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ISS Releases the 2012 Updates to its Proxy Voting Policy

November 22, 2011

On November 17, 2011, Institutional Shareholder Services (ISS) released updates to its proxy voting policy. These updated voting policies will be applied by ISS to make vote recommendations for all proposals submitted to a shareholder vote at annual or special meetings held by publicly traded companies on or after February 1, 2012. A summary of the most significant updates to ISS's voting policy is provided below. The full text of the updates is available on ISS's website at http://www.issgovernance.com/policy.

Pay-for Performance (for Evaluation of Management Say-on-Pay Proposals)

2011 Voting Policy. Under ISS's current 2011 voting policy, ISS recommends a vote against a management say-on-pay proposal if it determines, on a case-by-case basis, that there is a misalignment between CEO pay and company performance based on sustained underperformance relative to the company's peers. In evaluating the existence of such a misalignment, ISS currently considers:

- Whether a company's one-year and three-year total shareholder return (TSR) was in the bottom half of its industry group (based on the company's four-digit Global Industry Classification Standard (GICS) assignment);
- Whether the total compensation of a CEO who has served at least two consecutive fiscal years is aligned with the company's total shareholder return over time (considering the most recent year-over-year change as well as the trend over the prior five-year period).

2012 Voting Policy. In 2012, ISS will continue to evaluate the alignment of CEO pay and performance on a case-by-case basis in determining whether to recommend for or against a management say-on-pay proposal. However, for 2012, ISS has modified its pay-for-performance methodology in an effort to provide a more "robust view of the relationship between executive pay and performance" to evaluate the proper alignment of CEO pay and performance over a sustained time period. Under ISS's modified policy, ISS will evaluate pay for performance by considering the alignment of CEO pay and TSR performance against both a peer group of companies and the company itself. More specifically, ISS will analyze a company's pay-for-performance based on the following factors:

- <u>Peer-Group Alignment.</u>
  - The degree of alignment between the company's rank for both TSR and CEO total pay within a peer group (selected by ISS as described below), as measured over one-year and three-year periods (weighted 40/60); and
  - The multiple of the CEO's total pay relative to the median pay level in the peer group.

- <u>Absolute Alignment.</u> 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.

If ISS's analysis demonstrates "significant unsatisfactory long-term pay-for-performance alignment" (or for non–Russell 3000 companies, if misaligned pay and performance are otherwise suggested), ISS will analyze additional qualitative factors to determine how various pay elements may encourage or undermine long-term value creation and alignment with shareholder interests. ISS has not disclosed any quantitative thresholds of alignment that it will deem to be "unsatisfactory."

Impact of Change in CEO. Under ISS's current voting policy, companies that had appointed a new CEO within the prior two years received a free pass under ISS's pay-for-performance analysis. Going forward, this will no longer necessarily be the case. If ISS's quantitative analysis demonstrates an "unsatisfactory" pay-for-performance alignment, ISS will consider the recent appointment of a new CEO in the prior fiscal year as only one factor in its qualitative review.

Peer-Group Selection. For purposes of its peer-group-alignment analysis, the peer group selected by ISS will be comprised of 14 to 24 companies within a company's GICS industry group having a market capitalization and revenue (or assets for financial firms) closest to the company, with the company falling close to the median in revenue/asset size. In selecting peer companies, ISS will not consider or review the benchmark peers selected by a company to evaluate executive compensation, even if those companies are considered by the company to be more relevant to the market and geography in which it competes.

ISS has committed to provide additional guidance on its updated pay-for-performance methodology in a technical document that it expects to release in December 2011.

Board Response to Prior Vote on Management Say-on-Pay Proposal

With management say-on-pay proposals required for substantially all public companies during the 2011 proxy season, ISS has updated its voting policy for 2012 to more expressly set forth the factors ISS will consider in determining whether a company has sufficiently addressed shareholder concerns in the event a prior year's management say-on-pay proposal failed to receive a "meaningful" level of support. For these purposes, shareholder support of a management say-on-pay proposal of at least 70 percent of the votes cast will be viewed by ISS as meaningful (with "votes cast" calculated based on the total "for" and "against" votes only—i.e., abstentions and broker non-votes are not counted). For proposals that received the support of less than 70 percent of the votes cast in the previous year, ISS may recommend "against" or "withhold" from the members of a company's compensation committee (or, in exceptional circumstances, its full board of directors) on a case-by-case basis after considering the following factors:

- The company's response to shareholders' opposition of the prior year's management say-on-pay proposal, including:
  - Disclosure of engagement efforts with 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; and
  - Other recent compensation actions taken by the company;
- Whether the issues raised are recurring or isolated;
- The company's ownership structure; and
- Whether the support level was less than 50 percent, which would warrant a higher degree of responsiveness.

ISS's analysis on this issue also will contemplate the sufficiency of disclosure included in the company's proxy statement concerning its response to shareholders' opposition of the prior year's management say-on-pay proposal. ISS has provided the following guidance concerning the substantive disclosures a company should include in its proxy statement if it received less than 70 percent shareholder support for a prior year's management say-on-pay proposal:

- Companies should discuss their outreach efforts to major institutional investors;
- Companies should provide disclosure of the specific actions they have taken to address the compensation issues that resulted in the significant opposition vote, which should ideally be new and not a reiteration of existing practices;

- Disclosure should not be boilerplate, but should instead enable shareholders to gauge the level of effort taken by the company in response to the prior year's say-on-pay vote; and
- Placement of the disclosure in the proxy statement should be readily identifiable.

