2015 Benchmark U.S. Proxy Voting Policies

Frequently Asked Questions on Selected Topics

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ISS is providing answers to frequently asked questions with regard to select policies and topics of interest for 2015:

Proxy Access Proposals

1. How will ISS recommend on proxy access proposals?

Drawing on the U.S. Securities and Exchange Commission's (SEC) decades-long effort to draft a market-wide rule allowing investors to place director nominees on corporate ballots, and reflecting feedback from a broad range of institutional investors and their portfolio companies, ISS is updating its policy on proxy access to generally align with the SEC's formulation.

Old Recommendation: ISS supports proxy access as an important shareholder right, one that is complementary to other best-practice corporate governance features. However, in the absence of a uniform standard, proposals to enact proxy access may vary widely; as such, ISS is not setting forth specific parameters at this time and will take a case-by-case approach when evaluating these proposals.

Vote case-by-case on proposals to enact proxy access, taking into account, among other factors:

- Company-specific factors; and
- Proposal-specific factors, including:
  - The ownership thresholds proposed in the resolution (i.e., percentage and duration);
  - The maximum proportion of directors that shareholders may nominate each year; and
  - The method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

New Recommendation: ISS will generally recommend in favor of management and shareholder proposals for proxy access with the following provisions:

- **Ownership threshold:** maximum requirement not more than three percent (3%) of the voting power;
- **Ownership duration:** maximum requirement not longer than three (3) years of continuous ownership for each member of the nominating group;
- **Aggregation:** minimal or no limits on the number of shareholders permitted to form a nominating group;
- **Cap:** cap on nominees of generally twenty-five percent (25%) of the board.

Review for reasonableness any other restrictions on the right of proxy access.

Generally recommend a vote against proposals that are more restrictive than these guidelines.

Rationale for update:

Vested with clear legal authority by the Dodd-Frank Act, the SEC adopted a proxy access rule (Rule 14a-11) in August 2010 that provided a thoughtful balance of a number of factors including the ownership threshold and the holding period duration. The DC Circuit Court vacated the rule in July 2011 based on its findings of procedural deficiencies in the SEC's rulemaking process. ISS' earlier policy, updated for the 2012 proxy season, largely focused on attempts by shareholder proposal proponents to lower the safeguards against abuse (for example, an extremely low ownership threshold) of the access right that the SEC's formulation addressed. As such, the policy sought to maintain the balance that the SEC struck between protecting shareholders' rights and the potential abuse of the access process. Three years of voting results on both management- and shareholder-sponsored proxy access proposals drawing on the Commission's model appear to validate the SEC's formulation. Moreover, a 2014 CFA Institute study provides a cost-benefit analysis, which the court said was lacking in the SEC's rulemaking process, and concludes that "proxy access would serve as a useful tool for shareowners in the United States and would ultimately benefit both the markets and corporate boardrooms, with little cost or disruption to companies and the markets as a whole."

For companies that present both a board and shareholder proxy access proposals on the ballot, ISS will review each of them under the policy.

Exclusion of Shareholder Proposals

2. What are ISS' expectations regarding whether a company includes a shareholder proposal on its ballot?

The ability of qualifying shareholders to include their properly presented proposals in a company's proxy materials is a fundamental right of share ownership, which is deeply rooted in state law and the federal securities statutes. Shareholder proposals promote engagement and debate in an efficient and cost-effective fashion.

Over the course of the past several decades, the SEC has played the role of referee in resolving disputes raised by corporate challenges to the inclusion of shareholder proposals in company proxy materials. While federal courts provide an additional level of review, the vast majority of shareholder proposal challenges have been resolved without the need to resort to costly and cumbersome litigation. While individual proponents and issuers often disagree with the SEC's determinations in these adversarial proceedings, the governance community recognizes the Commission's important role as an impartial arbiter of these disputes.

On Jan 16, 2015, the SEC announced that it was reviewing Rule 14a-8(i)(9), which allows companies to exclude a shareholder proposal that "directly conflicts" with a board-sponsored proposal. Additionally, SEC Chair Mary Jo White indicated that for proxy season 2015, the Commission's Division of Corporation Finance will express no view on the application of Rule 14a-8(i)(9). As a result, companies that intended to seek no-action relief on that basis are now deciding their courses of action.

