

Client Alert

Current Issues Relevant to Our Clients

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ISS Releases 2014 U.S. Corporate Governance Policy Updates

Institutional Shareholder Services Inc. (“ISS”), a leading provider of proxy advisory and corporate governance services, recently released 2014 updates to its U.S. corporate governance policies (the “2014 Policy Updates”). The 2014 Policy Updates primarily address issues relating to (1) board responsiveness to majority-supported shareholder proposals, (2) chief executive officer (“CEO”) pay-for-performance evaluations and (3) shareholder proposals requesting information on lobbying activities and human rights risk assessments.

The 2014 Policy Updates, which are available [here](#), will be effective for annual meetings taking place on or after February 1, 2014. ISS expects to release a complete set of updated policies in December 2013.

Board Responsiveness to Majority-Supported Shareholder Proposals

ISS Policy. ISS generally recommends a vote “for” director nominees in uncontested elections. ISS may, however, recommend a “withhold/against” vote on a “case-by-case” basis for individual directors, certain committee members or the entire board of directors, as appropriate, after evaluating various factors relating to board accountability, board responsiveness, director independence and director competence. For 2014, ISS, with respect to its director vote recommendation, has updated the factors that it will consider in its evaluation of a board’s responsiveness to majority-supported shareholder proposals.

The 2014 Policy Updates provide that ISS will evaluate only whether a “board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year” and not whether the board failed to act on a shareholder proposal that received the support of a majority of “the shares outstanding the previous year” or “shares cast in the last year and one of the two previous years.” In addition, the 2014 Policy Updates clarify that ISS will consider the board’s rationale (as disclosed in the company’s proxy statement) in assessing a board’s less than full implementation of a majority-supported shareholder proposal.¹ Finally, the

2014 Policy Updates change ISS’ vote recommendation on director elections with respect to majority-supported shareholder proposals from “generally vote against” to a fact-specific “case-by-case” approach.

Corporate Governance Considerations. In response to the 2014 Policy Updates, a company may want to:

- revisit its 2013 annual meeting shareholder voting results with respect to any shareholder proposal;
- evaluate the board of director’s response to any such proposal that received majority shareholder support;
- analyze how that response might be evaluated by ISS (using as guidance, as applicable, the factors that ISS will consider in assessing a board’s less than full implementation of a majority-supported shareholder proposal); and
- assess the potential corresponding impact of ISS’ evaluation of the board’s response on ISS’ vote recommendation for the re-election of individual directors, applicable committee members or the entire board at the company’s 2014 annual meeting. Additional board action (and related disclosure thereof) might be contemplated if an

¹ Other factors that ISS will consider in assessing a board’s less than full implementation of a majority-supported shareholder proposal include the following:

- disclosed outreach efforts by the board to shareholders in the wake of the vote;
- the subject matter of the proposal;

- the level of support for and opposition to the resolution in past meetings;
- actions taken by the board in response to the majority vote and its engagement with shareholders;
- the continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
- other factors as ISS deems appropriate.

analysis of the board's response to a majority-supported shareholder proposal appears to be insufficient pursuant to ISS' evaluation criteria (as an ISS recommended "withhold/against" vote for a director may adversely impact that director's re-election to the board).

CEO Pay-for-Performance Evaluations

ISS Policy. As part of its executive compensation analysis and whether it will recommend a vote "for" or "withhold/against" members of the board's compensation committee and/or the company's say-on-pay proposal, ISS conducts a pay-for-performance evaluation to identify the alignment between CEO compensation and company performance over a certain period. With respect to companies in the Russell 3000 Index (which includes the largest 3,000 publicly held U.S. companies representing approximately 98% of the investable U.S. equity market), ISS' pay-for-performance analysis considers the following:

- peer group alignment (calculating (1) the relative degree of alignment between the company's annualized total shareholder return ("TSR") rank and the CEO's annualized total pay rank within a peer group, each measured over a three-year period, and (2) the multiple of the CEO's total pay relative to the peer group median); and
- absolute alignment (calculating the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years).

