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# INSTITUTIONAL SHAREHOLDER SERVICES RELEASES UPDATES TO GOVERNANCE “QUALITYSCORE” MODEL

Institutional Shareholder Services (ISS) released updates to its governance scoring model, Governance QualityScore, which went into effect on November 29, 2018. The model measures governance-related risk across four pillars: Audit & Risk Oversight, Board Structure, Compensation and Shareholder Rights & Takeover Defenses. **For 2019, the model has been enhanced to include a new *Diversity* subcategory under the Board Structure pillar that evaluates the presence of women leadership at the executive and board levels, and the distribution of age and tenure of current board members.**

ISS applies QualityScore<sup>1</sup> to approximately 5,800 publicly-traded companies in 30 markets. Among U.S. companies, QualityScore applies to S&P 500 and Russell 3000 constituents. A complete list of governance factors evaluated for U.S. companies<sup>2</sup> under QualityScore is provided in the [Attachment](#). The list identifies new, modified and zero-weight factors under each of the four governance pillars. As in prior years, ISS has not and is not expected to release specific scoring and weighting associated with each governance factor.

For U.S. companies, new governance factors adopted in May and November 2018 include:

PILLAR	NEW FACTOR	ISS VIEW
Compensation	What was the percentage of vote support received from the most recent Say-on-Pay or remuneration proposal?	QualityScore already has an existing factor indicating whether the Company received significant opposition to Say-on-Pay from shareholders (i.e., less than 70% support). This new factor allows shareholders to also consider the absolute level of Say-on-Pay support. <b><i>Early experience with this new factor suggests that the QualityScore result for companies with less than 90% Say-on-Pay support could be negatively impacted (for example, one company dropped from a Compensation score of 1 (best score) to 4).</i></b>

<sup>1</sup> QualityScore was introduced in 2017 and is the successor to ISS’s previous governance scoring models: Governance QuickScore (2013-2016), Governance Risk Indicators or “GRId” (2010-2012), and Corporate Governance Quotient (2002-2009).

<sup>2</sup> Non-U.S. company updates are also covered in the technical document but are outside the scope of this alert letter.

PILLAR	NEW FACTOR	ISS VIEW
Board Structure	What is the lowest percentage of vote support received by management-nominated directors at their most recent election?	Helps identify companies where investors might have governance concerns by comparing lowest director support levels across companies. Opposition to a board member signifies perceived lack of accountability, responsiveness, independence, and/or competence on the part of the targeted director, warranting further evaluation.
	What was the most recent percentage of vote support for the CEO?	Considers the vote support for the election of the CEO on the board of directors from the most recent annual shareholders' meeting. Controversial level of support was not disclosed. If the CEO does not serve on the board, then the company will not be penalized.
	What was the most recent percentage of vote support for the Board Chair?	Considers the vote support for the election of the Chairman of the Board on the board of directors. Controversial level of support was not disclosed.
	How many women serve in leadership roles on the board? <i>(new Diversity subcategory)</i>	Evaluates the number of women on the board serving in leadership positions including board chair, chair of key committees, non-employee chair, or lead director. According to an ISS policy survey, a majority of respondents indicate that they consider overall diversity on the board when evaluating boards. In addition, some studies found that increasing the number of women on boards of directors correlates with better long-term performance.
	How many women are named executive officers at the company? <i>(new Diversity subcategory)</i>	Evaluates the number of women who are named executive officers. Companies with no women as named executive officers will lose credit. Credit will be capped for companies having more than two women as named executive officers.
	What is the standard deviation of director age? <i>(new Diversity subcategory)</i>	Evaluates the range of director ages present on a board expressed as the sample standard deviation of ages. A well-rounded board has the benefit of a diversity of viewpoints, concerns, and questions influenced by board members' age. Companies below the 25 <sup>th</sup> percentile of the QualityScore universe will not receive credit, and companies at or above the 75 <sup>th</sup> percentile will receive maximum credit with increasing levels of credit in between.
	What is the standard deviation of director tenure (in years)? <i>(new Diversity subcategory)</i>	Evaluates the range of director tenures present on a board expressed as the sample standard deviation of tenures on the board. <b><i>This is a zero-weighted factor for the first year of introduction and is for informational purposes.</i></b>

PILLAR	NEW FACTOR	ISS VIEW
Shareholder Rights & Takeover Defenses	What is the proportion of votes outstanding controlled by shares with enhanced voting rights?	Helps investors differentiate between cases where multi-class share structures severely impair other class shareholder rights. Full credit is provided to companies with five percent or less of the voting power concentrated in enhanced voting rights shares. Credit is lost for incremental concentrated voting power with maximum credit lost when a majority of voting power is concentrated in enhanced voting rights shares.

