

## ISS Draft Policy Changes for 2020: Radio Silence on Compensation Modifications

### AUTHOR



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ISS released its proposed policy changes for 2020 which, for the first time in many years, include almost no changes for compensation-related items. In fact, it did not address many of the issues presented in the policy survey (e.g., director overboarding, gender diversity, or use of economic value added [EVA] as a secondary measure in the pay-for-performance test). That being said, don't be surprised if we do in fact see some important changes when the final policy is released in November. We understand that it is likely that ***EVA will be replacing previously used financial performance measures as the secondary measure. We also understand that it is likely that ISS reports will retain the previously used FPA measures as reference even if EVA is adopted as the official qualitative modifier.***

In a nutshell, the three US-based draft policy changes announced are as follows:

- **Splitting the Chair/CEO Role:** ISS provides scenarios under which it would support a shareholder proposal to split the role, including:
  - A weak or poorly-defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role;
  - The presence of 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;
  - Evidence that the board has failed to oversee and address material risks facing the company;
  - 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
  - Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

**Pearl Meyer Observation:** While we've seen year-over-year increases in proposals filed for an independent chair for some time, most of these proposals do not garner strong support. ISS's scenario approach shows a refreshing dose of qualitative and multidimensional review. It will be interesting to see if the new voting policy has an impact on this matter.

- **Repurchases:** Some companies put repurchase and stock buybacks to a shareholder vote. ISS has indicated it will recommend votes against buybacks if:
  - ISS suspects greenmail;
  - They are being used to "inappropriately manipulate incentive compensation metrics";
  - They threaten a company's long-term viability; or
  - Other company-specific factors are relevant.

**Pearl Meyer Observation:** With more and more worries about the strength of the market and the economy, companies continue to consider repurchases and buybacks when they view their own stock as an attractive use of funds. How ISS determines whether such programs are used to manipulate compensation is a mystery, however.

- **Problematic Governance Structure for IPOs:** ISS will issue an "Against" recommendation on the entire board, with the exception of new nominees, if the company has bylaw or charter provisions "that are considered to be materially adverse to shareholder rights." These provisions may include:
  - Supermajority voting;
  - A classified board structure; or
  - Other egregious provisions.

Again, our understanding is that there will likely be additional policies in the final release that are unrelated to the three draft change provisions above. For example, we know that the new excessive director compensation test and board gender diversity policies will become effective for 2020. And as mentioned above, be prepared for EVA to replace FPA as a secondary screen in the pay for performance test.

The comment period is open until October 18, with final policies typically released by Thanksgiving. We will update you upon release of these final policies.



## About the Author

Deborah Lifshy is a managing director in the New York office, where she specializes in advising clients on compensation matters from a legal perspective including securities disclosure, taxation and corporate governance issues, negotiation contracts, and reasonableness opinion letters.

## About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, Raleigh, and San Jose.



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