Executive Compensation Alert: The Trump Card in the GRId Game

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RMG's New Rating Process - GRId. RiskMetrics Group, Inc. ("RMG") recently released a new corporate governance rating system, Governance Risk Indicators ("GRId"), which replaced RMG's Corporate Governance Quotient system ("CGQ"). GRId does not represent new RMG policy on risk, but rather attempts to make RMG's rating process more transparent. GRId compares a company's corporate governance practices against what RMG has determined to be "best practices" rather than against the practices of peer group companies, which was the methodology applied by CGQ. GRId also aims to synchronize RMG's rating process with its proxy voting policies, and it will be updated annually. While GRId scores will not directly determine RMG's proxy voting recommendations on shareholder proposals and director elections, they are necessarily related and, more importantly, they may influence institutional investors' voting decisions.

GRId evaluates four areas of corporate governance: audit; board structure; compensation and shareholder rights. RMG issues a risk-assessment grade to the company of red (high concern), yellow (medium concern) or green (low concern) in each of the four categories. GRId is comprised of a series of 63 weighted questions targeted at each of the four areas. Each of the possible responses is assigned a number of points ranging from -5 to +5. The scores are then converted to a 100-point scale for ease of comparison and comprehension. Because the questions are weighted, certain individual questions can significantly impact a company's score.

Compensation-Related GRId Analysis. Compensation-related questions are at the center of the new system, claiming 28 of 63 questions. They are broken into sub-categories: executive short-term incentives, executive long-term incentives/equity compensation, dilution, equity vesting and holding periods, repricings, stock ownership, change-in-control triggers and pay practices (attached to this alert).

Change-in-Control Arrangements. The trump card is a company's severance trigger in its non-equity plan change-in-control agreements – it represents almost 25% of the total weighted compensation GRId score. The question of whether a company has "single" or "double" triggers in its non-equity plan change-in-control agreements is weighted heavily enough that it can move a company into the medium or high risk category.

No change-in-control agreements	+3 points
Double trigger	0 points
Single trigger/modified single trigger (walk right on change-in-control) in an agreement that was entered into or amended prior to the last year	-3 points
Single trigger/modified single trigger (walk right on change-in-control) in a agreement that was entered into or amended within the last year	-5 points
No disclosure	-5 points

Pay Practices. The pay practices subcategory with ten questions represents approximately 32% of the total weighted compensation GRId score. This subcategory aims to uncover any problematic or risky pay practices. The questions are equally weighted and are:

Did the company include a claw-back provision?
Are any of the NEOs eligible for a multi-year guaranteed bonus?
Do any of the NEOs receive tax gross-ups on their perks other than relocation and other broad-based benefits?
What is the multiple of salary plus bonus in the change-in-control agreements for NEOs (other than CEO)?
What is the multiple of salary plus bonus for the CEO upon a change-in-control?
Does the company provide excise tax gross-ups for change-in-control payments?
What is the length of the employment agreement with the CEO?
Are executives given credit toward pension for years not worked?
In the last fiscal year, did the company grant premium priced options of at least 125% of market price that need to be maintained for at least 30 consecutive days?
Has the company voluntarily adopted a say-on-pay advisory vote resolution for the most recent annual meeting or committed to a resolution going forward?

These questions generally track what RMG has identified in its proxy voting guidelines as the most problematic pay practices, including among other things: egregious employment contracts; overly generous new CEO new-hire packages; excessively large bonus payouts without justifiable performance requirements or proper disclosure; egregious pension/SERP payouts; excessive perquisites and excessive severance or change-in-control terms (including payments exceeding 3x of base salary and bonus as well as single trigger terms and gross-up provisions, both of which are more problematic if in a new or recently amended agreement) and tax reimbursements.

Robust Disclosure. Whether or not a company makes adequate disclosure may also significantly impact its risk grade. A company's failure to make any disclosure in its public filings relating to certain question topics may result in a lower score than the disclosure of the existence of a less than ideal pay practice.

While the GRId rating system may provide more clarity than its predecessor system, it still remains disconnected from a company's actual circumstances. Companies will need to continue to balance the benefits of a "low risk" score from RMG with the need to effectively address their business risks and opportunities.

If you have questions about GRId, please contact Scott Spector or Blake Martell.

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