



ISS Announces Updates to 2017 Policy and QualityScore Governance Ratings

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In the past week, ISS has announced draft updates to their 2017 proxy voting guidelines and updates to their QuickScore (now called QualityScore) governance rating system. This alert provides a summary of the key updates for both ISS corporate governance evaluation processes.

ISS 2017 U.S. Policy Draft Updates

Last week, ISS announced their draft updates to their 2017 policy. The updates represent the third key milestone in ISS's benchmark policy development, which, if adopted, would go into effect for all shareholder meetings occurring on or after February 1st, 2017. ISS has opened a comment period until November 10th to solicit feedback from institutional investors, corporate issuers, and consultants on the proposed updates before the final policy guidelines are announced in the second half of November.

ISS has indicated that other policy changes that are not submitted for draft review would be implemented for the 2017 proxy season (e.g., the inclusion of additional performance metrics beyond total shareholder return in ISS's pay-for-performance quantitative evaluation). In addition, other policy updates, including burn rate thresholds and pay-for-performance quantitative concern thresholds, are typically published in mid-December through ISS's FAQ document.

The key proposed update to ISS's U.S. executive compensation policy relates to executive pay assessments for cross-market companies (companies who are incorporated in one country but listed in a different country, often the U.S.). ISS is proposing to evaluate companies who are listed in the U.S., but incorporated elsewhere, based on U.S. policy guidelines for all compensation-related proposals on the ballot. For proposals where there is no applicable U.S. policy, the ISS policy from the country requiring the ballot item will be used.

The intent of the proposed update is to align ISS voting recommendations so as to not have inconsistent recommendations on the same pay program. A majority of ISS respondents to the 2016-2017 Policy Survey supported aligning the voting recommendations for multiple proposals covering the same compensation program.

The other proposed updates to ISS's U.S. policy guidelines unrelated to executive compensation include:

- **General share issuance mandates for cross-market companies**
 - o ISS is proposing to recommend in favor of general share issuance authorities up to 20 percent of currently issued capital, as long as the duration of the issuance authority is reasonable and clearly disclosed.

- **Unilateral board actions – multi-class capital structure at IPO**
 - o ISS is proposing to clarify its director election policy to state that, upon a company holding an IPO with a multi-class capital structure with unequal voting rights or other problematic governance provisions, ISS will generally issue adverse director vote recommendations unless there is a "reasonable" sunset provision on the unequal structure or the problematic provisions.

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- **Restrictions on binding shareholder proposals**
 - o ISS is proposing to amend its director election policy to include a provision to issue adverse vote recommendations on governance committee director elections where companies have placed “undue” restrictions on shareholders’ ability to amend the company’s bylaws.

Pay Governance will issue an additional alert once the final ISS policy guidelines are announced in the second half of November.

ISS QualityScore Governance Rating

ISS’s QualityScore (rebranded from QuickScore) is a governance ratings model that helps institutional shareholders monitor portfolio corporate governance risk. It evaluates factors across four pillars (Board Structure, Compensation, Shareholders Rights, and Audit and Risk Oversight) to provide an indication of relative governance quality among corporate issuers. The ISS QualityScore annual methodology update ensures the scoring evaluation remains closely aligned with ISS’s proxy voting guidelines.

The following factors have been added to the QualityScore pillars for Board Structure and Compensation:

Board Structure

- What proportion of non-executive directors has been on the board less than 6 years?
- Does the board have any mechanisms to encourage director refreshment? (*Non-scored*)
- Does the company disclose the existence of a formal CEO and key executive officer succession plan?
- What is the proportion of women on the board?
- Has the board adequately responded to low support for a management proposal?

Compensation

- Does the company employ at least one metric that compares its performance to a benchmark or peer group (relative performance)?

In addition to the factors highlighted above, factors have been updated in the QualityScore pillars for Shareholder Rights and Audit and Risk Oversight. Details of the updates can be found in the ISS technical document posted on the ISS website:

<https://www.isscorporatesolutions.com/file/documents/QualityScore%20Techdoc%20Nov2016.pdf>

ISS has opened their Data Verification Site from now through November 11th, which allows companies to preview and verify the data ISS will use to formulate the QualityScore ratings. QualityScores will be published on November 21st for corporate issuers. The Data Verification Site will be open again on November 21st, and will be open year-round with the exception of the time between a company’s proxy statement is filed and when the ISS research report is issued.

General questions about this Viewpoint can be directed to Brian Johnson at brian.johnson@paygovernance.com.