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Early Review of 2019 US Proxy Season Vote Results

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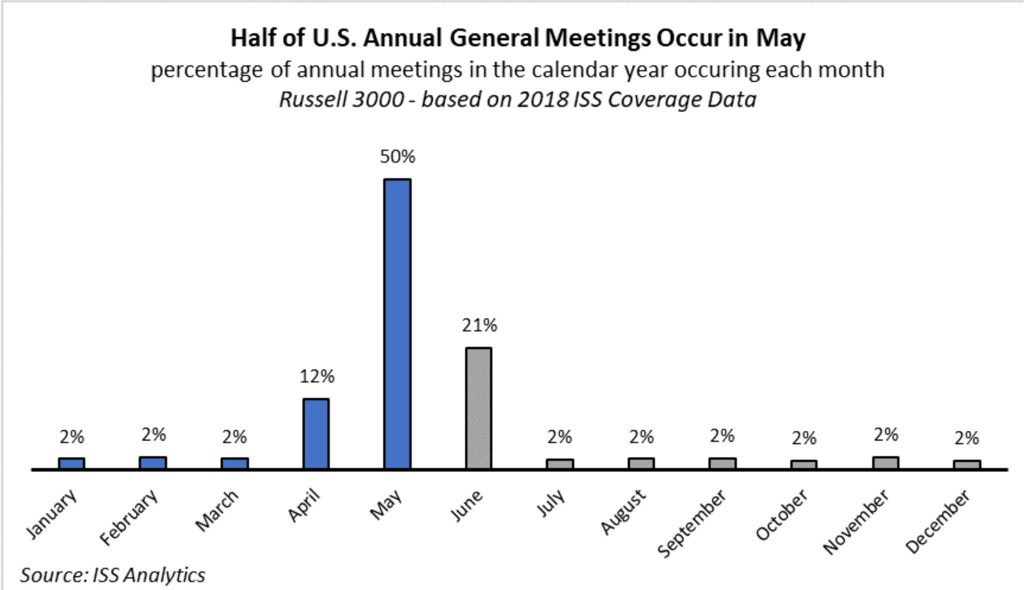
As the busiest part of the 2019 U.S. proxy season is behind us, we take an early look at the vote results of annual general meetings convened from January to May. As of now, approximately 70 percent of Russell 3000 annual general meetings expected during the calendar year have already taken place, and the figure will rise to close to 90 percent of all calendar-year annual meetings by the end of June. In our review of the vote results for the 1,812 Russell 3000 2019 annual general meetings that took place from January to May and are available in the ISS database, we identify the following major trends:

- **Director elections face the strongest opposition seen in the past nine years**, as evidenced in the increase in the number of director elections with support levels below 80 percent of votes cast. This trend indicates increased scrutiny and higher complexity in investor voting policies.
- **Environmental and social (E&S) shareholder proposals outnumber governance shareholder proposals for third consecutive year**, as the breadth of governance topics addressed by proponents is narrowing, while the range of E&S issues continues to expand.
- **Investors are narrowing the gap between governance issues and E&S issues**, as the difference in support rates between these two categories of proposals decreased to its lowest level.
- **Withdrawal rates for E&S proposals remain at record levels, while withdrawal rates for governance proposals remain low**, as companies are more willing to accommodate E&S proponent requests and oppose shareholder proposals on governance topics where market has failed to reach consensus.
- **Say-on-pay proposals received one of the highest opposition rates since their introduction to U.S. ballots in 2011**, as investors continue to evolve their evaluation of compensation programs.

