

ISS's New Pay-For-Performance Review Framework is Now in Place

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In December, ISS issued a [whitepaper](#) providing further guidance on its new pay-for-performance review framework first introduced in its 2012 proxy voting guidelines update (effective for meetings on or after February 1, 2012). As described in our memo [New ISS Policies Overhaul Say-on-Pay Analysis](#) (November 29, 2011), the revised pay-for-performance methodology includes both a three-part quantitative analysis and a qualitative analysis. The quantitative analysis is made up of two relative measures ("Relative Degree of Alignment," comparing CEO pay and TSR performance against a comparison group over 1- and 3-year periods, and "Multiple of Median," comparing the prior year's CEO pay to the median pay of a comparison group for the same period) and one absolute measure ("Pay-TSR Alignment," comparing trends in CEO annual pay and the value of an investment in the company over the prior 5-year period).

The whitepaper provides extensive detail on ISS's pay-for-performance evaluation methodology, which continues to analyze pay based on award opportunity (and not realized pay) with a focus on Total Compensation as reflected in a company's Summary Compensation Table. Of particular interest, the whitepaper provides insight into (1) how ISS will construct a company's relative alignment comparison group and (2) how the results of a company's quantitative analysis will determine whether ISS considers the company to be at risk of having a pay-for-performance disconnect.

Comparison Group. Comparison groups will consist of 14 to 24 companies selected from a database of more than 4000 companies (the Russell 3000 index, together with publicly traded peers disclosed by Russell 3000 companies in their proxy statements). Comparison groups will be constructed twice per year, and will be selected from a group of companies within the same 2-digit GICS category, between 0.45 times and 2.1 times annual revenues (assets for financial companies) and with market capitalizations between 0.2 times and 5 times. In constructing a comparison group, ISS will start with companies within the same 6-digit GICS category and those closest in revenue and market capitalization. Approximately 25 unidentified "super-mega" non-financial companies (over \$50 billion in revenue and at least \$30 billion market capitalization) will make up their own comparison group.

Impact of Quantitative Analysis. The quantitative analysis is intended to identify companies with a likely pay-for-performance disconnect by identifying companies that are (1) high concern with respect to a single evaluation measure or (2) medium concern with respect to two or three evaluation measures. The whitepaper includes the following table showing where results would trigger concern:

Measure	Medium concern High concern			
<i>Relative Degree of Alignment</i>	-30	~25th percentile	-50	~10th percentile
<i>Multiple of Median</i>	2.33x	~92nd percentile	3.33x	~97th percentile
<i>Pay-TSR Alignment</i>	-30%	~10th percentile	-45%	~5th percentile

ISS's new approach to evaluating pay-for-performance alignment is complex and may be difficult for companies to model on their own. Despite this challenge, there are a number of actions companies can take to ready themselves for the second year of say-on-pay as described in our [Say-on-Pay Year Two: a Planning Primer](#) (December 13, 2011) memo.

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.

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