Simpson Thacher

Memorandum

ISS Releases 2020 Proxy Voting Policies

December 26, 2019

On November 12, 2019, Institutional Shareholder Services Inc. (ISS) released updates to its 2020 benchmark proxy voting policies, which will generally be applied for shareholder meetings on or after February 1, 2020. Policy changes include the following:

Board Accountability for Problematic Governance Structures at Newly Public Companies

ISS has separated out from its existing policy a specific policy highlighting problematic governance structures and capital structures with unequal voting rights. These policies generally apply to newly-public companies which are defined to include companies that emerge from bankruptcy, spin-offs, direct listings and those companies that complete a traditional initial public offering.

MULTI-CLASS CAPITAL STRUCTURES WITH UNEQUAL VOTING RIGHTS

For newly public companies, ISS will generally recommend a vote against or withhold from the entire board if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting it to a reasonable time-based sunset. In assessing the reasonableness of a time-based sunset provision, ISS will consider the company’s lifespan, its post-IPO ownership structure and the board’s disclosed rationale for the sunset period selected. Under the new policy, however, no sunset period of more than seven years from the date of the IPO will be considered reasonable. ISS will continue to recommend a vote against or withhold from incumbent directors in subsequent years unless the problematic capital structure is reversed or removed.

PROBLEMATIC GOVERNANCE PROVISIONS

For newly public companies, ISS will generally recommend a vote against or withhold from directors individually, committee members or the entire board if, prior to or in connection with the company's public offering, the company or its board adopted specified problematic bylaw or charter provisions. Problematic provisions include supermajority vote requirements to amend the bylaws or charter, classified board structures or other egregious provisions that are considered to be materially adverse to shareholder rights. ISS will continue to make recommendations on director nominees on a case-by-case basis in subsequent years, unless the adverse provision is reversed or removed.

Under both new policies, new director nominees who have served on the board for less than one year will be evaluated on a case-by-case basis depending on the timing of their appointment and the problematic governance issue in question.

Unfettered Rights for Shareholders to Amend Bylaws Desired

At present, ISS generally recommends a vote against or withhold from the members of the governance committee if the company's governing documents impose undue restrictions on shareholders' ability to amend the bylaws. For 2020, ISS has added subject matter restrictions to the non-exclusive list of restrictions described as problematic. ISS has further clarified that submitting a management proposal to shareholders asking them to approve or ratify these types of provisions is not sufficient and that ISS will generally continue to recommend a vote against or withhold on an ongoing basis until shareholders are provided with an unfettered ability to amend the bylaws or a proposal providing for such unfettered right is submitted for shareholder approval.

Shareholder Proposals on Independent Board Chairs

ISS' update for 2020 largely codifies its existing policy application with respect to shareholder proposals requiring that the board chair position be filled by an independent director. ISS is maintaining its holistic approach to evaluating these proposals, but the policy now explicitly states the types of factors that will be given substantial weight, including the existence of a majority non-independent board and/or the presence of non-independent directors on key board committees, a weak or poorly-defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role, the presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair, and/or departure from a structure with an independent chair, evidence that the board has failed to oversee and address material risks facing the company, a material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights, or evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

Limitations on Accommodations for New Director Nominees

ISS has historically evaluated new director nominees on a case-by-case basis, holding them less accountable for problematic governance practices under certain circumstances. For 2020, ISS has clarified that a "new nominee" is not only a director who is being presented for election to shareholders for the first time, but also must be someone who has been on the board for less than one year. Similarly, ISS now will only exempt from its attendance policy "new nominees" who have served for less than one year. Under its attendance policy, ISS generally recommends a vote against or withhold from directors who attend less than 75% of the aggregate of their board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed.

Share Repurchase Programs

Under its 2020 update, ISS will continue to generally recommend "for" management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms, or to grant the board authority to conduct open-market repurchases. That said, ISS has clarified that its policy is designed to safeguard against: the use of targeted share buybacks as greenmail or to reward company insiders by purchasing their shares at a price higher than they could receive in an open market sale, the use of buybacks to boost EPS or other compensation metrics to increase payouts to executives or other insiders, and repurchases that threaten a company's long-term viability (or a bank's capitalization level). In the absence of these abusive practices, ISS has indicated that support will generally be warranted for a grant of authority to the board to engage in a buyback.

Gender Diversity in Full Force

ISS has updated its policy to reflect that the one-year transition period for the U.S. gender diversity policy has now passed. For 2020, for companies in the Russell 3000 or S&P 1500 indices, absent a firm commitment from the company to achieve gender diversity within a year, ISS will generally recommend against the chair of the nominating committee (or other directors as appropriate) if the board lacks a female director. In addition, ISS has clarified that such a commitment from a board with no women on it previously will only be a mitigating factor for 2020, not beyond. Furthermore, ISS has indicated that going forward, having board gender diversity the previous year but not in the current year will not alone prevent withhold/against recommendations; the company will also need to acknowledge the current lack of a gender-diverse board and provide a firm commitment to re-achieving board gender diversity by the following year, i.e., a plan, with measurable goals, outlining the way in which the board will achieve gender diversity.

Social and Environmental Matters

ISS evaluates shareholder 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, on a case-by-case basis, taking into account specified factors. For 2020, ISS has added race and ethnicity-based pay information to the mix, in addition to gender.

Compensation Tweaks

- ISS has added evergreen (automatic share replenishment) provisions as an “egregious” factor in its "Equity Plan Scorecard" (EPSC) used to evaluate equity-based compensation plans.
- ISS is enhancing its Pay-for-Performance model by incorporating the use of Economic Value Added (EVA) metrics in the model’s secondary Financial Performance Assessment (FPA) screen. ISS has indicated that it believes EVA provides a strong framework for comparing performance across companies of varying business models and capital structures and that many of the key measures in the current FPA, such as ROIC and EBITDA growth, have comparable measures under the EVA framework.

If you have any questions or would like additional information, please do not hesitate to contact **Karen Hsu Kelley** at +1-212-455-2408 or kkelley@stblaw.com, **Shari A. Ness** at +1-212-455-2383 or shari.ness@stblaw.com, or any other member of the Firm’s Public Company Advisory Practice.