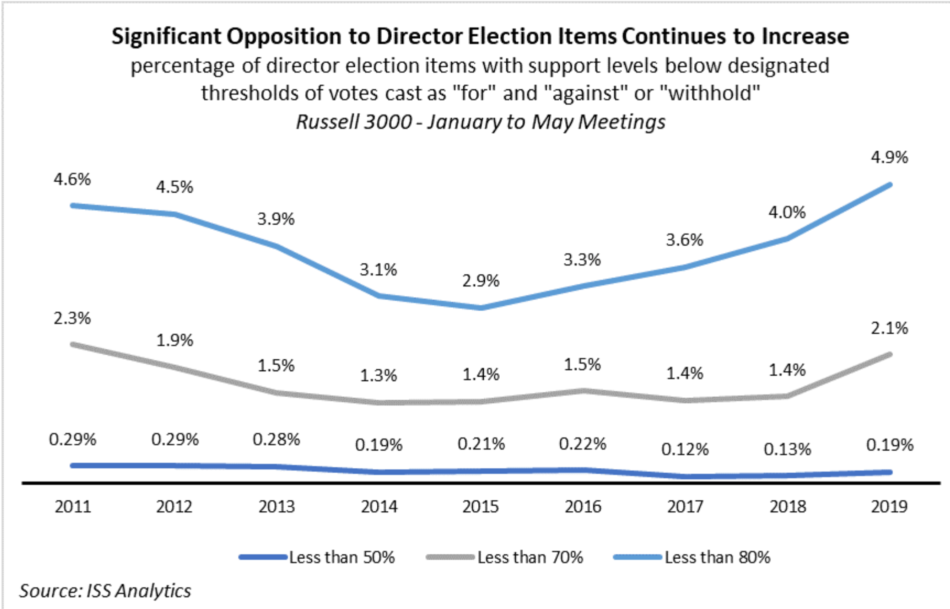


Director Elections

Significant opposition to director elections has steadily increased since 2015. Approximately 4.9 percent of director election items that took place between January and May of 2019 received support by less than 80 percent of votes cast “for” and “against” or “withhold,” up from 4.0 percent in 2018, and much higher compared to the historical low of only 2.9 percent in 2015 for meetings during the same period. This is the highest level of significant opposition since the advent of say-on-pay proposals in 2011.

But we are not close to historical records of significant opposition. In the aftermath of the U.S. financial crisis, and prior to the introduction of say-on-pay votes, many investors expressed compensation concerns through opposition to director election proposals. In 2009, 9.4 percent of director election proposals received support from less than 80 percent of votes cast.

The rise in significant opposition shows that investor views and processes on board and director evaluations continue to evolve. Many investors add new factors to their analysis or refine existing criteria of their board evaluation policies. In addition to board accountability, factors such as board diversity, board refreshment, director overboarding, and board leadership appear to be taking a larger role in investors’ director election assessment process. And while director election policies become more involved, for each of the factors under assessment, investors have a diverse set of viewpoints based on their own unique preferences and policies. The higher opposition rates are also independent of proxy advisor recommendations. In 2019, the percentage of negative ISS recommendations dropped to 8.1 percent of director election items, from 8.9 percent of proposals in 2018.