For companies that present both a board and shareholder proposal on the ballot on a similar topic, ISS will review each of them under the applicable policy.

ISS will view attempts to circumvent the normal avenues of dispute resolution and appeal with a high degree of skepticism[1]. Omitting shareholder proposals without obtaining regulatory or judicial relief risks litigation against the company. Presenting only a management proposal on the ballot also limits governance discourse by preventing shareholders from considering an opposing viewpoint, and only allowing them to consider and opine on the view of management.

Thus, under our governance failures policy, ISS will generally recommend a vote against one or more directors (individual directors, certain committee members, or the entire board based on case-specific facts and circumstances), if a company omits from its ballot a properly submitted shareholder proposal when it has not obtained:

1) voluntary withdrawal of the proposal by the proponent;
2) no-action relief from the SEC; or
3) a U.S. District Court ruling that it can exclude the proposal from its ballot.

The recommendation against directors in this circumstance is regardless of whether there is a board-sponsored proposal on the same topic on the ballot. If the company has taken unilateral steps to implement the proposal, however, the degree to which the proposal is implemented, and any material restrictions added to it, will factor into the assessment.

Unilateral Bylaw/Charter Amendments Policy

3. Does the Unilateral Bylaw/Charter Amendments policy create a new approach for ISS?

No. ISS has a long history of recommending its clients oppose directors who adopt, without obtaining shareholder approval, bylaw or charter amendments that materially diminish shareholder rights. Such unilateral board actions were covered under ISS' Governance Failures policy, but due to a recent increase in their occurrence, as of 2015 ISS separated these actions into a standalone policy to increase transparency to clients and issuers, and to facilitate the application of custom clients' policies.

The Governance Failures policy is designed to recognize one-off egregious actions that are not covered under other policies. If a type of corporate action that disadvantages shareholders becomes commonplace, ISS will often address such problematic practice via a standalone policy. In 2014, the three most common categories of conduct addressed under this policy were:

- Unilateral bylaw amendments that diminish shareholders' rights;
- Excessive share pledging, and
- Failure to opt out of state statutes requiring a classified board (Indiana and Iowa).

[1] As precedent, ISS recommended against the board of directors at Kinetic Concepts in 2011 for omitting a shareholder proposal when the SEC had denied the firm's request for no-action relief. ISS changed the vote recommendation when the board implemented the proposal.

4. Which types of unilateral bylaw/charter amendments are likely to be considered by ISS to materially diminish shareholders' rights?

If a unilaterally adopted amendment is deemed materially adverse to shareholder rights, ISS will recommend a vote against the board.

Materially adverse unilateral amendments include, but are not limited to:

- Authorized capital increases that do not meet ISS' Capital Structure Framework;
- Board classification to establish staggered director elections;
- Director qualification bylaws that disqualify shareholders' nominees or directors who could receive third-party compensation;
- Fee-shifting bylaws that require a suing shareholder to bear all costs of a legal action that is not 100 percent successful;
- Increasing the vote requirement for shareholders to amend charter/bylaws;
- Removing a majority vote standard and substituting plurality voting;
- Removing or restricting the right of shareholders to call a special meeting (raising thresholds, restricting agenda items); and
- Removing or materially restricting the shareholder's right to act in lieu of a meeting via written consent.

Unilaterally adopted bylaw amendments that are considered on a case-by-case basis, but generally are not considered materially adverse:

- Advance notice bylaws that set customary and reasonable deadlines;
- Director qualification bylaws that require disclosure of third-party compensation arrangements;
- Exclusive Venue/Forum (when the venue is the company's state of incorporation);

In assessing bylaw and charter changes at pre-IPO companies, ISS will consider the timing of the adoption of the provisions that diminish post-IPO shareholders rights, the clarity of disclosures of such changes (including in the company's prospectus or other documents connected to the public offering) and the continuity of board membership.

5. How likely is ISS to support management proposals for fee-shifting bylaws?

As of early February 2015, approximately 50 bylaws allowing fee shifting have been adopted unilaterally, with none put to a shareholder vote. Our Litigation Rights policy states:

Generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., in cases where the plaintiffs are partially successful).

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