

ISS Draft Voting Policies Indicates Possible Impact on Compensation Committee Elections from Say-on-Pay Votes and Recommendations for Proxy Access Proposals; Provides New Pay-for-Performance Analysis

October 18, 2011 | Client Update | 3-minute read

What will cause ISS to recommend withhold or against the election of compensation committee members as a result of poor say-on-pay votes in 2012? A hint lies in the just-released [ISS draft voting policies for 2012](#). ISS is looking for input from the corporate governance community until October 31st.

ISS will review the election of compensation committee members and the say-on-pay proposal on a case-by-case basis if the company's prior say-on-pay proposal received significant opposition, taking into account: (a) the level of opposition; (b) the company's ownership structure; (c) disclosure of engagement efforts with major institutional investors; (d) the company's response; (e) specific actions taken to address the issues that appear to have caused poor vote results; (f) other recent compensation actions taken by the company; and (g) ISS' current analysis of the company's executive compensation and whether any prior issues of concern are recurring or one-time. The key question is what level of opposition is deemed "significant" enough to warrant such scrutiny. In its request for comment, ISS asks whether levels below 70% support is the appropriate threshold, noting that during its policy survey 72% of investors who responded favored this approach.

ISS is also undertaking to update its analysis of pay-for-performance, the primary cause of its negative recommendations for say-on-pay. The description of the new methodology is complex, and includes two factors under the term "relative alignment," where a company will be compared to a peer group of 14-24 companies selected on the basis of market cap, revenue (or assets for financial firms) and GICs group. Under this test, ISS will examine: (a) the degree of alignment between the company's TSR rank and the CEO's total pay rank within the peer group over one-year and three-year periods and (b) the multiple of the CEO's total pay relative to the peer group median, which is designed to identify whether high performing companies are nonetheless "overpaying." Then ISS will analyze "absolute alignment," to measure the trend in the CEO's pay and the company's TSRs over the prior five years. A qualitative review follows the initial alignment analysis, including a review of the types of awards, the clarity of the company's disclosure and benchmarking practices.

While ISS is shifting away from its much-maligned prior practice that many criticized as ultimately focusing too much on the year-over-year changes in CEO pay, ISS noted that in backtesting the new methodology, the set of companies identified as having long-term pay-for-performance misalignment differed somewhat from those identified under the prior scheme. It is also unclear how much discretion, and resulting transparency in the selection, will be involved in developing the peer group with ISS moving away from relying purely on the S&P GICs standard that was at least publicly available.

For proxy access shareholder proposals, ISS will undertake a case-by-case review in making its recommendation, based on: (a) the proponent's rationale for the proposal at the targeted company; (b) the ownership thresholds proposed in the

resolution (e.g., percentage and duration); (c) the maximum number of directors that shareholders may nominate each year; and (d) the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. Notably, the list does not include consideration of whether the proposal is precatory or binding, although ISS indicates that these factors are not intended to be exhaustive in its evaluations.

Other policy updates up for comment includes recommendations against boards for not following majority, or possibly plurality, in determining the frequency of say-on-pay votes, evaluations of proposals to adopt 162(m) plans and reviews of shareholder proposals on the highly controversial subjects of hydraulic fracturing and political contributions. Final updates will be released the week of November 14th.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Ning Chiu

+1 212 450 4908

ning.chiu@davispolk.com

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