

ISS Previews 2020 Policy Updates, Including a Policy on Multi-Class Stock Structures

As it does each fall, Institutional Shareholder Services (“ISS”), the corporate governance advisory services firm, has published a preview of the likely material updates to its proxy voting guidelines for U.S. companies for the 2020 proxy season. The preview highlights three proposed updates in the corporate governance area, each of which is of interest to the Boards of Directors of technology and life sciences companies. Specifically, ISS is considering:

- A policy that would trigger an unfavorable voting recommendation for the entire Board of Directors if, in connection with a company’s IPO, it implements a multi-class stock structure with unequal voting rights, unless the structure is subject to a reasonable time-based “sunset” provision of no more than seven years;
- Codifying the factors that will increase the likelihood of a favorable vote recommendation for a shareholder proposal requiring that the board chair position be filled by an independent director; and
- Codifying its existing policy with respect to when it will issue a favorable vote recommendation for management proposals to conduct an open-market share repurchase program.

Equally noteworthy is what ISS didn’t do – that is, it is not proposing any changes to its proxy voting guidelines covering executive compensation matters. We expect that ISS will issue updated compensation FAQs related to its voting policies later this year and will provide information on any noteworthy changes at such time.

ISS’ updated policies will be effective for annual meetings of shareholders held on or after February 1, 2020.

Background

On October 7, 2019, as a prelude to the publication of its voting policy guidelines for 2020, ISS announced that it was soliciting comments from companies, shareholders, and other market participants on a number of the policy updates under consideration. While the proposed updates do not reflect all of the policies that will apply during the 2020 proxy season, they represent the more significant issues that have been percolating just under the surface

in recent years and often portend areas where ISS plans to exercise scrutiny going forward.

Multi-Class Stock Structures

The proposed update would clarify ISS’ corporate governance review at newly-public companies by creating two distinct policies to address (i) multi-class capital structures with unequal voting rights and (ii) problematic governance provisions. With respect to the former policy, for newly public companies, ISS will generally issue an unfavorable vote recommendation for the entire board (except new nominees) if, prior to or in connection with the company’s IPO, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting the capital structure to a reasonable time-based sunset. ISS goes on to state that no sunset period of more than seven years from the date of the IPO will be considered to be reasonable.

With respect to problematic governance provisions, ISS is proposing to streamline its existing policy. As revised, the policy would provide that at newly public companies, ISS would issue an unfavorable vote recommendation for directors individually, committee members, or the entire board (except new nominees) if, prior to or in connection with its IPO, the company or its board adopted by-law or charter provisions that are considered to be materially adverse to shareholder rights, considering the following factors (i) supermajority vote requirements to amend the bylaws or charter; (ii) a classified board structure; or (iii) “other egregious provisions.” The presence of a reasonable sunset provision would be a mitigating factor.

Independent Board Chair Shareholder Proposals

ISS is proposing to update the factors that it considers when analyzing a shareholder proposal to separate the Board Chair and Chief Executive Officer roles. While intending to maintain a “holistic” approach to evaluating these proposals, the updated policy would list the types of factors that will be given substantial weight. The enumerated factors are (i) a weak or poorly defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role; (ii) the presence of

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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; (iii) evidence that the board has failed to oversee and address material risks facing the company; (iv) 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 (v) evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests. Identification of such factors will generally result in ISS recommending support for the proposal.

Open-Market Share Repurchase Program Management Proposals

As proposed, ISS will issue a favorable vote recommendation for a management proposal to institute an open-market share repurchase program in which all shareholders may participate on equal terms, or to grant the board authority to conduct open-market repurchases, in the absence of company-specific concerns regarding (i) 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; (ii) the use of buybacks to boost earnings-per-share or other compensation metrics to increase payouts to executives or other insiders; and (iii) repurchases that threaten a company's long-term viability (or a bank's capitalization level). This policy is to apply to U.S. domestic issuers listed solely in the United States, regardless of their country of incorporation.

What's Next?

ISS has indicated that it plans to issue its final policy updates for 2020 during the middle of November. As in prior years, the policy updates will go into effect at the beginning of February of the following year; in this case, February 1, 2020.

To access the ISS portal for its proposed policy updates, click [here](#).

Need Assistance?

Compensia has extensive experience in assisting companies in addressing ISS' U.S. benchmark voting policy guidelines. If you would like assistance in analyzing the potential impact of the ISS policies on your executive compensation program, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Jason Borrevik at 408.876.4035 or Mark A. Borges at 415.462.2995. ■

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