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ISS Publishes 2011 U.S. Corporate Governance Policy Updates Including Recommendation for Annual Say-on-Pay Votes

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As we previously reported, on October 18, 2010, the Securities and Exchange Commission proposed amendments to its rules to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") regarding shareholder approval of executive compensation and disclosure. Section 951 of the Dodd-Frank Act added Section 14A to the Securities Exchange Act of 1934. Section 14A requires a registrant to, among other things, (1) conduct a non-binding shareholder vote to approve named executive officer compensation ("Say-on-Pay") and (2) conduct a separate non-binding vote to determine how often the Say-on-Pay vote will be held ("Say-on-Frequency").*

Say-on-Pay

Under proposed Rule 14a-21(a), a registrant must conduct, at least once every three years, an advisory Say-on-Pay vote via its proxy statement. Proposed Item 24 of Schedule 14A requires that a registrant disclose the Say-on-Pay vote in its proxy statement and explain the effect of the vote (*i.e.*, that the vote is non-binding).

Say-on-Frequency

Proposed Rule 14a-21(b) requires that a registrant provide, at least once every six years, an advisory Say-on-Frequency vote via its proxy statement. Shareholders must be given the opportunity to vote for a frequency of every one, two or three years, or to abstain. Management may make a recommendation, but it must make clear that the vote is not to approve or disapprove management's recommendation, but to express a preference among the three alternatives or to abstain.

Proposed Item 24 of Schedule 14A requires that a registrant disclose the Say-on-Frequency vote in its proxy statement and explain the effect of the vote (i.e., that the vote is non-binding).

ISS Recommendation

On November 19, 2010, Institutional Shareholder Services Inc. ("ISS") published its 2011 U.S. Corporate Governance Policy Updates describing its proxy voting recommendations for meetings held on and after February 1, 2011. ISS indicated that, with respect to the Say-on-Frequency vote, it will recommend that its clients vote for holding Say-on-Pay votes every year, rather than every two or three years. ISS stated that it believes that, as a communication vehicle, Say-on-Pay votes are only useful when received in a timely and consistent manner, and less frequent votes "would make it difficult to create the meaningful and coherent communication that the votes are intended to provide." As part of its rationale, ISS states that its recommendation is consistent with client feedback.

Given ISS's influential role in the voting decisions by investors, particularly institutional investors, the ISS policy in favor of annual Say-on-Pay votes is likely to heavily influence the recommendations that registrants make to shareholders with respect to the Say-on-Frequency vote. Many registrants will want to avoid a situation where a frequency other than the registrant's recommendation is preferred by shareholders, representing an implicit rejection of the recommendation. This situation could pose investor relations concerns, even though the Say on-Frequency vote is non-binding. In light of the ISS policy, the risk of this result will be heightened if a registrant recommends any frequency other than an annual frequency. Under amended New York Stock Exchange Rules adopted pursuant to the Dodd-Frank Act, broker discretionary voting of uninstructed shares is prohibited for Say-on-Frequency votes.

Registrants will be required to disclose the results of the Say-on-Frequency vote on a Form 8-K within four business days following the day of the shareholder meeting. In addition, under the proposed rules, the registrant will be required to disclose, in the quarterly report on Form 10-Q covering the period during which the Say-on-Frequency vote occurs, or in the annual report on Form 10-K if the Say-on-Frequency vote occurs during the issuer's fourth quarter, its decision regarding how frequently it will conduct Say-on-Pay votes in light of the results of the Say-on-Frequency vote.

Under the proposed amendments to Rule 14a-8, if the registrant has adopted a policy to conduct Say-on-Pay votes at the frequency that received a plurality of the votes cast in the most recent Say-on-Frequency vote, the registrant will be permitted to exclude any shareholder proposal seeking a Say-on-Pay vote or relating to the frequency of Say-on-Pay votes.

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* Regardless of the timing of the Securities and Exchange Commission's adoption of final rules, registrants must conduct Say-on-Pay and Say-on-Frequency votes for annual meetings held on or after January 21, 2011.

If you have any questions regarding these rule proposals or the ISS U.S. Corporate Governance Policy 2011 Updates, please contact one of the authors.