If the above analysis reveals "significant unsatisfactory" long-term pay-for-performance misalignment, ISS may also evaluate a number of additional qualitative factors as it feels is relevant to its pay-for-performance analysis.²

The 2014 Policy Updates revise the relative degree of alignment (the first prong of the "peer group alignment" measure) from a one- and three-year period (weighted 40/60) to a single three-year measurement period. ISS

² ISS may consider the following qualitative factors in its CEO pay-for-performance evaluation:

- the ratio of performance- to time-based equity awards;
- the overall ratio of performance-based compensation;
- the completeness of disclosure and rigor of performance goals;
- the company's peer group benchmarking practices;
- actual results of financial/operational metrics (e.g., growth in revenue, profit and cash flow) 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., bi-annual awards);
- realizable pay compared to grant pay (note that beginning with annual meetings taking place on or after February 1, 2014, ISS research reports will include a realizable pay analysis for S&P 1500 companies); and
- any other factors ISS deems relevant.

noted that the single measurement period, among other reasons, provides a smoother performance measure that does not overemphasize any particular year and avoids volatility during the measurement period.

Corporate Governance Considerations. A company may consider conducting its own pay-for-performance analysis (with assistance from its compensation consultant, as necessary) utilizing the revised "relative degree of alignment" calculation to determine its CEO's pay-for-performance alignment over the applicable three- and five-year periods. That calculation may be one of several factors considered by the board or compensation committee in setting CEO compensation and could potentially provide initial insight as to whether ISS might identify pay-for-performance alignment concerns.

Lobbying and Human Rights Risk Assessment Shareholder Proposals

ISS Policy – Lobbying Proposals. ISS reported that the 2013 proxy season saw significant activity regarding shareholder proposals seeking a report on a company's direct, indirect and grassroots lobbying-related policies, procedures, oversight and expenditures as well as a company's memberships and payments to tax-exempt groups involved in certain legislative activities. For 2014, ISS, with respect to such proposals, will recommend a vote "for" or "against" on a "case-by-case" basis following its evaluation of the following factors:

- the company's current disclosure of relevant lobbying policies and management and board oversight;
- the company's disclosure regarding trade associations or other groups it supports, or is a member of, that engage in lobbying activities; and
- recent significant controversies, fines or litigation regarding the company's lobbying-related activities.

The 2014 Policy Updates further elaborate how ISS will evaluate lobbying proposals and the factors ISS will consider in its analysis. Specifically, the first factor is updated to reflect that management oversight of lobbying activity, in addition to that provided by the board, is considered in ISS' analysis (whereas prior to the 2014 Policy Updates, ISS simply assessed the company's "oversight mechanisms"). A new second factor is added to formally include trade association activity as a relevant issue in ISS' analysis. Finally, ISS deleted a factor relating to certain public policy issues, as ISS noted that it is no longer relevant to its analysis.

ISS Policy – Human Rights Risk Assessment Proposals. ISS reported that during the 2013 proxy season,

shareholders filed a new resolution requesting companies to conduct an assessment of the human rights risks in their operations or in their supply chain, or to report on their human rights risk assessment process. Those resolutions differed from the human rights proposals previously submitted by shareholder proponents, which typically sought a report on a company's human rights policies or the amendment of a company's human rights policies to bring them into greater conformity with international human rights standards and conventions.

In light of this development, the 2014 Policy Updates include a new policy to address how ISS will analyze this latest form of human rights shareholder proposal. With respect to such proposals, ISS will recommend a vote "for" or "against" on a "case-by-case" basis following its evaluation of the following factors:

- the degree to which existing relevant company policies and practices are disclosed, including information on the implementation of those policies and any related oversight mechanisms;
- the company's industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
- recent significant controversies, fines or litigation regarding human rights involving the company or its suppliers and whether the company has taken remedial steps; and
- whether the proposal is unduly burdensome or overly prescriptive.

Corporate Governance Considerations. If a company receives a lobbying or human rights risk assessment shareholder proposal during the 2014 proxy season, the company's response (if a response is deemed appropriate) should necessarily highlight the level of applicable information (e.g., policies, practices and oversight mechanisms) currently available to the public, including information disclosed on a company's website and in regulatory filings (e.g., Form 10-K, proxy statement and campaign disclosure form). The extent to which a company has applicable policies, practices and oversight mechanisms and the level of related disclosure will likely be dependent upon the company (e.g., size of company, whether it is a multinational, etc.) and corresponding industry and peer norms. The company may also evaluate the updated factors ISS uses in considering whether to recommend a vote "for" or "against" a lobbying or human rights risk assessment proposal. This evaluation might assist the company in strategizing what, if any, further actions the company or board should take in response to the proposal (e.g., what additional information should be disclosed and where that public disclosure should be made).

For More Information

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