

## Director Independence (U.S.)

### Background

ISS classifies directors into 3 [categories](#) of independence: Inside Directors, Affiliated Outside Directors, and Independent Outsiders. The Affiliated Outside Director definition generally takes into account previous employment with the company, material transactions with outside directors' companies, and family relationships.

### Policy Directions

ISS is considering using more of a case-by-case analysis of facts and circumstances in determining director independence for 2015 or beyond. Three areas of focus are: former CEOs; familial relationships, and professional relationships.

### Former CEOs

Under NYSE and NASDAQ listing standards, a director who formerly served as a company executive is deemed to be independent three years after having ceased to serve in such capacity. ISS' benchmark policy has a similar five-year "cooling off" policy for former executive officers, with the exception of former CEOs. Due to their influence on the board and management, ISS considers former CEOs as always affiliated with the company they previously headed.

### Familial Relationships

When assessing the independence of directors with familial ties to a company, ISS uses the SEC definition of immediate family member: spouses, parents, children, step-parents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household. This definition means that, at a company whose leadership includes descendants of the company's founder, ISS would consider a director who is a first cousin of the CEO to be independent. On the other hand, ISS also uses this definition when examining professional services providers: if a director's child is employed by a firm that provides professional services to the company, the director is considered affiliated.

### Definition of Professional Relationships

When determining the independence of directors, NYSE- and NASDAQ-listed firms apply "transactional" thresholds for payments to the employer of a director (or his or her immediate family member). For the NYSE, this is the greater of \$1 million or 2% of revenues; for NASDAQ, the greater of \$200,000 or 5% of revenues. However, for payments made directly to a board member for services (other than director fees) or to a director's immediate family member, the threshold is \$120,000. Further restrictions apply to directors or family members who work at the company's auditor: e.g. for the NYSE the director cannot be a partner or an employee of the auditor; and an immediate family member cannot be a partner (but can be an employee) and cannot work, or have worked, on the company's audit.

ISS uses the exchanges' transactional thresholds for most transactional relationships, but applies a different threshold for relationships that are "professional": i.e., advisory in nature, and potentially involving access to sensitive company information or strategic decision making. These include: investment banking/financial advisory services; commercial banking (beyond deposit services); investment services; insurance services; accounting/audit services; consulting services; marketing services; legal services; property management services; realtor services; lobbying services; executive search services; and IT consulting services. For these, ISS uses a threshold of \$10,000 (the amount requiring disclosure in the director compensation table); and applies this threshold to services whether provided by the director; director's family member; director's employer; or the family member's employer.

## Request for Comment/Feedback

Please feel free to add any additional information or comments on this policy. In addition, ISS is specifically seeking feedback on the following:

1. Do you support a case-by-case analysis of facts and circumstances in determining independence with respect to former CEOs, familial relationships, and/or professional services, rather than set definitions, or would you recommend that ISS maintain its current approach?
2. For former CEOs, should ISS apply a case-by-case approach? If so, which factors would be relevant? For example: a minimum number of years since service as CEO (if so, how many); number of years served as CEO; ongoing professional relationship with the company since serving as CEO; overlapping tenure as CEO with any current directors; whether current management was appointed by the former CEO; etc.?
3. On familial relationships, should ISS consider relationships beyond "immediate family member" to be material?
4. Should ISS adopt a more case-by-case approach on professional services? If so which factors would be most relevant? For example:
  - a. Threshold: apply a higher overall threshold (like \$120,000); apply different thresholds for direct services from a family member or the director vs. the employer of the family member or director?
  - b. For services provided by an outside firm, differentiate by: who is employed- the director, spouse, or other family member; the position of the person- partner, executive officer, or employee; whether the employment is in a different division or location than the one providing the services to the company; whether it is the company's primary accounting firm or law firm vs. one providing secondary services; the size of the company; the size of the service provider; the availability of other service providers; or the timing of the hiring of the service firm vs. the appointment of the director?
  - c. Types of services ISS considers to be professional: Should ISS exclude any of the current types of services considered to be "professional," or include any others? Should the same degree of rigor be applied to all professional service types, or are some services potentially more relevant to a director's independence than others, such as legal or accounting?

To submit a comment, please send via email to [policy@issgovernance.com](mailto:policy@issgovernance.com). Please indicate your name and organization.