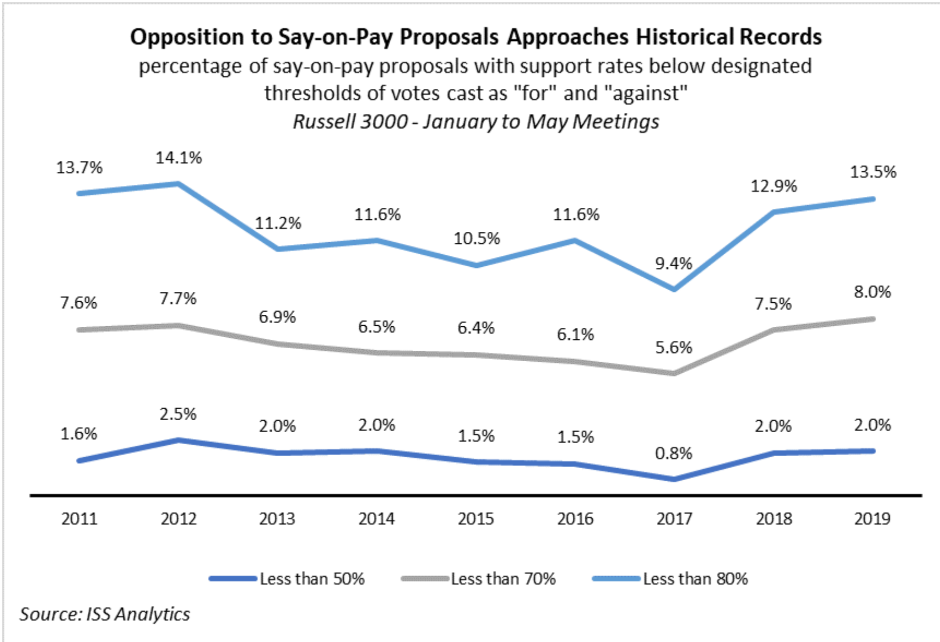


Say-on-Pay Proposals

The rate of opposition to say-on-pay proposals continues to increase to almost historical records, after reaching its lowest point in 2017. While 2018 was a year of negative returns for U.S. stocks, based on our early estimates, executive compensation levels are reaching new record highs. The median CEO pay increase was 6 percent in the S&P 500, with the increase primarily driven – as in recent years – by significant stock grants. In fact, stock compensation comprised the majority of CEO pay at the S&P 500 for the first time this year. In line with, or perhaps due to, investors expectations, the proportion of performance-based continues to increase, reaching 58 percent of total pay among S&P 500 CEOs.

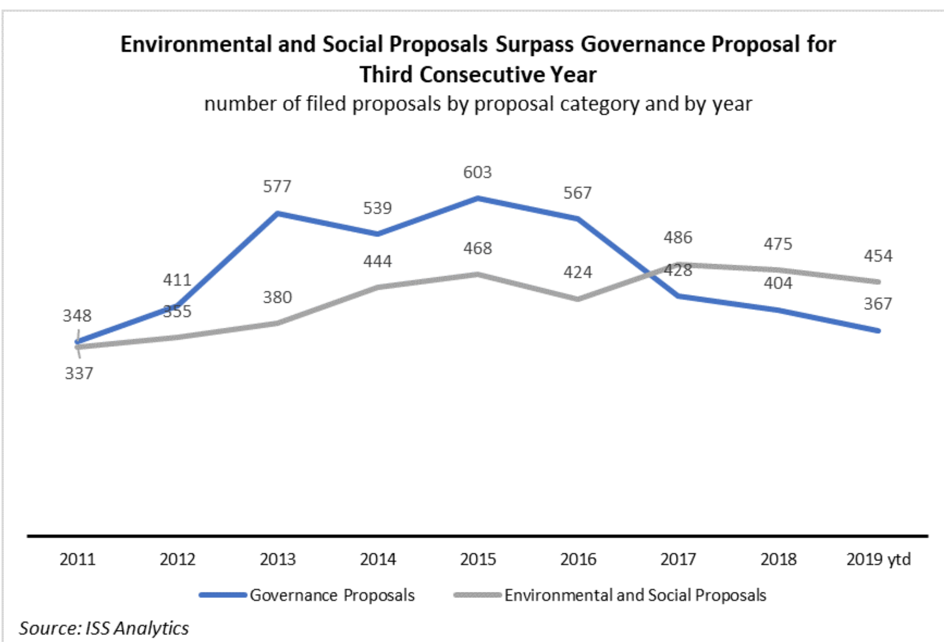
However, increasingly, investors are applying more rigor in their analysis of executive compensation programs, and many create their own screens and assessment models for flagging problematic practices or misalignment between pay and performance. The disclosure of performance metrics and the rigor of incentive targets receive significant scrutiny, as many investors expect these aspects of the compensation program to align with the company's strategy and long-term sustainable returns. Mega-grants or "one-time" special awards also tend to raise questions.

But beyond some of the more common problematic practices mentioned above, investors may be paying closer attention to a diverse set of issues that may typically fall of the radar for most companies, investors, and even proxy advisors, as we explain in our recent review of the venial sins in executive compensation. Such practices may include excessive emphasis on TSR, complicating the compensation program with too many metrics, or disclosing retentive pay (compensation that the executive expects to receive regardless of performance) in the guise of performance pay. The key point is that investors' analysis of compensation programs is becoming more sophisticated, and, similar to director election assessments, the diversity of perspectives and analysis frameworks continues to increase.



