

# Meridian Client Update

## ISS Issues Proposed Policy Updates for 2016

On October 26, 2015, Institutional Shareholder Services (ISS) issued draft updates to its proxy voting policies. The proposed policy updates would revise ISS proxy voting policies for U.S. listed companies in the following two areas relating to corporate governance:

- Director Overboarding (i.e., a director’s service on an “excessive” number of boards), and
- Unilateral Board Actions.

If adopted by ISS, these policy updates would take effect on February 1, 2016.

Issuers and investors may submit comments via e-mail ([policy@issgovernance.com](mailto:policy@issgovernance.com)) on the proposed policy updates to ISS no later than November 9, 2015. All comments received will be published by ISS, unless otherwise requested in the body of the e-mail submission.

ISS will release final 2016 policies on November 18, 2015.

## Director Overboarding Current Policy

Under its current policy, ISS will recommend to vote AGAINST or WITHHOLD from any individual director who (1) sits on more than six public company boards, or (2) serves as CEO of a public company and sits on the boards of more than two public companies other than the company in which he or she serves as CEO (“outside boards”). In the case of such CEOs, ISS will only issue negative vote recommendations against the director with respect to his or her service on outside boards.

## Proposed Policy

As shown in the chart below, ISS is proposing to adopt a more stringent policy on overboarding for (1) directors who serve as a CEO of a public company and (2) directors that do not serve as a CEO of a public company. In the latter case, ISS is considering two potential standards for an acceptable number of directorships, whereby a director who is not an active CEO may serve on no more than either four or five directorships in total.

Number of Directorships	Current Policy	Proposed Policy
Directors who are Active CEOs	No more than 2 outside directorships	No more than 1 outside directorship
Directors who are not Active CEOs	No more than 6 directorships	No more than 4 or 5 directorships

Under the proposed policy, ISS would still issue negative vote recommendations against a director who is an active CEO with respect to his or her service on outside boards if he or she serves on more than one outside board. ISS would not consider majority-owned company subsidiaries to be outside boards.

In all cases, there would be a **proposed one-year grace period until 2017** during which time ISS would include cautionary language in its research reports but would not issue a negative vote recommendation solely because a director was considered overboarded under the revised policy.

**Meridian Comment.** In proposing more stringent policies on overboarding, ISS is contemplating the adoption of bright-line rules in situations that might be better served by case-by-case evaluations. The proposed standard does not consider relevant factors such as the specific individual's time commitments, the expertise he or she brings to the board, his or her attendance record, the businesses and operations of the boards on which he or she serve and whether the director's role on the board is part and parcel to other professional responsibilities.

As a general matter, the number of board seats that directors hold has declined in recent years, and therefore a new, more stringent ISS policy standard on excessive directorships may only affect a relatively small population of corporate directors. However, ISS notes that it expects that the proposed policy would result in 336 active CEOs being considered overboarded, compared to 79 CEOs under its current policy.

## Unilateral Board Actions

### Current Policy

Under its current policy, ISS will generally recommend a vote AGAINST or WITHHOLD from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the certain factors. The unilateral charter or bylaw amendments that ISS considers as materially diminishing shareholder rights include, among other corporate actions, (1) classifying the Board of Directors and (2) increasing vote requirement for shareholders to amend charter/bylaws.

ISS's current policy does not expressly address whether ISS will continue to issue negative vote recommendations on directors in subsequent years if a company's board does not sufficiently address the unilateral board action that materially diminished shareholder rights.

### Proposed Policy

ISS is proposing to revise its policy on unilateral board actions related to the adoption or amendment of charter/bylaw provisions to either (1) classify the board of directors or (2) establish supermajority vote requirements. As described below, the proposed policy distinguishes between post-IPO amendments and pre-IPO amendments (or those adopted in connection with the IPO).

- **Post-IPO Amendments.** Under the proposed policy, if a board unilaterally amends the company bylaws or charter to either classify the board or establish supermajority vote requirements **in any period after completion of a company's IPO**, ISS will generally issue negative vote recommendations against director nominees until such time as the unilateral action is either reversed or is ratified by a shareholder vote.

- **Pre-IPO or IPO-Related Amendments.** Under the proposed policy, if a board amends the bylaws or charter **prior to or in connection with the company's IPO** to classify the board and establish supermajority vote requirements to amend the bylaws or charter, ISS will generally issue adverse vote recommendations for director nominees at subsequent annual meetings following completion of the IPO.

In the proposed policy update, ISS notes that the proposed policy would not affect the manner in which ISS evaluates and determines initial vote recommendations on directors with respect to problematic unilateral bylaw and charter amendments. Rather, the proposed policy would explicitly state that certain provisions adopted unilaterally by the board, if not sufficiently addressed, can form the basis for continued adverse vote recommendations for director nominees in subsequent years. ISS explains that the principle underlying the policy continues to be that shareholders should have the right to opine on changes that materially affect their rights, particularly when such changes would diminish their rights or increase the risk of board and management entrenchment.

**Meridian Comment.** In early 2015, ISS updated its policy on unilateral bylaw and/or charter amendments based on its observation of a substantial increase in the amount of bylaw and/or charter amendments that were adopted by boards without shareholder ratification. The significant increase in such amendments is primarily due to the recent trend of companies adopting bylaw and/or charter amendments immediately preceding, or in conjunction with, their IPOs. Pre-IPO companies should consider ISS's policies before determining whether to unilaterally adopt bylaw and/or charter provisions that ISS considers as materially diminishing shareholder rights.

The proposed policy on unilateral board actions would not impact most public companies. Very few boards unilaterally amend their governing documents after an IPO to either classify the board or adopt supermajority vote requirements to amend the bylaws or charter (ISS has only identified 3 companies that introduced such post-IPO amendments).

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The **Client Update** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or [dkalfen@meridiancp.com](mailto:dkalfen@meridiancp.com).

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