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Securities Alert

Changes to the New York City Retirement Systems' Proxy Guidelines

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The New York City Retirement Systems (NYRS) recently published a major overhaul of their proxy voting policies, the first in 30 years. Released in April 2016, the "Corporate Governance Principles and Proxy Voting Guidelines" provide insight into NYRS's priorities and concerns leading into the 2017 proxy season. These guidelines apply to four different NYC pension funds (the NYC Employees Retirement System; the NYC Police Pension Fund, the NYC Fire Department Pension Fund and the NYC Board of Education System) and are materially the same as guidelines of the NYC Teachers' Retirement System. The NYC Comptroller's Office is the chief investment advisor for the system and actively monitors the System's investments and votes corporate proxies. Clients with stock held by any of these NYC pension funds should keep the following items in mind over the next year:

Board Composition

The Guidelines emphasize the importance of director independence and director diversity on corporate boards to enhance the Board's collective experience and decision-making capabilities. NYRS has historically favored boards with racial and gender diversity. For the first time, however, NYRS explicitly expanded board diversity to include sexual orientation and gender identity.

Board Tenure

Although explicitly opposing director age or term limits, the Guidelines expressed concerns about inadequate director successor planning, "excessively high" tenure on the board, and the failure to routinely elect new directors. Consequently, NYRS may oppose incumbent directors serving on governance committees if the board does not change its composition with enough regularity.

Executive Pay

The Guidelines reaffirmed NYRS's conviction that executive compensation incentives should closely align with the company's long-term interests. For the first time, the Guidelines explicitly oppose an "excessively high disparity" between a Chief Executive Officer's salary and median workers' pay compared to peers or over time, especially if the disparity lacks a "compelling justification." The Guidelines also oppose:

- Change-in-control payments that exceed three times an executive's average annual compensation during the previous five years
- Excessive equity dilution
- Multi-year employment contracts with guaranteed payments that are not related to the executive's performance

Board Oversight of Climate Risk and Environmental Stewardship

NYRS will evaluate directors' relevant experience with climate and environmental challenges when making election decisions. The Guidelines also set forth expectations for companies to issue periodic reports on their sustainability policies and practices. These reports should include information on companies' efforts to address:

- Environmental risks and management
- Water stewardship

- Energy efficiency and conservationism
- Use of renewable energy sources
- Proper use and handling of toxics and hazardous materials, and product recycling

Even so, in solicitations seeking shareholder approval to discontinue a lawful product line or business operation due to its environmental risk, NYRS will generally vote against approval unless (1) continued operation poses “compelling, catastrophic legal and economic risks” to the company’s long-term success or (2) a viable alternative or replacement would enhance the company’s value and eliminating the original product line or business operation would not hurt the company financially.

Board Oversight of Employee Practices and Human Rights

The Guidelines also recommend board oversight and disclosure of material information related to developing, motivating, and retaining a talented workforce. This includes:

- Employee training and development
- Fair labor practices,
- Health and safety
- Responsible contracting
- Diversity

NYRS views unfavorably employment policies such as drug testing (unless justified by job hazards or probable cause), credit checks, and health or fitness standards unrelated to job performance. The Guidelines also encourage companies to adopt vigorous human rights policies that establish standards for both the company itself and its supply chain. Such policies should include labor rights such as the freedom of employees to form or join a union, the right to collective bargaining, and equal pay protections, as outlined by the International Labor Organization.

The above is a brief highlighting of the changes in the Comprehensive “Guidelines,” an instructive 40 plus page document prepared by the NYC Comptroller’s Office. Issuers with large holdings by the various NYC pension funds in the System should familiarize itself with the entire set of Guidelines in planning for any shareholder vote.

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