Board Response to Say-on-Frequency Vote Results

Item 5.07(d) of Form 8-K requires a company to disclose, following each meeting of shareholders at which shareholders voted on the frequency of future advisory votes on executive compensation, the board's decision, in light of the results of the frequency vote, regarding how often the company will include a management say-on-pay proposal in its proxy materials. Under ISS's 2012 policy, it will recommend "against" or "withhold" from a company's entire board of directors (except new nominees, who would 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 which received a majority of the votes cast at the most recent shareholder meeting at which shareholders voted on say-on-pay frequency. If no option received a majority of the votes cast and a board selects a frequency option other than the option that received a plurality of the votes cast, ISS will consider other factors on a case-by-case basis in determining whether an "against" or "withhold" recommendation from the company's board of directors is warranted. These factors will include the board's rationale for selecting a frequency that is different from the frequency that received plurality support, the company's ownership structure and vote results, ISS's analysis of whether there are compensation concerns or a history of problematic compensation practices, and the previous year's support level on the company's say-on-pay proposal.

Voting on Director Nominees in Uncontested Elections

In ISS's revised 2012 policy, a material failure of risk oversight—in addition to a material failure of governance, stewardship or fiduciary responsibilities at a company—will now be considered by ISS as one of the extraordinary circumstances in which ISS may recommend an "against" or "withhold" vote from individual directors, members of a board committee, or the entire board of directors. In reformulating its policy, ISS indicated that "[t]he intention is not to penalize boards for taking prudent business risks or for exhibiting reasonable risk appetite, but is instead intended to address situations where there has been a material failure in a board's role in overseeing the company's risk management practices."

Proxy-Access Proposals

ISS has revised its existing proxy-access policy to expand and refine the factors it will consider in evaluating these proposals, although it has retained its existing case-by-case approach to reviewing proxy-access proposals. ISS has also broadened its policy to apply both to shareholder proposals and management proposals. Under its revised policy, the non-exclusive factors that ISS will consider in reviewing proxy-access proposals include:

- Company-specific factors and
- Proposal-specific factors, including:
  - The ownership thresholds proposed in the resolution (i.e., percentage and duration);
  - The maximum proportion of directors that shareholders may nominate each year; and
  - The method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

Given the wide variability of proxy-access proposals expected for the 2012 proxy season, ISS has designed its policy to retain flexibility and has expressly determined not to specify specific parameters for acceptable proxy-access proposals. As the proxy season progresses, however, ISS expects to issue additional guidance (via FAQs and/or through other reports) regarding acceptable proxy-access proposals based on an examination of the specific text of submitted proposals. At a minimum, we expect this guidance will confirm ISS's informal guidance at recent conferences that proxy-access proposals specifying ownership and holding-period thresholds that mirror the requirements of Rule 14a-8 (i.e., minimum ownership of at least $2,000 of a company's shares for at least one year) will not be supported by ISS.

Political Spending and Lobbying Proposals

ISS has revised its policy to generally vote "for" proposals requesting enhanced disclosure of a company's political contributions and trade-association spending policies and activities. Previously, ISS considered these policies on a case-by-case basis only. In determining whether it will vote "for" these proposals, ISS will consider:

- The company's current disclosure of policies and oversight mechanisms related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes, including information on the types of organizations supported and the business rationale for supporting these organizations; and
- Recent significant controversies, fines, or litigation related to the company's political contributions or political activities.

For 2012, ISS has also refined its voting policy on shareholder proposals requesting information about a company's lobbying activities in light of renewed attention on corporate grassroots lobbying activities in particular. The policy continues to apply on a case-by-case basis; however, changes for 2012 clarify that the policy applies to proposals seeking information about a company's lobbying activities generally rather than information solely about a company's lobbying initiatives. The changes also clarify that the policy applies to proposals that address broader efforts to inform or sway public opinion in addition to formalized, political lobbying activities. Under the revised policy, ISS considers proposals requesting information on a company's lobbying activities, including direct lobbying as well as grassroots lobbying activities, on a case-by-case basis after considering:

- The company's current disclosure of relevant policies and oversight mechanisms;
- Recent significant controversies, fines or litigation related to the company's public-policy activities; and
- The impact that the policy may have on the company's business operations.

Management Exclusive-Venue Proposals

Following a January 2011 Ninth Circuit decision, several companies sought shareholder approval of board-adopted charter or bylaw provisions that designate Delaware as the exclusive forum for specified intra-corporate disputes during the 2011 proxy season. ISS developed an informal, unpublished policy to evaluate these forum-selection proposals during 2011. Under this policy, ISS reviewed forum-selection proposals on a case-by-case basis and recommended against them unless the company had in place the following:

- An annually elected board of directors;
- A majority vote standard in uncontested director elections;
- A "meaningful" special meeting right (generally a 10% demand level without onerous restrictions on timing and topics); and
- The absence of a poison pill, unless the pill was approved by stockholders.

ISS has formalized its voting policy on forum-selection proposals for 2012,