

ISS' 2013 Draft Policy Changes Comments Due by October 31

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Institutional Shareholder Services ("ISS") recently released draft policy changes for 2013. ISS has invited all financial market participants to provide feedback on the proposed changes to its 2013 benchmark proxy voting guidelines. The comment period will close October 31, 2012. The proposed policy changes are discussed below.

Management Say-on-Pay Proposals

Peer Group Formation: Instead of relying solely on a company's GICS industry classification, ISS is considering the use of a company's self-selected peers meeting ISS size criteria as a factor for peer group formation. The proposed methodology would use peers identified by a company as well as peers from the company's GICS group, with an initial focus at an 8-digit GICS resolution to identify peers that are in a related industry. When ISS determines the peer group, it will prioritize peers that maintain the company near the median of the group, are in the company's chosen peer group, and have chosen the company as a peer. ISS is specifically seeking feedback on (a) additional or alternate ways to use a company's self-selected peer group, (b) a reasonable size range (revenue/assets) for peer group construction, and (c) additional factors for peer group formation that should be considered.

Realizable Pay: Another consideration by ISS is the addition of realizable pay, in comparison with grant date pay, to the qualitative review for large-cap companies that are identified as "high concern" under the pay-for-performance quantitative test. Realizable pay would consist of the sum of cash and equity-based compensation based on actual earned awards, and target values for ongoing awards, calculated using stock price at the end of the measurement period. ISS is specifically seeking feedback on (a) how to define realizable pay, (b) whether stock options should be based on intrinsic or Black-Sholes value, and (c) the appropriate measurement period for realizable pay.

Pledging of Company Stock: ISS is considering the addition of the pledging of company stock by directors or executives to the list of *most* problematic pay practices, which may result in a negative vote recommendation. ISS is specifically seeking feedback on (a) the level of pledging of company stock that causes concern; (b) whether the vote recommendation should be directed at the (i) Say-on-Pay proposal, (ii) the board, or (iii) members of a board committee and which committee; and (c) whether a company's remedial actions should be sufficient to address the concern without a negative vote recommendation.

Say-on-Golden Parachute Proposals ISS proposes to consider existing change-in-control arrangements when making vote recommendations rather than focusing only on new or

extended arrangements. Features in change-in-control arrangements that may lead to an "against" vote recommendation include one or more of the following:

- Single- or modified single-trigger cash severance
- Single-trigger acceleration of unvested equity awards
- Cash severance greater than three times salary and bonus
- Excise tax gross-ups triggered and payable (rather than a provision to provide excise tax gross-ups)
- Excessive golden parachute payments (on an absolute basis or as a percentage of the value of the transaction)
- Recent amendments that incorporate problematic features, or recent actions (such as extraordinary equity grants) that make packages so attractive as to influence merger agreements that may not be in the shareholders' best interests
- Company assertion that a proposed transaction is conditioned on shareholder approval of the say-on-golden parachute advisory vote

Recent amendments that incorporate problematic features will tend to carry more weight on the overall analysis; however, multiple problematic legacy features will also be closely scrutinized. ISS is specifically seeking feedback on (a) whether investors differentiate between new and existing arrangements when determining whether to support a proposal, (b) whether the number of problematic features is a consideration when evaluating a proposal, and (c) any additional factors that should be considered.

If you have any questions regarding these proposed changes or any other executive compensation-related questions, please contact one of the authors or the Reed Smith attorney with whom you usually work.

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