In addition to the factors identified above, the new Diversity subcategory for U.S. companies includes the following existing factors previously included under other subcategories:

- What proportion of non-executive directors on the board has lengthy tenure (nine or more years)?
- How many women are on the board (more or less than three)?
- What is the proportion of women on the board (more or less than 50%)?
- Does the board have any mechanisms to encourage director refreshment?
- What proportion of non-executive directors has been on the board less than 6 years (more or less than one-third)?

Additional clarifying updates to the existing factors were made throughout the model, and no factors impacting U.S. companies were removed from last year’s model.

\* \* \* \* \*

**The complete QualityScore technical document can be requested [here](#).**

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## Questions for U.S. Companies

### COMPENSATION

<b>Pay for Performance (4 questions)</b>	What is the size of the CEO's 1-year pay as a multiple of the median pay for the company's peers (MOM)?
	What is the degree of alignment between the company's TSR and change in CEO pay over the past five years (PTA)?
	What is the ratio of the CEO's total compensation to the next highest-paid active executive?
	What is the degree of alignment between the company's annualized 3-year pay percentile rank, relative to peers, and its 3-year annualized TSR rank, relative to peers (RDA)?
<b>Non-Performance Based Pay (2 questions)</b>	Are any of the named executive officers eligible for multi-year guaranteed bonuses?
	What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) to Base Salary?
<b>Use of Equity (7 questions)</b>	Do the company's active equity plans prohibit share recycling for options/SARs?
	Do the company's active equity plans prohibit option/SAR repricing?
	Do the company's active equity plans prohibit options or SAR cash buyouts?
	Do the company's active equity plans have an evergreen provision?
	Do the company's active equity plans have a liberal change-in-control vesting provision?
	Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?
	Does the company's equity grant rate exceed the mean +1 standard deviation of its industry/index peers?
<b>Equity Risk Mitigation (6 questions)</b>	Did the company disclose a claw back or malus provision?
	What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARS?
	What are the minimum vesting periods mandated in the plan documents for restricted stock?
	What is the holding or retention period for stock options for executives?
	What is the holding or retention period for restricted shares or stock awards for executives?
<b>Communications &amp; Disclosure (3 questions)</b>	What proportion of the salary is subject to stock ownership requirements or guidelines for the CEO?
	Does the company disclose a performance measure of the short-term incentive plan for executives?
	What is the level of disclosure on performance measures for the latest active or proposed long term incentive plan?
<b>Termination (6 questions)</b>	Does the company employ at least one metric that compares its performance to a benchmark or peer group (relative performance)?
	What is the trigger under the change-in-control agreements?
	Do equity-based plans or other long-term awards vest completely upon a change-in-control?
	What is the multiple of pay in the severance agreements for the CEO upon a change-in-control?
	What is the basis for the change-in-control or severance payment for the CEO?
	Does the company provide excise tax gross-ups for change-in-control payments?
<b>Compensation Controversies (4 questions)</b>	What is the length of employment agreement with the CEO? *
	Has the ISS qualitative review identified a pay-for-performance misalignment?
	Has ISS identified a problematic pay practice or policy that raises concerns?
	Did the most recent Say-on-Pay proposal receive significant opposition from shareholders?
	What was the percentage of vote support received from shareholders on the most recent Say-on-Pay or remuneration proposals?

\*Indicates factor carries zero weight; included for informational purposes only

Questions in green are new.

## Questions for U.S. Companies

### BOARD STRUCTURE

<b>Board Composition (7 questions)</b>	How many directors serve on the board? *
	What percentage of the board is independent based on an ISS local market classification?
	What percentage of the board is independent, based on an ISS global classification?
	What is the classification of the Board Chair?
	Has the company identified a Senior Independent Director or an independent Lead Director?
	What percentage of the board consists of immediate family members of majority shareholders, executives, and former executives within the past five years?
	What percentage of the board consists of former or current employees of the company? *
<b>Composition of Committees (12 questions)</b>	What percentage of the nominating committee is independent based on an ISS local market classification?
	Are there Company executives on the nominating committee?
	What is the classification of the chair of the nominating committee?
	What percentage of the compensation committee is independent based on an ISS local market classification?
	Are there executives on the compensation committee?
	What is the classification of the chair of the compensation committee?
	What percentage of the audit committee is independent based on an ISS local market classification?
	Are there executives on the audit committee?
	What is the classification of the chair of the audit committee?
	What percentage of the nominating committee is independent, based on an ISS global classification?
	What percentage of the compensation committee is independent under ISS' global classification?
	What percentage of the audit committee is independent based on an ISS global classification?
<b>Board Practices (9 questions)</b>	Does the CEO serve on a significant number of outside boards? / How many boards does the CEO sit on?
	How many (non-executive) directors serve on a significant number of outside boards?
	What percentage of directors attended less than 75 percent of the board and/or key committee meetings?
	Did any director attend less than 75 percent of the aggregate board and applicable key committee meetings without a valid excuse?
	What percentage of directors received shareholder approval rates below 80%?
	Does the company disclose the existence of a formal CEO and key executive officers' succession plan?
	What was the average outside directors' total compensation as a multiple of the peer median?
	What proportion of directors with more than one year of service own stock, who can legally or practically do so?
	Did any executive or director pledge company shares?
<b>Board Policies (4 questions)</b>	Does the company disclose a policy requiring an annual performance evaluation of the board?
	Does the company disclose board or governance guidelines?
	Are directors subject to stock ownership guidelines?
	Does the company have a policy prohibiting hedging of company shares by employees?
<b>Related Party Transactions (3 questions)</b>	What percent of the directors were involved in material related-party transactions (RPTs)?
	Do the directors with related-party transactions sit on key board committees?
	Are there material related-party transactions (RPTs) involving the CEO?

