Kingsdale Market Update

November 19, 2018

ISS 2019 Benchmark Policy Updates

Today, Institutional Shareholder Services Inc. ("ISS") released its 2019 Benchmark Proxy Voting Guidelines updates applicable for shareholder meetings taking place on or after February 1, 2019. This follows ISS' Benchmark Policy Consultation released on October 18, 2018. (See Kingsdale's previous memo here). The restated guidelines, which may contain further changes in addition to those described herein, are expected to be published by December 7, 2018 and certain FAQs are expected to be published by December 31, 2018.

The previously considered changes to ISS' Pay-for-Performance model, namely to add Economic Value Added ("EVA") based metrics in place of traditional GAAP-based metrics under the Financial Performance Assessment test, have been put on hold. Instead, the current GAAP-based metrics will continue to be used with EVA-based metrics added for informational purposes.

For the U.S. market, ISS' changes cover a wide range of topics including director attendance, ratification of charter or by-law provisions, sustained poor performance, board responsiveness, and stock splits.

For the Canadian market, ISS' minor changes target the gender diversity and overboarding policies. In addition, ISS made minor changes to the evaluation of environmental and social shareholder proposals covering both the U.S. and Canadian markets.

Director Attendance (U.S. Market)

ISS is making minor amendments to its director attendance policy. In cases of chronic poor attendance without reasonable justification, ISS may, in addition to recommending withholding votes from directors with poor attendance (less than 75% of aggregate of board and committee meetings), recommend withholding votes from members of the nominating or governance committees (or the whole board). Chronic poor attendance is stratified in the following manner: three years of poor attendance by a director will result in withhold recommendations for the chair of the nominating or governance committee; four years will result in withholding from the full nominating or governance committees;
and, at the extreme, five years of poor attendance will result in withhold from the whole board.

Management Proposals to Ratify Existing Charter or By-law Provisions (U.S. Market)

ISS notes that the use of board sponsored proposals to ratify existing charter or by-law provisions increased significantly during the 2018 proxy season. This was in response to guidance from the Securities and Exchange Commission (the "SEC") staff that granted some companies no-action relief if companies sought to exclude shareholder proposals by including "conflicting" proposals to ratify one or more governance provisions in an attempt to block shareholder proposals requesting for governance enhancements. ISS has developed a new policy to evaluate such management sponsored proposals; they will recommend withholding votes from individual directors, members of the governance committee, or the full board when a board asks shareholders to ratify existing charter/by-law provisions considering the following factors: (i) the presence of a shareholder proposal addressing the same issue on the same ballot, (ii) the board's rationale for seeking ratification, (iii) disclosure of actions to be taken by the board should the ratification proposal fail, (iv) disclosure of shareholder engagement regarding the board's ratification request, (v) the level of impairment to shareholders' rights caused by the existing provision, (vi) the history of management and shareholder proposals on the provision at the company's past meetings, (vii) whether the current provision was adopted in response to the shareholder proposal, (viii) the company's ownership structure, and (ix) previous use of ratification proposals to exclude shareholder proposals.

Director Performance Triggering Board Accountabilty (U.S. Market)

ISS made minor amendments to its "Director Performance Evaluation" policy. Previously, for Russell 3000 companies, ISS looked at sustained poor performance measured by one- and three-year total shareholder returns in the bottom half of a company's four-digit Global Industry Classification Standards code.
For these companies, ISS may recommend withholding votes from the entire board except new nominees. ISS is expanding its evaluation of sustained poor performance to the five-year horizon.

Board Responsiveness (U.S. Market)

ISS is making minor amendments to its board responsiveness policy to hold directors or committee members responsible if the board fails to act on a management proposal seeking to ratify an existing charter or by-law provision that received majority opposition in the previous year.

Reverse Stock Splits (U.S. Market)

ISS has updated the framework to evaluating reverse stock splits. Previously, ISS would generally support reverse stock splits if the number of authorized shares would be proportionately reduced. If not proportionally reduced, ISS would still generally support the proposal if a stock exchange has provided notice to the company of a potential delisting. ISS is updating its policy to take into account companies not listed on major stock exchanges that wish to conduct a reverse stock split without proportionately reducing their authorized shares as delisting notices are not applicable for non-major exchanges. ISS will now also support reverse stock splits if the effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy. ISS will also consider other factors such as the disclosure of substantial doubt about the company's ability to continue as a going concern without additional financing and the company's rationale.

Social and Environmental Issues (U.S. and Canadian Market)

ISS is making minor amendments to its evaluation framework for social and environmental shareholder proposals. Previously, ISS took into consideration whether the implementation of the proposal would be likely to protect or enhance shareholder value. Now, the enhancement or protection of shareholder value is the *primary* consideration for evaluating such proposals. The factors that feed into the analysis remain unchanged but ISS has added one factor which assesses whether there are significant controversies, fines, penalties or litigation associated with the company's environmental or social practices.

Board Gender Diversity (U.S. and Canadian Market)

For U.S. companies within the Russell 3000 or S&P 1500 indices (one-year grace period) with meetings occurring on or after February 1, 2020, ISS will generally recommend voting against or withholding votes from the chair of the nominating committee (or other directors) at companies where there are no women on the board. ISS cites several mitigating factors, such as including a firm commitment in the proxy statement to appoint at least one female to the board in the near term or the presence of a female board member at the preceding meeting.

For Canadian companies, ISS is expanding its current gender diversity policy from S&P/TSX Composite Index to widely-held TSX companies. Widely-held refers to S&P/TSX Composite Index companies as well as other companies that ISS designates as such based on the number of ISS clients holding securities of the company.

Director Overboarding (Canadian Market)

Beginning February 1, 2019, as previously announced, ISS will be removing the secondary attendance trigger for its director overboarding policy. ISS, however, is expanding the number of boards public company CEOs can sit on to two outside boards (from one), and non-CEO directors to five public company boards (from four).

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