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ISS Issues 2016 U.S. Voting Policy FAQs

Institutional Shareholder Services (ISS) has issued FAQs with respect to its U.S. voting policies for the upcoming proxy season. The FAQs clarify ISS positions on a broader variety of topics than were covered in the voting policy updates issued in November. We highlight the FAQs of most interest below, and urge companies to consult the publication in more detail as needed.

Board Responsiveness to Majority-approved Proxy Access Shareholder Proposal

- ISS will evaluate a board's response to a majority-approved proxy access shareholder proposal by examining whether the "major points" of the proposal are being implemented and whether any additional provisions that were not in the shareholder proposal unnecessarily restrict the proxy access right.
- ISS may issue a recommendation against the board if the proxy access process being implemented or proposed contains material restrictions that are more stringent than those included in a majority-supported proxy access shareholder proposal, including:
 - Ownership thresholds above 3%;
 - Ownership duration longer than three years;
 - Aggregation limits below 20 shareholders; and
 - A cap on nominees below 20% of the board.

Lack of disclosure by the company of shareholder outreach where there are deviations from the cap or aggregation limit specified in the shareholder proposal may also warrant negative vote recommendations.

- If a management implemented proxy access policy or proposal contains restrictions or conditions on proxy access nominees, ISS will review the implementation and restrictions on a case-by-case basis. ISS considers the following to be "potentially problematic" restrictions or conditions especially when used in combination:
 - Prohibitions on resubmission of failed nominees in subsequent years;

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- Restrictions on third-party compensation of proxy access nominees;
 - Restrictions on the use of proxy access and proxy contest procedures for the same meeting;
 - Provisions on how long and under what terms an elected shareholder nominee will count towards the maximum number of proxy access nominees; and
 - Provisions on when the right will be fully implemented and accessible to qualifying shareholders.

Two types of restrictions will be considered “especially problematic” because they could effectively nullify the proxy access right:

- Counting individual funds within a mutual fund family as separate shareholders for purposes of an aggregation limit; and
- Imposing post-meeting shareholding requirements for nominating shareholders.

Board Responsiveness to Other Majority-approved Shareholder Proposals

- The factors by which ISS will evaluate board responsiveness to majority-approved shareholder proposals are not changed, but ISS provides guidance for specific shareholder proposals as noted below. In particular, ISS stresses the need for a company to conduct, and disclose, outreach among its largest shareholders to understand their goals for a particular proposal and to clearly disclose its response and rationale for the board actions taken in response to the proposal. Further, ISS states that a recommendation other than “for” a management proposal offered in response to a majority-approved proposal would generally not be considered as sufficient action taken.
- Shareholder Right to Call Special Meetings. A provision allowing shareholders to call a special meeting with an ownership threshold higher than that specified in the shareholder proposal may nevertheless be considered responsive, if the company conducted shareholder outreach and found that a different threshold was acceptable and disclosed such efforts and rationale. Restrictions on agenda items are generally seen as negating the right to call a special meeting. For example, the exclusion of any agenda items that were or will be on the annual meeting agenda would not be acceptable because the prohibition would prevent shareholders from calling a special meeting to elect a dissident slate, as annual meeting agendas would typically always include the election of directors. “Reasonable” limitations on the timing and number per year of special meetings are generally acceptable.

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- Shareholder Action by Written Consent. Reasonable restrictions to ensure that the right to act by written consent will not be abused are acceptable. These include:
 - An ownership threshold of no greater than 10%;
 - A total review and solicitation period of no more than 90 days (to include the period of time for the company to set a record date after receiving a shareholder request to do so, and no more than 60 days from the record date for the solicitation process);
 - Limits on when written consent may be used of no more than 30 days after a meeting already held or 90 days before a meeting already scheduled to occur; and
 - A requirement that the shareholder must use best efforts to solicit consents from all shareholders.

Restrictions that go beyond these will be examined in light of the disclosure by the company about its outreach to shareholders, the board's rationale and other factors. Restrictions on agenda items are not deemed to be reasonable.

- Removal of Supermajority Vote Requirements. In general, a reduction from one supermajority to a slightly lower supermajority (*e.g.*, 75% to 66 2/3%) would not be sufficient, nor would a removal of some, but not all supermajority vote requirements. However, the company's outreach to shareholders and the board's rationale will be considered.
- Board Declassification. Phasing in the declassification of the board to allow directors to complete their full elected terms (*i.e.*, over a three-year period) is generally acceptable, but other delays should be vetted with shareholders and the rationale for that delay disclosed.
- Independent Chair. Full implementation would consist of separating the chair and CEO positions, with an independent director filling the role of chair, although a policy that the company will adopt this structure upon the resignation of the current CEO would also be considered responsive. Anything short of this will be evaluated on a case-by-case basis, depending on the disclosure of shareholder input obtained through the company's outreach, the board's rationale and the facts and circumstances of the case. There are many factors that can cause investors to support such proposals, without necessarily demanding an independent chair immediately. ISS gives as an example where a company learns through outreach that shareholders are concerned about the lack of a lead director, weaknesses in the lead director's responsibilities or its choice of lead director. In this case, creating or strengthening a lead director position may be considered a sufficient response, assuming no other factors are involved.

Poison Pills

- Negative recommendations will be issued every three years against an annually elected board, and every year against a classified board, that adopts a poison pill without shareholder approval. The negative recommendation is issued against an annually elected board on a three-year cycle based on the premise that poison pills should not have a term longer than three years and shareholders should have a vote on the pill at least every three years. Because it takes three years to hold all members of a classified board accountable, ISS will recommend against such boards annually for those directors that are up in that particular year.
- Negative recommendations will be issued for the boards of IPO companies that adopt a poison pill before it is public if the pill is not put to a vote at the first annual shareholder meeting or if the company does not commit to putting the pill to a vote within 12 months after the IPO. After that period, ISS will follow the foregoing policy for boards generally. ISS provides sample “commitment language” it wishes to see with respect to a vote on the pill.

“Shares Cast”

- For purposes of its board accountability and responsiveness policies, ISS calculates “shares cast” using a formulation of For/(For + Against), with abstentions not counted, for all companies. This is regardless of what standard actually applies to the particular vote.

Hedging/Pledging

- Any amount of hedging of a company’s stock by directors or executives through covered call, collar or other derivative transactions will be considered a problematic practice warranting a negative recommendation against appropriate board members.
- ISS views any amount of pledged stock as an irresponsible use of company equity and will examine the following factors in determining vote recommendations for directors at companies that have executives or directors with pledged company stock:
 - Presence of anti-pledging policy that prohibits future pledging activity in the companies’ proxy statement;
 - Magnitude of aggregate pledged shares in terms of total common shares outstanding, market value or 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.

ISS recommends that any executive or director with significant pledged stock act responsibility and not jeopardize shareholders' interests when they unwind those positions.

Standstill Agreements

- With respect to any standstill agreement or settlement agreement entered into with a dissenting shareholder, ISS will review the terms of the standstill agreement and any other conflicting relationships or related-party transaction and may issue a negative recommendation affecting the reelection of Nominating Committee members if they view any terms of or circumstances surrounding the agreement to be egregious.

Other FAQs

In addition to the foregoing, ISS issued FAQs on its director independence standards and voting policies related to board meeting attendance, overboarding, audit-related issues, evaluation of proxy access nominees, independent chair shareholder proposals, capital/restructuring proposals and social/environmental issues. We also note that ISS has standalone FAQs on compensation matters.

The FAQs and ISS's other voting policies can be found at <http://www.issgovernance.com/policy-gateway/2016-policy-information/>

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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