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## Questions for U.S. Companies

### BOARD STRUCTURE - continued

<b>Board Controversies (7 questions)</b>	How many directors received withhold / against votes of 50% or greater at the last annual meeting?
	Has the board adequately addressed a shareholder resolution supported by a majority vote?
	Has the board adequately responded to low vote support for a management proposal?
	Has ISS determined that the board had problematic governance practices that reduced shareholder rights?
	What was the lowest percentage of vote support received by management-nominated directors at their most recent election?
	What was the most recent percentage of vote support for the CEO?
	What was the most recent percentage of vote support for the Board Chair?
<b>Diversity (9 questions)</b>	What proportion of non-executive directors on the board has lengthy tenure?
	How many women are on the board?
	Does the board have any mechanisms to encourage director refreshment?*
	What is the proportion of women on the board?
	What proportion of non-executive directors has been on the board less than 6 years?
	How many women serve in leadership roles on the board?
	How many women are named executive officers at the company?
	What is the standard deviation of director age?
What is the standard deviation of director tenure (in years)?*	

\*Indicates factor carries zero weight; included for informational purposes only

Questions in green are new.

## Questions for U.S. Companies

### SHAREHOLDER RIGHTS & TAKEOVER DEFENSES

<b>One Share, One-Vote (4 questions)</b>	Does the company have classes of common stock with different voting rights?
	What is the proportion of votes outstanding controlled by shares with enhanced voting rights?
	Are there any directors on the board who are not up for election by all classes of common shareholders?
	Is there a sunset provision on the company's unequal voting structure?
<b>Takeover Defenses (12 questions)</b>	Are all directors elected annually?
	Is the board authorized to issue blank check preferred stock?
	Does the company have a shareholder rights plan (poison pill) in effect?
	What is the trigger threshold for the poison pill?
	Does the poison pill have a sunset provision?
	Does the poison pill have a qualified offer clause?
	What is the expiration date of the poison pill?
	Is the poison pill designed to preserve tax assets (NOL pill)?
	When was the poison pill implemented or renewed?
	Does the company's poison pill include a modified slow-hand or dead-hand provision?
	Does the company have a controlling shareholder? *
If the company has a majority voting standard, is there a plurality carve-out in the case of contested elections?	
<b>Meeting &amp; Voting Related Issues (14 questions)</b>	Does the company require a supermajority vote to approve amendments to the charter and bylaws?
	Does the company require a supermajority vote to approve mergers or business combinations?
	What is the percentage of share capital needed to convene a special meeting?
	Can shareholders act by written consent?
	Does the company have a majority vote standard in uncontested elections?
	Are there material restrictions as to timing or topics to be discussed or ownership levels required to call the meeting?
	Does the company have an exclusive venue or forum provision?
	Does the company have a fee-shifting provision?
	Does the company have a representative claim limitation or other significant litigation rights limitations?
	Does the company provide proxy access to shareholders?
	What is the ownership threshold for proxy access?
	What is the ownership duration threshold for proxy access?
	What is the cap on shareholder nominees to fill board seats from proxy access?
What is the aggregation limit on shareholders to form a nominating group for proxy access?	
<b>Other Shareholder Rights Issues (1 question)</b>	Can the board materially modify the company's capital structure without shareholder approval?

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## Questions for U.S. Companies

### AUDIT & RISK OVERSIGHT

<b>External Auditor (3 questions)</b>	Non-Audit fees represent what percentage of total fees?
	What is the tenure of the external auditor? *
	Did the auditor issue an adverse opinion in the past year?
<b>Audit &amp; Accounting Controversies (6 questions)</b>	Has the company restated financials for any period within the past two years?
	Has the company made non-timely financial disclosure filings in the past two years?
	Has a regulator taken enforcement action against the company in the past two years?
	Has a regulator initiated enforcement action against an officer or director of the company in the past two years?
	Is the company or any of its officers or directors currently under investigation by a regulatory body?
	Has the company disclosed any material weaknesses in its internal controls in the past two fiscal years?
<b>Other Audit Issues (1 question)</b>	How many financial experts serve on the audit committee?

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