

Publications

Securities Alert: Summary of 2012 Updates to the ISS U.S. Corporate Governance Policy

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On November 17, 2011, Institutional Shareholder Services Inc. (“ISS”) released the 2012 Updates to its U.S. Corporate Governance Policy (the “2012 Updates”). The 2012 Updates will be effective for shareholder meetings on or after February 1, 2012. The 2012 Updates that are relevant to most issuers are summarized below.

We will be discussing the 2012 Updates on December 8, 2011 at our complimentary teleseminar *Proxy Season Prep – Planning for the 2012 Proxy Season*. To RSVP or for more information on this teleseminar, please contact Kayla Allen at ksallen@vorys.com.

Say-on-Pay. The 2012 Updates refine the methodology used by ISS to evaluate the alignment between pay and performance for purposes of determining its recommendation on a company’s say-on-pay proposal. The refined pay-for-performance methodology consists of (1) a quantitative analysis that considers peer group alignment and absolute alignment and (2) if the quantitative analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment, a qualitative analysis of various factors to determine causal and mitigating factors of the misalignment.

Quantitative Analysis. Under the 2012 Updates, a company’s peer group will generally consist of 14-24 companies selected based on their market cap and revenue (or assets for financial firms) and the company’s Global Industry Classification Standard industry group. The peer group selection process is designed so that the subject company is close to median in revenue/asset size. The peer group alignment analysis determines (1) the degree of alignment between the company’s total shareholder return (“TSR”) rank and the CEO’s total pay rank within the peer group, as measured over one-year and three-year periods (weighted 40 percent and 60 percent, respectively), and (2) the multiple of the CEO’s total pay relative to the peer group median. It is unclear how the two elements of the peer group alignment analysis will be integrated. The absolute alignment analysis determines the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years (i.e., the difference between the trend in

annual pay changes and the trend in annualized TSR during the period).

Qualitative Analysis. If the quantitative analysis conducted by ISS reveals an unsatisfactory alignment between pay and performance, ISS will analyze the following qualitative factors to determine a final vote recommendation on the subject company's say-on-pay proposal:

- The ratio of performance- to time-based equity awards
- The ratio of performance-based compensation to overall compensation
- The completeness of disclosure and rigor of performance goals
- The company's peer group benchmarking practices
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers
- Special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (e.g., biennial awards)
- Any other factors deemed relevant

ISS will provide additional guidance on its pay-for-performance methodology in December 2011 and will also disclose its peer group methodology and rationale, allowing investors and issuers to better understand how ISS constructs peer groups.

Proxy Access. The 2012 Updates retain the case-by-case analysis of proxy access proposals, but broaden the scope of the policy to apply to proposals submitted by shareholders *and* management. The 2012 Updates also expand and refine the factors that ISS considers in its analysis to specifically include: (1) company-specific factors; (2) ownership thresholds proposed in the resolution (i.e., percentage and duration); (3) the maximum proportion of directors that shareholders may nominate each year; and (4) the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. This list of factors is not intended to be exhaustive. ISS expects to provide additional guidance on its proxy access policy in January 2012 based on its review of submitted proxy access proposals.

Voting on Board Nominees in Uncontested Elections.

Board Response to High Opposition to Say-on-Pay Proposal. If a company's previous say-on-pay proposal received the support of less than 70 percent of votes cast, ISS will consider the following factors when determining how to vote on Compensation Committee members and the say-on-pay proposal:

- The company's response, including:
 - Disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support
 - Specific actions taken to address the issues that contributed to the low level of support
 - Other recent compensation actions taken by the company
- Whether the issues raised are recurring or isolated

- The company's ownership structure
- Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness

Board Response to Results of Say-on-Frequency Vote. The 2012 Updates adopt a policy to determine whether to vote against or withhold votes from directors if the board implements a say-on-pay schedule that is less frequent than the frequency most recently preferred by shareholders. ISS will vote against or withhold votes from the entire board of directors (except new nominees, who will be considered on a case-by-case basis) if the board implements a say-on-pay vote on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting at which shareholders voted on say-on-frequency. ISS will vote on a case-by-case basis on the entire board if the board implements a say-on-pay vote on a less frequent basis than the frequency that received a plurality, but not a majority, of the votes cast at the most recent shareholder meeting at which shareholders voted on say-on-frequency, taking into account:

- The board's rationale for selecting a frequency that is different from the frequency that received a plurality
- The company's ownership structure and vote results
- ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices
- The previous year's support level on the company's say-on-pay proposal

Board Accountability – Governance Failures. The 2012 Updates expand the scope of this policy to authorize ISS to recommend a vote against or withhold votes from director(s) due to material failures of risk oversight at the company.

Exclusive Venue Proposals. The 2012 Updates revise the voting standard for exclusive venue proposals from voting against such proposals to voting on a case-by-case basis on such proposals. The 2012 Updates also add the company's litigation history to, and remove the existence of a meaningful special meeting right from, the list of factors examined by ISS in its analysis of the proposal.

Shareholder Proposals Addressing Social and Environmental Issues.

Recycling. The 2012 Updates broaden the existing policy to apply to proposals that seek information on a company's existing recycling programs and to explicitly include a company's current level of disclosure of such programs when determining a voting recommendation.

Political Spending. The 2012 Updates revise the voting standard for proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities from voting on a case-by-case basis to generally voting for such proposals.

Lobbying Activities. The 2012 Updates clarify that the ISS lobbying activity policy (1) applies to proposals seeking information on the company's lobbying activities generally and not only to those seeking information on its initiatives and (2) applies to proposals addressing broader efforts to inform/sway public opinion as well as formalized, political lobbying activities.

Workplace Safety. The 2012 Updates adopt a new policy to vote on a case-by-case basis on requests for workplace safety reports, including reports on accident risk reduction efforts.

Water Issues. The 2012 Updates adopt a new policy to vote on a case-by-case basis on proposals requesting a company report on, or to adopt a new policy on, water-related risks and concerns.

This client alert is for general information purposes and should not be regarded as legal advice.