Client Alert

ISS and Glass Lewis Issue Proxy Voting Policy Updates for the 2016 Proxy Season

EXEQUITY

Independent Board and Management Advisors

Both ISS and Glass Lewis released their proxy voting updates for the 2016 proxy season.[1] ISS also issued an updated set of FAQs for its Equity Plan Scorecard (EPSC) policy,[2] which made some changes to how the policy will be applied during the 2016 proxy season.

Summary of Policy Updates

	ISS	Glass Lewis
Compensation Policies	• **EPSC policy**: ISS updated the EPSC factors and weights • **Compensation-related votes at externally managed issuers**: ISS will recommend against Say on Pay votes at such issuers unless sufficient compensation disclosure • **Shareholder proposals to adopt holding periods**: ISS broadening its policy to encompass such proposals more generally and to strongly consider retention ratio and holding period duration, among several other factors	• **One-time and transitional awards**: Glass Lewis has added information to its discussion of such awards to highlight factors it evaluates in considering such awards • **Equity compensation plans**: Glass Lewis clarifies the quantitative and qualitative factors used to analyze such plans

[1] ISS's policy updates are available in Americas, Proxy Voting Guidelines Updates, Effective for Meetings on or after February 1, 2016 (November 20, 2015), available at http://www.issgovernance.com/file/policy/2016-americas-policy-updates.pdf; Glass Lewis & Co., LLC's policy updates are available in Proxy Paper Guidelines, 2016 Proxy Season, United States, available at http://www.glasslewis.com/assets/uploads/2015/11/GUIDELINES_United_States_20161.pdf.

[2] 2016 U.S. Equity Plan Scorecard Frequently Asked Questions, Effective for meetings on or after February 1, 2016 (November 20, 2015), available at http://www.issgovernance.com/file/policy/faq-on-iss-us-equity-plan-scorecard-methodology.pdf.

	ISS	Glass Lewis
Other Policies	• **Overboarded director policy** revised to decrease number of boards a director can sit on and not be considered overboarded (serving on more than five public company boards) • **Unilateral bylaw/charter amendments**: ISS will now recommend against directors after such action is taken until approved by shareholders, and will recommend against newly public company directors that took such action immediately prior to the IPO	• **Overboarded directors**: Glass Lewis will note when directors are on more than five boards, but vote recommendation still made on basis of current policy (over six boards to be considered overboarded). For 2017, Glass Lewis announced that it would revise its policy so that directors serving on more than five public company boards or two public company boards if serving as a CEO will be considered overboarded.
Effective Date	• Shareholder meetings on or after February 1, 2016	• Not explicitly stated in the 2016 Proxy Paper Guidelines Glass Lewis released; expect will apply to meetings held in 2016

ISS Policy Updates

The ISS policy updates related to compensation for 2016 are set out below.

EPSC Policy Updates

ISS updated its EPSC policy in the Equity Plan Scorecard FAQs that it issued along with the 2016 Policy Updates. ISS made a few changes to the policy for 2016:

- **Changed Groups**: ISS replaced the IPO/bankruptcy group with respect to equity plan evaluations under the EPSC policy with two groups: Special Cases—Russell 3000/S&P 500 companies and Special Cases—Non-Russell 3000 companies. Additionally, ISS revised the maximum points attributed to the three pillars for these two new groups. The groups and maximum pillar points are as follows for 2016:

Company Group	"Pillars" and Maximum Points		
	Plan Cost	Plan Features	Grant Practices
S&P 500 and Russell 3000 companies	45	20	35
Non-Russell 3000 companies	45	30	25
Special Cases*—Russell 3000/S&P 500	50	35	15
Special Cases*—Non-Russell 3000	60	40	0

* Companies that either went public or emerged from bankruptcy that do not disclose three years of grant data.

***Note**: In 2015, companies that went public or emerged from bankruptcy during the prior three years were all covered by the IPO/Bankruptcy company group that had the same EPSC weightings as the new Special Cases–Non-Russell 3000 company group.*

Under the EPSC policy, a plan proposal must score at least 53 points (ISS refers to this as the Threshold) in order for ISS to recommend FOR the proposal (barring any overriding factors).

- **Burn Rate**: ISS adjusted the points awarded under the burn rate factor so that full points will be awarded if a company's burn rate is at or below 50% of the applicable ISS Burn Rate benchmark (formerly referred to as the Burn Rate Cap) and points awarded are reduced more significantly for burn rates exceeding 50% of the ISS Burn Rate benchmark than last year.[3]

- **Overriding Factors**: ISS removed the possibility that an ***excessive*** shareholder value transfer cost or burn rate alone could be treated as an overriding factor, i.e., neither of these alone will cause a negative ISS vote recommendation.

