

ISS Policy Survey Hints at Changes to Pay-For-Performance, Director Pay and More

ISS' annual policy survey gives companies a chance to weigh in on potential voting recommendation changes. We outline what these are and the potential implications.

Institutional Shareholder Services (ISS) took the first step in its annual policy update process when it [recently released](#) its annual corporate governance policy survey to clients. Following the survey period, ISS releases draft policies in the early fall for a two-week comment period, followed by final policy updates that typically come in November. Adopted policies are effective in February for the proxy season.

In this article, we summarize the key potential policy changes ISS is questioning. It's important to note, issues addressed in the policy survey do not necessarily become policy. ISS uses the responses as a guide for its policy review process, and may not update policies in all areas surveyed. Similarly, occasionally the proxy firm will update policies that are not included in the policy survey.

As was the case last year, the survey process has been split into two separate surveys, one focused on "Governance Principles" and the other focused on "Policy Application." The Governance Principles Survey covers a small number of global high-profile governance topics and closes on August 24. The Policy Application Survey contains a more expansive and detailed set of questions. This survey is open through September 21. Any organization can complete both surveys by [clicking here](#).

Part 1: Governance Principles Survey

Board Gender Diversity: ISS is repeating last year's questions on gender diversity to gauge the evolution in views on the topic. For example, is it concerning if there are no female directors on a public company's board? And if the answer is yes or maybe, what actions should shareholders take? ISS notes that in prior survey questions along these lines, 69% of investor respondents considered having no female directors problematic, and 26% felt if a company has a published policy explaining its gender diversity consideration practices it would alleviate their concerns. ISS notes that 16% of Russell 3000 companies had no female board members in 2018, down from 21% in 2017. We believe ISS may formalize its gender diversity policy into vote recommendations given the firm has surveyed investors multiple times on this subject.

One-Share, One-Vote Principle: As a follow-up to last year's question on One-Share, One-Vote, ISS is asking if it should "adjust" vote results to show the results if all shares had equal voting rights. If so, should ISS use these

adjusted vote results to impact the need for board responsiveness? And if a company has a sunset provision on unequal voting rights, what is a suitable length of time? What the proxy advisory firm is really getting at is whether super voting shares should be counted as a single share when considering proxy voting results. This would have a significant impact on shareholder proposals and Say-on-Pay voting.

Director Accountability and Track Records: ISS is asking when evaluating a director that sits on multiple boards, is it relevant for the proxy advisory firm to examine a director's controversies on other boards. If so, what types of shortfalls would be relevant and what is an appropriate look-back period? Following the financial crisis, ISS instituted a policy that considered recommending votes against directors who served on the boards of outside firms (e.g., Lehman Brothers, Bear Stearns, etc.) deemed by ISS to be "failed financial firms." That policy was highly controversial, and only applied for one year. It appears that ISS is considering reinstating some form of that policy.

Auditor Independence: ISS is asking when evaluating the independence of the external auditor, what factors, if any, should be considered in addition to non-audit services and fees as a percentage of total fees. Currently, ISS rarely recommends votes against ratification of a company's auditor, except when non-audit fees are excessive. Based on survey questions that probe audit firm/partner tenure and identification of fines/controversies/weaknesses, it appears that ISS is considering expansion of factors that it will consider in recommending votes on auditor ratification.

Audit Committee: ISS is asking what factors are important when evaluating the effectiveness of a company's audit committee. In addition to the auditor independence, the survey questions whether shareholders should consider audit committee refreshment and frequency of audit committee meetings in its evaluation of a company's audit committee. This evaluation would presumably would be expressed in votes on the election of audit committee members.

Part 2: Policy Application Survey

Quantitative Pay-for-Performance Screens (US & Canada): ISS' approach to evaluating pay-for-performance involves two steps: a quantitative screen followed by a review of the company's executive compensation disclosures. ISS' current methodology uses total shareholder return in addition to several GAAP metrics. ISS is considering supplementing the four GAAP metrics with Economic Value Added (EVA) to improve the Financial Performance Assessment portion of the pay-for-performance screening. This is not unexpected given ISS' February 2018 acquisition of EVA Dimensions LLC, a business intelligence firm that measures and values corporate performance based on the EVA framework.

Non-employee Director Pay (US): According to ISS data, director pay has increased significantly since 2012. Starting in 2018, ISS identified director pay outliers. In 2019, the firm will begin recommending against compensation committees where elevated director pay persists over multiple years without a "compelling justification." ISS is asking what constitutes a compelling justification for multiple consecutive years of outlier director pay. ISS has already announced it will begin to issue negative vote recommendations based on two or more years of "outlier director pay" next year. In the survey, ISS asks for responses regarding justifiable reasons for high director pay, including payments related to corporate transactions, scientific or topical

expertise, and extraordinary performance or extraordinary service. It is unclear if any of these justifications is adopted into policy, what disclosure ISS would require to allow application of these exceptions in vote recommendations.

Independent Chair (US): ISS is considering amending the criteria it uses to evaluate independent chair proposals. They are asking what factors are important when determining if a shareholder proposal asking the board to establish an independent chair should be considered. ISS notes its strong preference for independent chairs. Based on the wording of this question and the available responses, it appears that ISS is considering adding additional factors to its policy on recommending independent chair proposals, presumably adding additional factors to its test.

Minimum Stock Ownership Requirements for Bylaw Amendments (US): Rule 14a-8 enables investors with at least \$2,000 of a company's stock to file shareholder proposals. The firm is asking interested parties that support minimum ownership thresholds above this \$2,000 level what they consider to be an appropriate level of ownership as well as whether multiple shareholders should be allowed to aggregate their stock ownership to meet this level. This question mirrors the recent debate on proxy access shareholder proposals and signals ISS' willingness to support thresholds above the 14a-8 minimums.

Board Qualifications Matrix (US): As part of its Boardroom Accountability Project 2.0, the New York City Pension Funds has advocated for a director matrix to help shareholders assess an individual director's fit, as well as the mix of skills among all directors on the board. In its survey, ISS is asking what level of disclosure about directors' skills do you consider to be most useful to shareholders. While it is unlikely that ISS would immediately adopt proxy voting policies based on such disclosure, it appears that the inclusion of this question is a step toward scrutinizing companies' director nomination practices.

Next Steps

If you have any questions about these policy questions or other executive compensation and corporate governance related matters, please write to consulting@radford.com. In the meantime, we encourage companies with opinions on these matters to [respond](#) to the ISS policy survey before the deadline. We will continue to follow the ISS policy survey process and will provide updates when new information is available.

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