

Japan Policy – Poison Pill Proposals

Background and Overview

From an investor viewpoint, the justification for a poison pill is its usage as a tool to force a would-be acquirer into negotiations with the board, and extract more favorable terms for shareholders. Such a situation is most likely to occur when the company is temporarily vulnerable to a hostile takeover due to a low market valuation which does not reflect its intrinsic value, and thus requires temporary protection.

The key point here is that the pill should be a temporary measure, and a pill that is repeatedly renewed can instead serve as a management entrenchment device. In Japan, 88 percent of companies with a pill in effect adopted it initially nine years ago or more. Shareholder concern over the continued maintenance of pills is growing.

ISS' current Japanese proxy voting guidelines for the approval of pills does not include as a factor the number of years the company has maintained a pill. ISS is proposing a change to the policy to address shareholder concerns that companies should not routinely renew pills, irrespective of the context of the individual company's managerial environment.

Under the current ISS policy, we analyze pill proposals in two stages. The first stage examines the "necessary conditions" which must all be met before ISS will consider supporting the adoption of a pill. The second stage involves an examination of the company's actual vulnerability to a hostile takeover and other issues to make a case-by-case decision.

Key Changes Under Consideration

The proposed policy update is to add as a first stage necessary condition that the pill's total duration¹ does not exceed three years. Absent this condition, the evaluation of the pill proposal will not progress to the second stage of the analysis.

Intent and Impact

The proposed policy update is intended to communicate that companies should not routinely renew pills. The proposed policy update is also intended to accelerate the current trend of pill abolition. The peak of pill maintenance in Japan was observed in 2009, when about 570 Japanese companies had pills in place. Since then, the number of companies that decided to abolish their pills has been increasing, given regulatory developments concerning the issue as well as changes in the business environment. As of June 30, 2017, 464 companies still have a pill in place (including 17 pills adopted without a shareholder vote), according to ISS data.

The threshold of three years was selected to be consistent with ISS' pill policy which stipulates that the duration of the pill should not exceed three years.

Under the current pill policy, ISS has not recommended in favor of any pill proposals to date in 2017. Accordingly, the policy change will not have a significant impact on ISS vote recommendations in terms of the number of pills supported/opposed.

¹ The pill's total duration is defined as the sum of the number of years the company has had a pill in place and the number of years the proposed pill will be effective.

Request for Comment

While we appreciate any comments on this topic, ISS is specifically seeking feedback on the following:

- Do you think it is appropriate to add the duration of maintaining a pill since it was first introduced to the "necessary conditions" in the first stage of analysis? If not why?
- If you think it is appropriate to add this criterion, what length of time do you consider acceptable for such duration as a new necessary condition in the first stage of analysis?