- **Change-in-Control Vesting Provisions**: ISS revised the way in which it assesses change-in-control vesting provisions so that it will now separately evaluate the treatment of time-based and performance-based equity upon a change in control. Under the revised policy, each factor will receive full, partial, or no points depending on the vesting terms of the particular type of award:[4]

Points	Time-Based Awards		Performance-Based Awards
Full Points	• No accelerated vesting *OR* • Accelerated vesting only if awards are not assumed/converted	**AND**	• Forfeiture or termination of outstanding awards *OR* • Vesting based on (a) actual performance as of the change-in-control date, **or** (b) prorated (at target or based on actual performance) based on the time elapsed in ongoing performance period(s)
No Points	Automatic accelerated vesting	**OR**	Payout of performance-based awards above target level
Half Points	Anything else		

- **Holding Period**: ISS has raised the minimum holding period necessary to receive full credit under this EPSC factor to 36 months from 12 months. Companies will receive half of the possible points for this factor for a holding period of 12 months to less than 36 months, and no points for a holding period less than 12 months or no holding period is specified.

- **CEO Vesting Requirement**: ISS reduced the point allocation to zero when the CEO vesting requirement on performance-based equity is "Not Applicable," i.e., when no performance-based equity awards have been granted to the CEO in the past three years.

Compensation Votes at Externally Managed Issuers

ISS will generally recommend AGAINST Say on Pay proposals at companies with an external manager when there is insufficient detail in the company's disclosures for ISS to perform its pay-for-performance analysis. ISS indicated that it identified approximately 48 externally managed issuers that might be affected by this new policy.[5]

---

[3] See Sweet Sixteen: ISS Policy Updates and the Proxy Season Preview, presented to the Chicago chapter of NASPP by Peter Kimball, Vice President, Advisory Services, ISS Corporate Solutions, December 2, 2015.
[4] Ibid.
[5] Ibid.

Shareholder Proposals to Adopt Holding Periods

ISS updated its policy on shareholder proposals to adopt holding periods to clarify the factors it considers in its case-by-case analysis. The policy was also broadened to encompass equity retention proposals more generally, which eliminated the need for a separate policy tied to a specified retention ratio.

The revised policy clarifies that a proponent's suggested retention percentage/ratio and the required retention duration are two of several factors that will be assessed. This eliminated the need for a separate ISS policy on specified retention ratios.

Overboarded Directors

ISS revised its policy on overboarded directors such that it will report on any directors serving on more than five public company boards during 2016, and then starting on February 1, 2017 will recommend against directors who sit on more than five public company boards.

This policy change did not affect CEO directors. Directors that are CEOs of public companies who sit on boards of more than two public companies besides their own will still be considered overboarded, and ISS will recommend WITHHOLD votes at their outside boards.

The table below shows the level of directors that will cause ISS to consider a director to be overboarded:

Overboarded Directors

	2016	2017
Directors Serving as CEO	> 3 public company boards	> 3 public company boards
Other Directors	> 6 public company boards	> 5 public company boards

Unilateral Bylaw/Charter Amendments

ISS modified its policy to introduce distinctions for unilateral bylaw/charter amendments by companies in the process of going public and those that are newly public companies. ISS clarified it will consider unilateral bylaw/charter amendments in both cases in determining its director vote recommendations until such time as the actions are reversed or submitted to a binding shareholder vote.

Other Updates: Updated FAQs and Burn Rate Benchmarks for 2016

ISS also issued an extensive set of updated FAQs[6] in December for the 2016 proxy season as well as the Burn Rate Benchmarks that will apply in 2016 (see Appendix for the Burn Rate Benchmarks detailed by specified company groups).

[6] Frequently Asked Questions: U.S. Executive Compensation Policies, December 18, 2015, available at http://www.issgovernance.com/file/policy/us-executive-compensation-policies-faq-dec-2015.pdf; Frequently Asked Questions: U.S. Equity Compensation Plans, December 18, 2015, available at: http://www.issgovernance.com/file/policy/1_us-equity-compensation-plans-faq-dec-2015.pdf; Frequently Asked Questions: U.S. Proxy Voting Policies and Procedures (Excluding Compensation-Related), December 18, 2015, available at http://www.issgovernance.com/file/policy/us-policies-and-procedures-faq-dec-2015.pdf.

Glass Lewis Policy Clarifications

Glass Lewis did not update its policies for 2016. Instead, Glass Lewis added clarifying language to several compensation-related policies for 2016 and announced a change in policy for overboarded directors that will be effective for 2017.

