

ISS Survey Results Released for 2016 Proxy Season

September 28, 2015 | Client Update | 5-minute read

ISS has [released](#) the results of its survey, which will govern changes to its policies beginning with annual meetings after February 1, 2016. A draft of the updated policy will be issued on October 26, and final policies in November. 412 responses to the survey were received, with 114 identifying as institutional investors. Below is a summary of certain of the survey questions and the responses noted by ISS.

Proxy access. The types of “material restrictions” in proxy access provisions adopted by companies where a proxy access shareholder proposal passed in 2015, that would be considered problematic enough to recommend against directors.

Survey response. Investors indicated the following provisions would be problematic:

- Ownership threshold of more than 3% (72% of investors) or more than 5% (90% of investors)
- Ownership duration of greater than three years (90% of investors)
- Aggregation limit of fewer than 20 shareholders (76% of investors)
- Cap on nominees at less than 20% of the board (79% of investors)
- More restrictive advance notice requirements (70% of investors)
- Information disclosures that are more extensive than those required of the company’s nominees (80% of investors)
- Renomination restrictions in the event a proxy access nominee fails to receive a stipulated level of support or withdraws his or her nomination (68% of investors)
- Restrictions on third-party compensation (72% of investors)

In addition, some investors noted counting different mutual funds within a single fund family as different shareholders would also be viewed negatively.

Overboarding. The appropriate number of other board seats for directors (both CEOs and non-executives) that would be considered “overboarding” and warrant negative recommendations.

Survey response. 35% of investors indicated that four total boards were appropriate, 18% supported a limit of five board seats and 20% favored 6 seats.

48% of investors want active CEOs to only sit on two boards, meaning only one outside board, while 32% favored three total board seats. Two-thirds of investors believe that stricter limits should also apply to directors with demanding jobs, not just CEOs, or to board chairs, lead independent directors and audit committee members.

Charter and bylaw amendments by boards. What types of charter or bylaw amendments that a board unilaterally adopts would be considered sufficiently problematic to warrant recommending against those directors (such as increasing authorized capital, restricting third-party compensation for dissident nominees or restricting advance notice requirements). In addition, for how long a board that unilaterally adopts a bylaw or charter amendment “that diminishes shareholders’ right” should be held accountable, such as for only one year after or until the provision is eliminated.

Survey response. 57% of investors want to continue to hold directors accountable until the rights are restored. Bylaw amendments that most irked investors include classifying a board, diminishing rights to call special meetings, establishing supermajority vote requirements, mandating fee shifting or restricting third-party compensation of directors or director nominees.

Director independence. Whether there should be a cooling-off period for former executives and professional service providers before being viewed as independent directors in addition to those that already exist.

Survey response. ISS currently has a five-year cooling-off period before considering a former executive (other than a former CEO) to be independent. 46% of investors want the clock to start running only after the individual has left the company. 82% indicated that there should be a cooling-off period for former employees of a firm providing professional services to the company.

Executive compensation. The use of adjusted or non-GAAP metrics in incentive compensation programs, including whether they are only acceptable if restricted to common metrics, clearly disclosed or must also be reconciled with GAAP metrics.

Survey response. 81% of investors believe that adjusted metrics can be acceptable, depending on the nature and extent of the adjustments, with 66% of those investors noting that performance goals and results should be clearly disclosed and reconciled with GAAP metrics, and the reasons for the adjustments adequately explained. Some of the most acceptable forms of adjustments include taking into account discontinued operations, non-recurring or extraordinary charges and foreign exchange volatility. A majority of investors indicated that adjustments for goodwill write-downs, litigation expense and compensation expenses were not appropriate. Investors were evenly divided about acquisition expenses.

Director compensation. The types of equity compensation, such as stock options, different forms of restricted stock and stock appreciation rights that may not be appropriate as compensation for directors.

Survey response. 71% of investors consider grants of shares to be appropriate. However, 70% of investors consider grant of stock options and SARs, and 63% with respect to grants of performance-vesting restricted stock, to be inappropriate. Investors were concerned about equity awards that blur the distinction between executives and directors or that link director compensation to management performance.

Pre-IPO companies. Who should be held accountable, if anyone, when a pre-IPO board adopts bylaw amendments that “materially diminishes shareholders’ rights” before becoming public.

Survey response. 48% of investors believe that companies should not adopt these types of bylaws while 18% indicated that these bylaws would not be problematic so long as the company does not have supermajority provisions that make it difficult to repeal them.

Net operating loss (NOL) poison pills. Whether a sunset provision shorter than three years is appropriate for an NOL pill renewal and whether certain types of governance features (such as classified boards or dual class structures) may lead investors to oppose NOL pills.

Survey response. 35% of investors stated that a sunset provision of less than three years is preferred, while 21% of investors do not want NOL pills to be renewed or extended at all. More than 75% of investors indicated that certain governance structures could lead them to vote against an NOL pill, including dual-class voting rights, classified boards, supermajority vote requirements, the absence of a right to call a special meeting and a recent history of proxy contests.

Share Buybacks. What types of five-year historical financial metrics should be included in ISS reports to assess capital allocation and share buyback decisions, to address concerns that “inappropriate buybacks may be value-destroying in the long term and...potentially increase the value of executive compensation packages.”

Survey response. 85 to 96% of investors would like to see five-year historical data on share buybacks, dividends, capital expenditures and cash balances.

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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