Shareholder Proposals

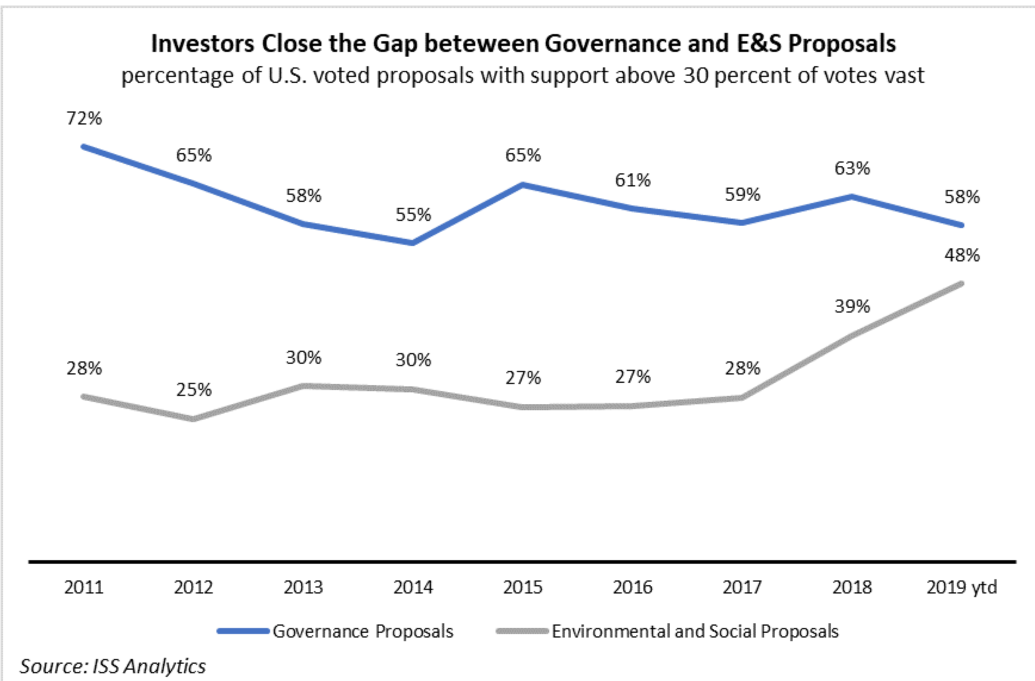
For the third consecutive year, the number of shareholder proposals filed in the U.S. related to environmental and social issues surpassed the number of shareholder proposals related to governance issues. We observe a greater variety in the types of environmental and social proposals filed compared to governance campaigns. Among governance topics, only nine proposal types were filed more than 10 times, while 15 environmental and social proposal categories accounted for more than 10 filings each. Proposals seeking to establish an independent chair ranked first in the number of filings (66 filings), followed by requests for political contributions disclosure (62 filings), and proposals related to board diversity (45 filings).



Support rates of voted proposals indicate that investors are closing the gap between governance proposals and environmental and social proposals. The median support rate for environmental and social proposals reached a record high of 30 percent of votes cast in 2019, compared to 39 percent for governance proposals. The difference in median support rates of only 9 percentage points is the lowest on record. We observe the same trend when comparing the percentage of proposals that received significant support rates above 30 percent of votes cast (remember, it is very difficult for shareholder proposals to receive high support rates, given management opposition, ownership structures, and a higher bar that investors require to support such requests).