One-Time and Transitional Awards

Glass Lewis clarified its policy with respect to one-off awards to also address transitional awards. Glass Lewis encourages companies to clearly disclose sign-on arrangements and provide a meaningful explanation of the payments and the process by which the amounts were reached, including the details and basis of any "make-whole" payments.

Glass Lewis also indicated that for severance and sign-on arrangements, it may consider the executive's regular target compensation levels or the sums paid to the executive (including the recipient's predecessor, where applicable) in evaluating the appropriateness of such an arrangement.

Equity Compensation Plans

Glass Lewis clarified its equity-based compensation plan proposals policy to indicate what qualitative factors it considers when determining its vote recommendations. Glass Lewis will consider the plan's administration, the method and terms of exercise, repricing history, express or implied rights to reprice, and the presence of evergreen provisions. Glass Lewis also indicated that it will review the choice and use of, and difficulty in meeting, awards' performance metrics and targets, if any. Glass Lewis also indicated that significant changes to the terms of a plan should be clearly laid out and explained to shareholders. Glass Lewis may also consider a company's size and operating environment, as well as executive compensation practices, when evaluating equity plans.

Overboarded Directors

Again, Glass Lewis did not change its policy. Rather, Glass Lewis has indicated that it will more closely monitor the number of boards that directors serve on, and may note as a concern instances of directors serving on more than five total boards and more than two other boards if the director also serves as CEO of the company. For 2016, Glass Lewis indicates that its director vote recommendation with respect to overboarding will be based on its current policy, i.e., a director is overboarded if serves on more than six public company boards or three total boards if also serves as CEO.

Starting in 2017, Glass Lewis has indicated that its policy will change such that a director who serves on more than five public company boards or two public company boards if also serves as CEO will be considered overboarded.

The table below shows the level of directors that will cause Glass Lewis to consider a director to be overboarded:

Overboarded Directors

	2016	2017
Directors Serving as CEO or Executive of Public Company	> 3 public company boards	> 2 public company boards
Other Directors	> 6 public company boards	> 5 public company boards

If you have any questions about this ***Client Alert***, please contact Edward Hauder ((847) 996-3990 or edward.hauder@exqty.com) or any of the following:

Ben Burney	(847) 996-3970	Ben.Burney@exqty.com
Robbi Fox	(847) 948-8655	Robbi.Fox@exqty.com
Mark Gordon	(925) 478-8294	Mark.Gordon@exqty.com
Jeff Hyman	(203) 210-7046	Jeff.Hyman@exqty.com
Lynn Joy	(847) 996-3963	Lynn.Joy@exqty.com
Stacey Joy	(847) 996-3969	Stacey.Joy@exqty.com
Chad Mitchell	(949) 748-6169	Chad.Mitchell@exqty.com
Jeff Pullen	(847) 996-3967	Jeff.Pullen@exqty.com
Dianna Purcell	(718) 273-7444	Dianna.Purcell@exqty.com
Bob Reilley	(856) 206-9852	Bob.Reilley@exqty.com
Mike Sorensen	(847) 996-3996	Mike.Sorensen@exqty.com
Jim Woodrum	(847) 996-3971	Jim.Woodrum@exqty.com
Ross Zimmerman	(847) 996-3999	Ross.Zimmerman@exqty.com

Illinois Office (Headquarters) – 1870 West Winchester Road, Suite 141 ● Libertyville, IL 60048
California Offices – 650 Town Center Drive, Suite 830 ● Costa Mesa, CA 92626
– 2840 Comistas Drive ● Walnut Creek, CA 94598
Connecticut Office – 108 Pine Ridge Road ● Wilton, CT 06897
New Jersey Office – 309 Fellowship Road, Suite 200 ● Mt. Laurel, NJ 08054
www.exqty.com

PUB/CA/2016 Proxy Season Policy Updates_20160107

Appendix: ISS 2016 Burn Rate Benchmarks

S&P 500

GICS	Description	Mean	Standard Deviation	Industry Benchmark*	Burn Rate to Maximize EPSC Points
10	Energy	1.13%	0.55%	2.00%	1.00%
15	Materials	1.16%	0.61%	2.00%	1.00%
20	Industrials	1.36%	0.68%	2.04%	1.02%
25	Consumer Discretionary	1.55%	0.79%	2.34%	1.17%
30	Consumer Staples	1.37%	0.65%	2.03%	1.01%
35	Health Care	1.98%	0.84%	2.82%	1.41%
40	Financials	1.70%	1.25%	2.95%	1.48%
45	Information Technology	3.35%	1.56%	4.91%	2.45%
50	Telecommunication Services	0.85%	0.18%	2.00%	1.00%
55	Utilities	0.78%	0.35%	2.00%	1.00%

* The benchmark is generally the Mean + Standard Deviation, subject to minimum benchmark of 2%. In addition, year-over-year burn rate benchmark changes are limited to a maximum of two (2) percentage points plus or minus the prior year's burn rate benchmark.

