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ISS Issues Final Policies for 2012

Author: John D. Martini, Partner, Philadelphia
Author: Jeffrey G. Aromatorio, Partner, Pittsburgh
Author: Dodi Walker Gross, Partner, Pittsburgh
Author: David N. Pardys, Partner, Philadelphia
Author: Craig P. Tanner, Partner, San Francisco
Author: Jenny C. Baker, Associate, Chicago
Author: Kerry Halpern, Associate, Philadelphia

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On November 17, 2011, Institutional Shareholder Services Inc. ("ISS") issued its final U.S. Corporate Governance Policy for 2012. The policy includes changes from the ISS 2011 policy, which may affect ISS's recommendations with respect to say-on-pay votes on executive compensation, and the election of directors of public companies. The following analysis summarizes the changes made to the ISS policy with respect to executive compensation as they apply to the upcoming 2012 proxy season.

Evaluation of Executive Pay (Say-on-Pay)

Previously, ISS assessed pay-for-performance alignment by examining a company's one-year and three-year total shareholder return ("TSR") relative to all other companies in the same 4-digit Global Industry Classification Standard ("GICS") industry group, and by considering other factors such as the year-over-year change in the CEO's total pay and five-year trends in company TSR and CEO pay. The ISS proposal includes changes to the peer group used by ISS to analyze pay for performance, quantitative evaluation of pay-performance alignment on a relative basis against the peer group and an absolute basis against the company's historic TSR, and qualitative review of other factors for companies that demonstrate a weak pay-for-performance alignment.

- *Peer Group*. Companies will no longer be evaluated against all companies in the 4-digit GICS industry group, but will instead be evaluated against a smaller peer group that is similar in market cap, revenue (or assets) and industry.

- *Peer Group Alignment*. The degree of alignment between the company's TSR rank and the CEO's total pay rank within the peer group will be evaluated on a relative basis over one and three years (weighted 40/60, to put more emphasis on the longer term). The multiple of the CEO's total pay relative to the peer group median will be quantified, to identify cases where a high-performing company may be "overpaying."

- *Absolute Alignment.* CEO pay alignment will be evaluated on an absolute basis against the company's TSR over each of the prior five fiscal years. This will be assessed as the difference between the trend in annual CEO pay changes and the trend in annualized TSR during the prior five-year period.

- *Qualitative Review*. Companies that demonstrate strong or satisfactory quantitative alignments will generally receive a positive recommendation (in the absence of other pay-related issues), while companies demonstrating weak alignment will receive further qualitative review to determine a final vote recommendation. Factors considered may include:

  - The ratio of performance-based to time-based equity awards

  - The overall ratio of performance-based compensation to total compensation

  - The robustness 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, and cash flow, both absolute and relative to peers

  - Secial circumstances, such as a new CEO in the prior fiscal year or equity grant practices

- Any other factors deemed relevant

Equity Plans of Newly Public Companies

In the executive summary to its final 2012 policies, ISS stated that equity plans coming to a shareholder vote for the first time after a company's initial public offering will be evaluated under the same guidelines as a standard equity plan, even if no new shares are being requested. ISS will make its recommendation based on evaluation of all aspects of the particular plan, including consideration of total shareholder value transfer, repricing, burn rate (if applicable), and any liberal change-in-control provisions. Other factors, such as pay-for-performance or problematic pay practices as related to say-on-pay, may be considered if deemed appropriate.

In explaining its rationale for this change, ISS stated that it anticipates continuing to support the majority of the equity plans of newly public companies, but that its ultimate recommendation is intended to ensure that any adverse equity plan provisions would not have a more detrimental potential impact on shareholders than the potential loss of the company's tax deductions related to named executive officer grants. The recently proposed regulations under Internal Revenue Code section 162(m), requiring newly public companies to obtain shareholder approval before awarding certain performance-based restricted stock units to named executive officers, will likely increase the impact of the new ISS rule as more plans are presented for shareholder approval.

Board Response to Say-on-Pay Vote

For any company that received less than 70 percent support on its prior say-on-pay vote, ISS will make its recommendation on a case-by-case basis with respect to the election of compensation committee members (or, in rare cases where the full board is deemed to be responsible, the full board) and the current say-on-pay proposal. ISS will take into account:

- The company's response, including disclosure of engagement efforts with major institutional investors regarding the compensation issue(s), specific actions taken to address the issue(s) that appear to have caused the significant level of against votes, and other recent compensation actions taken by the company
- The company's ownership structure
- Whether any prior issues of concern are recurring or one-time
- The level of opposition (support of less than 50 percent warrants the highest degree of responsiveness)

Board Response to Say-on-Pay Frequency Vote

The ISS has adopted a new policy and vote recommendation with respect to the frequency of the say-on-pay vote implemented by the board:

- ISS will recommend a "withhold/against" vote on all incumbent director nominees if the board implements the advisory say-on-pay vote on a less frequent basis than the frequency that received the majority of votes cast by shareholders.
- ISS will make its recommendation on a case-by-case basis if the board implements the advisory say-on-pay vote on a less frequent basis than the frequency that received a plurality, but not a majority, of votes cast by shareholders. ISS will take into account:
    - The board's rationale for choosing a frequency that is different from the frequency that received a plurality
    - The company's ownership structure
    - ISS's analysis of the company's executive compensation and whether there are compensation concerns or a history of problematic pay practices
    - The previous year's support level on the company's say-on-pay proposal

- The difference between the frequency adopted and the frequency supported by shareholders

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