companies. For IPO companies, ISS will recommend that shareholders vote against directors, committee members, or the entire board (except new nominees, who should be considered case by case) if, prior to or in connection with the IPO, the company or its board adopted bylaw or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights. A vote by shareholders within three years will not be sufficient, and instead a sunset provision will be necessary.

The following factors will be considered: the level of impairment of shareholders' rights; the disclosed rationale; the ability to change the governance structure (e.g., limitations on shareholders' right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter); whether the company has a classified board; any reasonable sunset provisions and other relevant factors. Unless the adverse provision and/or problematic capital structure is reversed or removed, ISS will take a case-by-case approach on director nominees in subsequent years.

ISS notes that the number of IPOs with dual-class structures has increased in the past few years, with only 8 in 2006 to 17 as of August 2016.

Restrictions on Binding Shareholder Proposals. Some states permit companies to restrict Rule 14a-8 rights in their charters. According to ISS, "these prohibitions flew under the radar until relatively recently." ISS will issue adverse vote recommendations for governance committee members if the company's charter imposes undue restrictions on shareholder's ability to amend the bylaws. Examples of these restrictions include a prohibition on the submission of binding shareholder proposals or share ownership or time holding requirements that are in excess of Rule 14a-8 requirements. The adverse recommendations would continue until the restrictions were removed.

Stock Distributions: Splits and Dividends. ISS will generally favor management proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase (the current policy uses "increase") in authorized shares is equal to or is less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

Management Proposals to Ratify Director Compensation. In response to lawsuits on non-employee director compensation, some companies have put forth advisory proposals seeking ratification.

Management proposals to ratify non-employee director compensation will be evaluated based on: if the equity plan under which non-employee director grants are made is on the ballot, whether or not it warrants support; the relative magnitude of director compensation as compared to companies of a similar profile; the presence of problematic pay practices relating to director compensation; director stock ownership guidelines and holding requirements; equity award vesting schedules; the mix of cash and equity-based compensation; meaningful limits on director compensation; the availability

of retirement benefits or perquisites; and the quality of disclosure surrounding director compensation.

Equity Plans for Non-Employee Directors. ISS has updated and broadened the factors it will consider when examining these plans. The general policy is a case-by-case determination based on: the total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; the company's three-year burn rate relative to its industry/market cap peers; and the presence of any egregious plan features (such as an option repricing provision or liberal CIC vesting risk).

If the director stock plans will exceed the plan cost or burn rate benchmarks when combined with employee or executive stock plans, ISS will also consider qualitative factors including the relative magnitude of director compensation as compared to companies of a similar profile; the presence of problematic pay practices relating to director compensation; director stock ownership guidelines and holding requirements; equity award vesting schedules; the mix of cash and equity-based compensation; meaningful limits on director compensation; the availability of retirement benefits or perquisites; and the quality of disclosure surrounding director compensation.

Equity and Incentive Compensation Plans. ISS will add dividends payable prior to vesting, or an evaluation of the payment of dividends on unvested awards, as a plan feature. Full points will be earned if the plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award, and no points will be given if the plan is silent or incomplete even if it is the company's general practice of not paying dividends until vesting.

In addition, an equity plan must specify a minimum vesting period of one year for all award types under the plan in order to receive full points for this factor. No points will be earned if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement.

Cash and Equity Plan Amendments. ISS has clarified how it reviews 162(m) plans and proposals to amend existing plans. ISS will generally favor approval of 162(m) only plans if the plan administering committee consists entirely of independent directors (as defined by ISS).

Amendments to cash incentive plans, including plans presented to shareholders for the first time after IPO and/or proposals that bundle material amendments other than for 162(m) purposes, will be reviewed on a case-by-case basis.

Equity incentive plan amendments will also be evaluated on a case-by-case basis. If the proposal requests additional shares and/or the amendments may potentially increase the transfer of shareholder value to employees, the recommendation will be based on the Equity Plan Scorecard (EPSC) evaluation as well as an analysis of the overall impact of the amendments. In addition, if the plan is being presented to shareholders for the first time after the company's IPO, whether or not additional shares are being requested, the recommendation will be based on the EPSC evaluation as well as an analysis of the overall impact of any amendments.

However, if there is no request for additional shares and the amendments are not deemed to potentially increase the transfer of shareholder value to employees, then the recommendation will be based entirely on an analysis of the overall impact of the amendments, and the EPSC evaluation will be shown for informational purposes.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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