Russell 3000 (Excluding the S&P 500)

GICS	Description	Mean	Standard Deviation	Industry Benchmark*	Burn Rate to Maximize EPSC Points
1010	Energy	1.69%	1.43%	3.12%	1.56%
1510	Materials	1.46%	1.08%	2.53%	1.27%
2010	Capital Goods	1.85%	1.24%	3.10%	1.55%
2020	Commercial & Professional Services	2.66%	1.62%	4.27%	2.14%
2030	Transportation	1.76%	1.63%	3.39%	1.69%
2510	Automobiles & Components	2.23%	1.24%	3.47%	1.74%
2520	Consumer Durables & Apparel	2.18%	1.61%	3.80%	1.90%
2530	Consumer Services	2.28%	1.57%	3.85%	1.92%
2540	Media	2.35%	1.97%	4.32%	2.16%
2550	Retailing	2.29%	1.91%	4.19%	2.10%
3010, 3020, 3030	Consumer Staples	1.71%	1.56%	3.26%	1.63%
3510	Health Care Equipment & Services	3.06%	2.08%	5.14%	2.57%
3520	Pharmaceuticals & Biotechnology	3.71%	3.06%	6.77%	3.38%
4010	Banks	1.64%	1.53%	3.17%	1.59%
4020	Diversified Financials	3.39%	3.61%	6.99%	3.50%
4030	Insurance	2.00%	1.77%	3.77%	1.89%
4040	Real Estate	1.38%	1.29%	2.67%	1.33%
4510	Software & Services	5.19%	3.55%	8.74%	4.37%
4520	Technology Hardware & Equipment	3.76%	2.43%	6.19%	3.09%
4530	Semiconductor Equipment	4.69%	2.32%	7.01%	3.50%
5010	Telecommunication Services	3.20%	2.03%	5.22%	2.61%
5510	Utilities	0.81%	0.80%	2.00%	1.00%

* The benchmark is generally the Mean + Standard Deviation, subject to minimum benchmark of 2%. In addition, year-over-year burn rate benchmark changes are limited to a maximum of two (2) percentage points plus or minus the prior year's burn rate benchmark.

Non-Russell 3000

GICS	Description	Mean	Standard Deviation	Industry Benchmark*	Burn Rate to Maximize EPSC Points
1010	Energy	2.55%	3.31%	5.86%	2.93%
1510	Materials	2.78%	3.35%	6.13%	3.06%
2010	Capital Goods	2.93%	3.49%	6.42%	3.21%
2020	Commercial & Professional Services	3.17%	3.45%	6.62%	3.31%
2030	Transportation	1.21%	1.67%	2.87%	1.44%
2510	Automobiles & Components	2.99%	3.29%	6.21%	3.11%
2520	Consumer Durables & Apparel	2.76%	2.58%	5.34%	2.67%
2530	Consumer Services	2.04%	2.00%	4.04%	2.02%
2540	Media	3.52%	2.60%	6.11%	3.06%
2550	Retailing	2.98%	2.55%	5.53%	2.76%
3010, 3020, 3030	Consumer Staples	2.60%	3.68%	6.28%	3.14%
3510	Health Care Equipment & Services	4.40%	3.92%	8.32%	4.16%
3520	Pharmaceuticals & Biotechnology	4.67%	3.80%	8.46%	4.23%
4010	Banks	1.27%	1.97%	3.24%	1.62%
4020	Diversified Financials	2.15%	3.98%	6.13%	3.06%
4030	Insurance	1.33%	2.50%	3.83%	1.92%
4040	Real Estate	1.36%	2.42%	3.78%	1.89%
4510	Software & Services	4.59%	3.62%	8.22%	4.11%
4520	Technology Hardware & Equipment	3.50%	2.91%	6.41%	3.20%
4530	Semiconductor Equipment	4.08%	3.29%	7.37%	3.68%
5010	Telecommunication Services	3.14%	3.56%	6.70%	3.35%
5510	Utilities	1.63%	3.20%	4.83%	2.41%

* The benchmark is generally the Mean + Standard Deviation, subject to minimum benchmark of 2%. In addition, year-over-year burn rate benchmark changes are limited to a maximum of two (2) percentage points plus or minus the prior year's burn rate benchmark.