Pearl Meyer

CLIENT ALERT

ISS and SEC Fall Roundup

As we all dig our heels into fall meetings and 2022 planning, there are several behind the scenes policy-making items that are evolving of which directors should be mindful.

ISS Policy Survey Results Forecast Upcoming Change

First, ISS has just released results of its policy survey. The questions posed, as well as the results of the survey, are important as they tend to signal changes to proposed policies which are generally released in November. ISS sorts results between investors and non-investors (mostly direct company responses). This year, three compensation-related questions appeared in the survey:

ESG Metrics in Incentive Plans: ISS asked whether ESG measures should be incorporated into incentive compensation plans and if so how. The vast majority of both investors (85%) and non-investors (75%) think ESG should be incorporated into compensation plans, but are split about whether they should be specific/measurable. Investors favor more measurable and specific goals while non-investors are split in opinion as to whether goals really need to be specific and measurable. For those respondents that indicated ESG should be incorporated, the majority of both investors (81%) and non-investors (71%) indicated that ESG could be in either short-term or long-term programs, as appropriate.

Longer-Term Perspective on CEO Pay Quantum (e.g., Three-year Quantum of CEO Pay): The current ISS quantitative test consists of four parts: (1) a Relative Degree of Alignment, which measures alignment between TSR and CEO pay over two to three years compared to ISS peers; (2) the Pay-TSR Alignment analysis, which measures the five-year historical trend in CEO pay and company TSR; (3) the Multiple of Median (MOM) analysis, which measures a CEO's one-year total pay relative to the ISS peer group median CEO pay; and (4) the Financial Performance Assessment measuring the percentile rank of a company's CEO pay and financial performance across certain EVA metrics, relative to ISS peers, over the prior two- to three-year period. ISS inquired as to whether a longer-term perspective with respect to the Multiple of Median analysis would be appropriate. The majority of both investors (85%) and non-investors (67%) said a longer-term perspective is relevant and would be helpful.

Mid-Cycle Changes to LTI programs in Response to the Pandemic: The slight majority of investors believe such changes are problematic, while only 15% of non-investors believe they may be problematic.

> ***Pearl Meyer Observation:*** *While it's difficult to predict exactly where ISS policy will land, it is quite possible that ISS will find a way to incorporate into one of their voting policies whether or not companies are using ESG in incentive plans. ISS may also be headed in the direction of incorporating a longer-term measure into its MOM test. Finally, we are hopeful that ISS will continue to take a holistic view of mid-cycle changes if robust disclosure is provided as rationale.*

SEC Will Not Enforce New Proxy Advisor Rule Changes in December

Whether and how to regulate proxy advisory firms, such as ISS and Glass Lewis, has long been a contentious issue, with many arguing that proxy advisor vote recommendations were riddled with conflicts of interest and errors, while others saw no reason for regulation given that the clients of these firms (e.g., institutional investors) were satisfied with their services.

As we detailed in an earlier Client Alert, over a year ago the SEC finally adopted rule amendments which made proxy voting advice subject to the proxy solicitation rules. In order to be exempt from the onerous requirements of such solicitation rules, the SEC provided two new conditions for exemptions from those rules, including that proxy advisors (1) provide their clients (institutional investors) with conflict of interest disclosure, and (2) provide companies with no-cost timely reports at the same time they are delivered to institutional investors so that companies have sufficient time to respond to or rebut the proxy advisor report (including the requirement that proxy advisors ensure that their clients have access to company responses). ISS promptly reactivated a pending lawsuit against the SEC to enjoin enforcement of the rule.

Initially, proxy advisors were required to comply with the new rule on December 1, 2021, but over the summer, SEC Chair Gary Gensler directed the staff to consider whether to recommend further regulatory action on the matter and reconsider the 2020 rule amendments. As a result, at least for now, the SEC's Division of Corporation Finances will not be recommending enforcement actions for failure to comply with the 2020 rule amendments.

> ***Pearl Meyer Observation:*** *It is uncertain how or when the SEC will move forward to review and perhaps revise these rules, although it appears that a majority of SEC members no longer support them and we know that ISS has agreed to freeze its lawsuit until the earlier of December 31st or agency adoption of new rules. In the interim, for however long that interim period may be, the Division of Corporation Finance's refusal to seek to enforce these rules seems to be tantamount to their suspension or repeal of the 2020 amendments. Clients should therefore be aware that their early and free access to reports will not be available at least this proxy season.*

Institutional Investor Say-on-Pay Disclosure

The SEC has proposed two new disclosure rules for mutual funds and institutional investors that will provide us with greater transparency into voting decisions, including say-on-pay.

The SEC first started requiring public disclosure of mutual fund voting on Form N-PX back in 2003. However, Form N-PXs are often lengthy documents (some up to 1,000 pages long) and there was not a uniform system of disclosure. Thus, it was extremely difficult for a reader to locate specific voting results. The proposed rules would require funds to tie the description of each voting matter to the company's form of proxy and to categorize each matter by type to help investors identify votes of interest and compare voting records. The proposal also would prescribe how funds organize their reports and require them to use a structured data language to make the filings easier to analyze.

As part of the same rulemaking package, the proposal would also require institutional investment managers (in addition to hedge funds and endowments) to disclose how they voted on say-on-pay and would—more than a decade later—fulfill one of the remaining rulemaking mandates under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Institutional investment managers generally would be subject to the same Form N-PX reporting requirements as funds with respect to their say-on-pay votes. This information is intended to enhance transparency as institutional investors have become key voters in such tallies as the portion of public company shares held by fund managers steadily grows.

While the proposal remains open to comment for sixty days, it could become effective in time for the next annual proxy season in the spring.

> ***Pearl Meyer Observation:*** *The proposed enhanced and organized disclosures on company websites, which clearly label what funds voted on by category, will provide infinitely easier access to information about compensation matters. In particular, it will provide important, timely, and easily accessible information to companies and board members on each voting matter (including their own approvals), as well as a breakdown of how and investors voted on say-on-pay matters. Armed with this information, companies may be able to react (and plan) in a targeted and more effective manner to adverse compensation-related voting activity.*

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About Pearl Meyer

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