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ISS Publishes FAQs with Clarifications for 2016 Proxy Season

ISS recently published [FAQs](#) that clarify its approach on a variety of procedural and governance matters heading into the 2016 proxy season. Among other things, the FAQs address ISS's approach to evaluating board responsiveness to proxy access shareholder proposals that receive majority support. As companies decide how to respond to the growing pressure to adopt proxy access, these FAQs indicate ISS's position regarding responsiveness to precatory resolutions and certain "second level" proxy access design and drafting issues.

Key Parameters of Proxy Access. After a shareholder proposal seeking proxy access has passed, ISS may issue an adverse recommendation if the form of proxy access implemented or proposed by a company contains material restrictions that are more stringent than those included in the majority-supported proxy access shareholder proposal, including:

- Ownership thresholds above three percent;
- Ownership for more than three years;
- Aggregation limits below 20 shareholders; and
- A cap on nominees below 20 percent of the board.

Where the nominee cap or aggregation limit differs from that specifically stated in a shareholder proposal that received majority support, ISS will evaluate the differences on a case-by-case basis, taking into account (and expecting to see) disclosure regarding shareholder outreach efforts. Most of the shareholder proxy access proposals that have previously passed asked companies to permit shareholders to "group" and aggregate shares they have individually held for 3 years in order to meet the 3% ownership threshold and were silent as to what a reasonable limit on aggregation would be; most (though not all) shareholder proponents have agreed to withdraw their proposals and major shareholders have been willing to support adopted proxy access bylaws where a company acts reasonably in selecting a group limit. If shareholders passed a proxy access proposal with a 25% nominee cap, the company should be able to propose a 20% cap without receiving an adverse recommendation from ISS, assuming it can demonstrate in its proxy statement sufficient shareholder outreach and support. The nomination cap is also an area where most shareholder proponents (and major shareholders) have been willing to show flexibility, and various approaches have emerged on the cap, including hybrid approaches that include both a percentage-based formulation and a numerical minimum or maximum.

Restrictions or Conditions on Proxy Access Nominees. On a range of "second-tier" issues that will have to be addressed as companies formulate proxy access bylaws to ensure that they are not abused, ISS will review proxy access implementation and restrictions on nominees on a case-by-case-basis. ISS considers the following restrictions to be "especially problematic" and to "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 ownership requirements for nominating shareholders.

In addition, ISS views the following restrictions as "potentially problematic," especially when used in combination, in the context of evaluating board responsiveness to a shareholder-supported proxy access proposal:

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- Prohibiting resubmission of failed nominees in subsequent years;
- Restricting third-party compensation of proxy access nominees (beyond requiring full disclosure of such arrangements);
- Restricting the use of proxy access and proxy contest procedures for the same meeting;
- How long and under what terms an elected shareholder nominee will count towards the maximum number of proxy access nominees; and
- When the new proxy access right will be fully implemented and accessible to qualifying shareholders.

While these proxy access parameters are not generally inconsistent with the approach taken by the majority of companies that have recently implemented proxy access, this area is still in flux. We would not expect ISS to issue withhold recommendations as a result of thoughtfully crafted and appropriate restrictions on the use of proxy access. Companies evaluating proxy access should consider outreach with their shareholders, especially on areas where they may want to take a different position on certain limitations. We also encourage companies implementing proxy access, whether preemptively or in response to the receipt or passage of a shareholder proposal, to do so in a measured fashion and to consult with counsel to distinguish between fundamental protections and those that might be considered inflammatory.

Voting on Proxy Access Nominees. ISS has also formulated a framework for evaluating proxy access nominees. This set of criteria is in a sense broader than that used in evaluating directors in proxy contests and includes:

- Nominee- and nominator-specific factors: the nominator's rationale and critique of management or incumbent directors; the nominee's qualifications and independence
- Company-specific factors: the company's performance relative to peers; background to the contested situation (if applicable); the board's track record and responsiveness; director and nominee independence; the company's governance profile; evidence of board entrenchment; current board composition (*e.g.*, skill sets, tenure and diversity); ongoing controversies, if any
- Election-specific factors: Whether the number of nominees exceeds the number of board seats; the voting standard for the election of directors

Board Responsiveness to Passage of Independent Chair Proposals. In evaluating board responsiveness to majority-supported independent chair proposals, ISS has stated that a policy that the company will adopt an independent chair structure upon the resignation of the current CEO would be considered responsive in the context of a company having previously lost the shareholder vote on an independent chair / separation of CEO-Chair proposal. It will evaluate partial responses on a case-by-case basis, depending on the disclosure of shareholder input obtained through outreach, the board's rationale and the facts and circumstances of the situation. Board leadership structure remains an area where major institutional shareholders have shown flexibility where a company conducts effective outreach.

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