

November 27, 2013

## ISS Publishes 2014 Corporate Governance Policy Updates

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**On November 21, 2013, Institutional Shareholder Services Inc. (“ISS”) released its final US policy updates for the 2014 proxy season (the “2014 Policies”), having received comments to its draft policies released on October 21, 2013.<sup>1</sup> The 2014 Policies are substantially similar to the draft policies.<sup>2</sup> There are only three updates for the US, none of which represent a significant change. The first modifies the existing pay for performance quantitative screen, the second clarifies ISS’s policy on board responsiveness to majority supported shareholder proposals and the third modifies the existing ISS policies on shareholder proposals related to lobbying and human rights. The 2014 Policies will generally be effective for shareholder meetings of publicly traded companies held on or after February 1, 2014.**

### Pay for Performance Quantitative Screen

Under its current policies (the “2013 Policies”), ISS uses two principal quantitative screens to identify companies where a potential pay for performance misalignment merits a deeper qualitative analysis of the pay program—absolute degree of alignment (“Absolute Alignment”) and relative degree of alignment (“RDA”). The Absolute Alignment screen measures alignment between CEO pay and total shareholder return (“TSR”) over the prior

<sup>1</sup> The 2014 Policies can be found at [http://www.issgovernance.com/policy/2014/policy\\_information](http://www.issgovernance.com/policy/2014/policy_information).

<sup>2</sup> Our client publication summarizing ISS’s draft policies can be found at <http://www.shearman.com/files/Publication/1ad10ce5-92bf-4ae3-ae03-57ef47335e29/Presentation/PublicationAttachment/060052ff-0745-42bb-bb9d-5994fc0d6f89/ISS-Publishes-2014-Draft-Policy-Changes-Comments-Due-by-November-4-2013-ECBMA-102813.pdf>.

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five fiscal years. The RDA screen measures the degree of alignment between the company's TSR and the CEO's total pay, as compared against the company's peers and as measured over one year and three year periods (weighted 40% and 60%, respectively).

The 2014 Policies simplify the methodology for calculating the RDA screen by limiting its review to a single three-year period (or any shorter period during which the company has disclosed pay data). ISS notes that a single three year measure will provide a better view on long term pay and performance alignment, with less impact from periods of high volatility and mean-reversion. Each year of TSR will be weighted equally rather than over-emphasizing the most recent year, as was the case under the 2013 Policies. Using a single three year period will also diminish the effects of the timing of equity awards for companies that grant awards early in the fiscal year.

### Board Responsiveness to Majority Supported Shareholder Proposals

In the 2014 Policies, ISS determined to fully implement the changes to its policy on board responsiveness to majority supported shareholder proposals that were introduced by the 2013 Policies, subject to certain clarifying changes as follows:

- ISS will issue a negative vote recommendation for the board or individual directors if a board fails to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year;
- ISS included additional guidance on the factors it will take into account in examining the sufficiency of the board's action in response to a majority-supported proposal; and
- ISS will apply a case by case judgment in determining which directors will be subject to a negative vote recommendation in the event that the level of responsiveness to a majority supported proposal is found to be insufficient. Responsiveness is deemed to be insufficient if there is less than full implementation of the proposal.

Under its prior policies, ISS would recommend that shareholders vote "against" or "withhold" their vote for the entire board of directors (other than new nominees who would be considered case by case) if the board failed to act on a shareholder proposal that either (1) received the support of a majority of the shares outstanding in the previous year, or (2) received the support of a majority of the shares cast in the prior year and one of the two previous years.

Under the 2014 Policies, the factors for assessing board responsiveness to majority vote proposals are: (1) the rationale provided in the proxy statement for the level of implementation (a new factor added by the 2014 Policies); (2) the subject matter of the proposal; (3) the level of support and opposition provided to the resolution in past meetings; (4) disclosed outreach efforts by the board to shareholders in the wake of the vote; (5) actions taken by the board in response to its engagement with shareholders; (6) the continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and (7) other factors as appropriate.

The change of the trigger for issuing a negative vote recommendation was implemented on a transitional basis, and will become effective for the 2014 proxy season (in relation to shareholder proposals that appeared on companies' ballots in 2013). No additional requirements are proposed to be implemented.

### Lobbying and Human Rights Risk Assessment

The 2013 Policies expanded the scope of ISS's policy regarding shareholder proposals requesting information on a company's lobbying activities to cover all types of lobbying proposals, including ones focused on lobbying policies and procedures. The 2014 Policies generally maintain the same scope and focus as the 2013 Policies, but modify the language to better reflect the factors considered in ISS's analysis and to remove criteria related to a shareholder resolution no longer filed by proponents. The factors considered under the 2014 Policies are: (1) current disclosure of relevant lobbying policies, and management and board oversight; (2) disclosure regarding trade associations or other groups that the company supports, or is a member of, that engage in lobbying activities; and (3) recent significant controversies, fines, or litigation regarding the company's lobbying related activities.

In the 2014 Policies, ISS introduces a new policy regarding shareholder proposals that ask companies to either perform a human rights risk assessment or report on their human rights risk assessment process. Under the 2013 Policies, ISS analyzed these proposals on a case-by-case basis. ISS determined it was necessary to give guidance on its evaluation of risk assessment proposals relating to human rights and has set forth the following factors that it will consider in making its recommendation: (1) the degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms; (2) 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; (3) recent, significant controversies, fines, or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and (4) whether the proposal is unduly burdensome or overly prescriptive.

### Benchmark Policy Consultation

ISS also announced the opening of a "consultation period" during which it is seeking market feedback on areas under consideration for longer-term policy changes (beyond 2014). This is the first time ISS has invited comment prior to releasing proposed updates. Areas up for consideration in the United States include director tenure, director independence, auditor ratification and equity-based compensation plans. The consultation period closes on February 14, 2014.

## Conclusion

In contrast to the sweeping reforms to ISS's policies made in 2013, the 2014 Policies primarily clarify and modify existing policies. The modified RDA screen should not present significant issues for most companies. Given the upswing of compensation and corporate governance related shareholder proposals in 2013, companies with shareholder proposals on their 2014 ballot should consider in advance how they will respond if these proposals gain majority support. The 2014 Policies will generally be effective for shareholder meetings of publicly traded companies held on or after February 1, 2014.

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