

ISS Updates for 2019 Spotlight Gender Diversity

November 26, 2018

On November 19, 2018, Institutional Shareholder Services released updates to its proxy voting guidelines for the Americas and other regions. These updates are applicable to shareholder meetings held on or after February 1, 2019. ISS surveyed market respondents earlier this year on several governance topics. Following roundtable discussions and a brief comment period, ISS ultimately decided to revise its U.S. voting guidelines with respect to only one survey topic: gender diversity on boards of directors.

The full text of the 2019 policy updates published by ISS is available [here](#).

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New Policy: Gender Diversity. Starting with the 2018 proxy season, ISS proxy research reports have noted when a company's board lacks gender diversity, but ISS has not issued adverse vote recommendations on director elections on this basis. Under the new policy, ISS will generally

issue recommendations to vote against or withhold shareholder approval from the chair of the nominating committee if there are no women on the company's board.

Additionally, on a case-by-case basis, the election of other directors who are responsible for the board nomination process—for example, where there is no formal nominating committee—may also receive similar treatment. ISS will also consider on a case-by-case basis any mitigating factors, including a firm commitment to appoint at least one female director to the board in the near term, or the presence of a female director on the board at the preceding annual meeting. The new policy applies to companies in either the Russell 3000 or S&P 1500 indices after a one-year grace period and will be effective for meetings held on or after February 1, 2020.

According to ISS survey results, more than 80 percent of investor respondents indicated that an absence of gender diversity on a board level was problematic, with 45 percent stating that the absence of at least one female director may indicate problems in the board recruitment process. As of September 2018, according to DataDesk data, only three companies in the S&P 500 had no female directors.

ISS's policy update reflects the significant focus major institutional investors have placed in recent years on board gender diversity. Each of BlackRock, Vanguard, CalPERS and CalSTRS has published policies to promote increased gender diversity on boards. For example, BlackRock indicated in its 2018 proxy voting guidelines for U.S. companies

that it would typically expect to see at least two female directors on every board. Additionally, Glass Lewis updated its voting policy regarding board gender diversity in November 2017 to generally recommend voting against the nominating committee chair of Russell 3000 company boards with no female members at annual meetings held after January 1, 2019. Depending on other factors, such as the size of the company, the industry in which the company operates and the governance profile of the company, Glass Lewis may extend this recommendation to vote against other nominating committee members. However, Glass Lewis may refrain from issuing a “no” vote when boards have provided a sufficient rationale for not having any female board members (e.g., restrictions regarding the board’s composition, such as director nomination agreements with significant investors).

Technical Updates: Director Performance and Shareholder Ratifications. In addition to the policy update on gender diversity, ISS also made technical changes to its U.S. policy guidelines for 2019 to reflect recent changes in market practice and codify current ISS practice. These changes include:

- Strengthening its existing policy regarding director performance evaluation for U.S. companies by explicitly including five-year total shareholder returns as an evaluation factor.
- Codifying the ISS approach to chronic poor attendance by directors.
- Implementing a policy that recommends voting against or withholding a vote for individual directors, members of governance committees or full boards where boards ask shareholders to ratify existing charter or bylaw provisions. This change is intended to discourage management from seeking to ratify existing governance provisions in order to block shareholder proposals that seek more favorable shareholder rights—a practice that, according to ISS, increased significantly during the 2018 proxy season.

Further Considerations: One-Share, One-Vote, Director Track Records and Pay-for-Performance Measures. ISS’s annual policy survey included a number of other topics in addition to gender diversity, including:

- Auditor ratification
- Director accountability and track records
- One-share, one-vote principle
- Independent chair shareholder proposals
- Disclosure of directors’ skills
- Pay-for-performance methodology
- Director pay
- Minimum stock ownership requirements for binding bylaw amendments

ISS ultimately did not make any policy changes involving these topics, even in cases where investors voiced strong support.

For example, regarding the one-share, one-vote principle, ISS asked whether it should provide, for U.S. companies with a dual-class voting structure, adjusted vote results indicating what the vote results would have been if all votes were counted equally. Despite 92 percent of investors responding that they would favor such reporting, ISS elected not to update its current policy, which simply provides that ISS will generally vote against proposals to create a new class of common stock unless the company provides a compelling rationale.

Similarly, ISS did not alter its voting guidelines to provide for director track records, despite 84 percent of investor respondents stating that it would be appropriate and useful to shareholders to note in a proxy research report, when applicable, that a director failed in his or her oversight responsibilities at another company and it resulted in a negative ISS recommendation.

ISS also considered introducing certain non-GAAP metrics known as “Economic Value Added” (or “EVA”) metrics as part of its pay-for-performance model, but ultimately decided to reconsider this proposal in the 2020 proxy season. During 2019, ISS research reports will feature EVA data as a supplement to GAAP-based measures for informational purposes.

What’s Next from ISS. ISS plans to publish updated Frequently Asked Questions on its website on December 31, 2018. In January 2019, ISS will evaluate new U.S. shareholder proposals anticipated for 2019 and update its U.S. proxy voting guidelines as needed.

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Please do not hesitate to contact us with any questions.

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