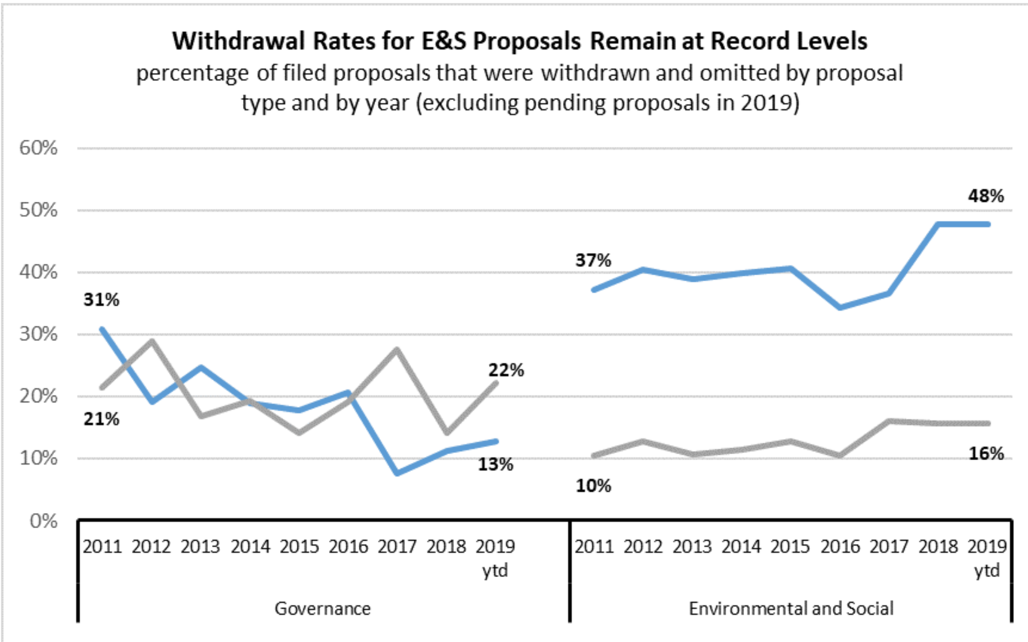
So far in 2019, 48 percent of voted E&S shareholder proposals received support above 30 percent of votes cast. As shown in our recent publication on long-term trends on environmental and social proposals, until 2010, this figure did not exceed 10 percent of voted proposals. As a pertinent example of these general trends, proposals related to political contributions disclosure received higher support rates compared to requests to establish an independent chair.

Historically, investors treated environmental and social issues very differently compared to governance proposals, with many abstaining from voting on these matters, and even more being very reluctant to support such proposals that may have appeared disconnected from investment management fundamentals. However, as ESG integration takes hold, recent voting trends indicate that we are entering a new era, whereby investors no longer compartmentalize environmental and social issues as a separate category from governance shareholder proposals. We are now dealing with ESG shareholder proposals, and every proposal type is evaluated based on its merits and relative to company and industry practice, without the mental barrier of the “E&S” moniker blocking investors’ view from these matters.



Companies are also more prone to engage with proponents and satisfy their requests in relation to environmental and social disclosures and targets compared to a few years ago. The percentage of environmental and social proposals that have been withdrawn so far in 2019 is at record levels, with almost half of proposals withdrawn, extending on trends we saw in 2018. Changing investor expectations on key issues such as diversity and climate change, public pressure on high-profile issues like the opioid crisis and gun safety, and companies' own more pro-active approach to managing social and environmental risks contribute to the rising rate of withdrawals of environmental and social proposals.

In contrast, withdrawal rates for governance proposals are very low compared to historical levels. The prevailing governance shareholder proposal campaigns currently being filed relate to issues where the market has not reached consensus, such as the establishment of an independent chair, the right to call a special meeting, or the right to act by written consent. And unlike past campaigns (e.g., annual director elections, proxy access, majority vote standard), the probability of current campaigns receiving majority support is lower. As such, companies are less keen on satisfying proponent demands and committing to significant governance changes. This trend may change in the opposite direction, if support levels for these proposals increase.



Source: ISS Analytics

We observe a slight increase in the omissions of environmental and social proposals in the past three years, due to companies being granted no-action relief by the SEC. This trend hides two separate developments. In 2017 and 2018, the spike in omission rates was primarily due to procedural errors by the proponent (primarily driven by the failure to meet requirements for proof of ownership). In 2019, the no-action reliefs for these matters primarily pertain to the proposals being deemed moot because the issues are substantially implemented by the company.

As additional disclosures of proxy voting results become available, ISS will continue to monitor and update the analysis of trends in these main areas of focus for companies and investors.

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