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Climate Change Risk Disclosure, Responsiveness to Say-on-Pay and Gender Pay Gap Lead ISS' 2018 Benchmark Policy Changes for U.S. Companies

On Thursday, November 16th, ISS released its 2018 Benchmark Policy changes that will be effective for annual meetings that occur on or after February 1st, 2018. This year's update includes new policies for U.S. companies around shareholder proposals regarding gender pay equity and climate change risk, disclosure on responsiveness to low say-on-pay votes, excessive compensation for non-employee directors, recommendations to vote against board members at companies with long-term poison pills and a new metric on relative financial performance assessment. The policy updates are the culmination of ISS' policy development process, which includes consideration of the results of ISS' 2017-2018 Global Policy Survey as well as feedback received over the past few months in various roundtable and group discussions with investors and corporate directors, including four held in the U.S.

Climate Change Risk Shareholder Proposals

ISS has expanded the conditions under which it will recommend for a climate change risk shareholder proposal to include those seeking disclosure on how a company identifies, measures and manages these risks. This is in addition to the current policy which provides that ISS will recommend for disclosure of the financial, physical and regulatory risks a company faces from climate change. This new language closely aligns with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which explicitly seeks disclosure of the board's and management's roles in assessing and managing climate-related risks and opportunities.

Gender Pay Gap Shareholder Proposals

Under this new policy, ISS will evaluate proposals relating to gender pay equity on a case-by-case approach through review of policies and disclosures on diversity and inclusion as well as compensation philosophy and fair and equitable compensation practices. It will also examine any recent controversies, litigation or regulatory action on gender pay issues and will compare the company's reporting on the topic against its peers. ISS did not previously have a policy on this type of shareholder proposal.

Board Diversity

In response to its 2017-2018 Global Policy Survey, which found that 69 percent of investors considered it problematic if there are no female directors on a public company board, ISS will now identify in its reports which boards have zero female directors. However, it will not use any lack of gender diversity as a factor in its vote recommendations on directors. ISS also added language to its fundamental principles regarding voting on director nominees in uncontested elections that boards should be sufficiently diverse to ensure consideration of a wide range of perspectives.

Pay-for-Performance Evaluation

ISS updated its primary evaluation factors for executive pay peer group alignment to include a relative assessment across additional financial performance metrics (the "relative financial performance assessment"). These metrics were introduced in 2017 as part of the qualitative assessment, and will now be included in the quantitative assessment. ISS will examine the rankings of CEO total pay within a peer group with respect to company financial performance across three or four financial performance metrics, which will vary by industry, each measured over a three-year period. ISS indicated it will provide more details on this in an upcoming white paper. In addition, ISS clarified its measurement of the multiple of the CEO's total pay relative to the peer group median to include just the most recent fiscal year (previously the timeframe for the evaluation was not defined).

Responsiveness to Say-on-Pay

For companies that receive the support of less than 70 percent of votes cast on their most recent say-on-pay proposal, ISS will now take additional shareholder engagement disclosure under consideration when deciding how to recommend on say-on-pay proposals and compensation committee members in the following year. ISS will consider disclosure of the timing and frequency of engagements and whether independent directors participated, disclosure of specific concerns by dissenting shareholders and disclosure of specific "and meaningful" actions taken to address shareholders' concerns. ISS notes that it prefers independent director participation as it is more conducive for candid investor feedback and that it will now consider the quality of pay and disclosure changes. ISS is also placing more emphasis on feedback from investors who voted against say-on-pay, which for some companies may not be the largest investors.

Excessive Non-Employee Director (NED) Compensation

ISS will now recommend voting against board committee members who are responsible for approving or setting NED compensation when there are two or more consecutive years of excessive NED pay without a compelling rationale or other mitigating factors. In support of this policy change, ISS cites its 2017 Board Study which found that median NED compensation in the S&P 1500 has grown every year since 2012 as well as investor response to its 2017-2018 Global Policy Survey. This policy will not impact vote recommendations in 2018.

Poison Pills

In cases in which companies have an active, non-shareholder-approved poison pill with a duration of longer than one year, ISS will recommend voting against all of a company's directors every year, regardless of whether the board is annually elected. This includes pills adopted in 2009 and earlier which had been grandfathered in under existing policy. Pills with a duration of one year or less that were not approved by shareholders will continue to be evaluated on a case-by-case basis, with an increased focus on the board's rationale for adoption.

Takeaways for Issuers

This year's benchmark policy changes can be characterized as more evolutionary than revolutionary. Echoing the findings of the surveys that ISS conducted this past fall, environmental and social topics continue to be front of mind for investors. Reflecting a broader market trend, many of the ISS policy changes take into account the elevated role of the board, including how directors oversee climate risk and engage with shareholders in critical pay situations. While these changes in isolation are unlikely to result in a significant increase in recommendations contrary to management's recommendation, the new policies are a strong indicator of where investors will be focused as we head into the 2018 proxy season.

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