

Beyond the Numbers: Factors that Influence ISS Recommendations for Say-on-Pay

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While only 142 Russell 3000 companies have failed say-on-pay in the last three years from over 7,000 companies with those votes, 893 companies had to counter negative recommendations from ISS. By now it is well-known that ISS uses both a quantitative test and then examines qualitative factors. The qualitative review is triggered when a company receives “high” concern on the quantitative metric that examines, among other things, the CEO pay and total shareholder return to other companies, but the review may also occur even when a company receives less than “high” concern.

The qualitative review becomes critically important because only half of those companies that fail the initial numerical test ever receive “against” recommendations from ISS. Put another way, a favorable qualitative analysis of the factors in a company’s executive compensation program can help a company obtain a positive recommendation, even if the initial ISS analysis shows that the company has paid too much or incorrectly, on both an absolute basis and relative to peers. Since ISS provides a lengthy list of factors that it will analyze in this second-step qualitative assessment, it can be difficult to cut through all the text and discern what really matters.

In a recent CompensationStandards.com [webcast](#) (subscription required), Pay Governance indicated that it had conducted [research](#) on exactly this question. The compensation consultant examined only the 118 companies from the S&P 1500 in 2013 that received “high” concerns on the quantitative test, since a “high” concern automatically causes a qualitative review of the companies’ compensation practices, and to avoid the possibility that the level of concern influenced the qualitative review. The research divided the statements regarding individual qualitative factors into “praises” (positive comments) or “concerns” (negative comments), and found that the number and nature of those comments generally correlated with ISS’ 2013 recommendations on say-on-pay.

Specifically, the most prevalent concerns cited by ISS in justifying its “against” recommendations include: change in control provisions in existing contracts; lack of rigorous incentive goals; low percentage of long-term incentives with performance vesting conditions; high pay positioning versus the market and lack of disclosure of specific goals. On the other end, the most common positive factors noted by ISS for pay programs when it decided to favor the company were: CEO pay opportunity was reduced for the most recent fiscal year-end; incentive program design changes; high percentage of long-term incentives with performance vesting conditions; effective shareholder outreach with corresponding disclosure and rigorous incentive goals.

While Pay Governance cautions that there is no way to predict ISS recommendations with absolute certainty and the ISS approach continues to evolve, its findings are helpful for companies concerned that they may receive “high” or “medium” concerns based on numerical pay and performance metrics alone, as to the aspects of their executive compensation programs that may be the most influential in terms of the final ISS recommendation. Criticisms of proxy advisory firm influence are widespread, but the reality remains that a negative ISS recommendation usually means that companies need to prepare to mount a defense.

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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