Davis Polk

Coming Soon to Score Your Company's Governance Practices: ISS GRId 2.0

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As 2011 neared a close, ISS announced that it will update its **Governance Risk Indicators (called GRId 2.0)** on February 24, 2012 to score all Russell 3000 companies. For the first time, actual scores in each of the categories of Board, Compensation, Audit and Shareholder Rights, will be displayed in addition to the overall "high," "medium," or "low" system. This could allow shareholders to measure companies against each other. Other major changes include:

Compensation updates. Mandatory say-on-pay was not around when GRId was adopted, so it is no surprise that most of the refinements are in the compensation area. The revised categories include: pay for performance, nonperformance-based pay, the use of equity, equity risk mitigation, communication & disclosure, and termination/severance. GRId 2.0 has 27 new questions covering topics like:

- Alignment between total shareholder return (TSR) and CEO pay relative to peers
- Ratio of CEO pay to executive pay
- Different types of tax gross-ups, including perk-related gross-ups
- Dividends paid on unvested restricted shares
- Equity plan provisions including prohibitions on repricings or automatic vestings upon a change-in-control
- Minimum vesting periods for equity awards
- Basis for change-in-control or severance payments for CEO and other executives

Audit, board and shareholder rights updates. GRId 2.0 also asks more granular questions about poison pills, including trigger thresholds, shareholder approval and slow-hand or dead-hand provisions. Other new questions include whether there are material restrictions to timing, topics or ownership levels for shareholders to call special meetings, and whether there are enforcement actions or investigations affecting directors or officers.

Simplified scoring and rating processes. Although it can't quite be discerned from the fairly complex description, GRId 2.0 will have a more simplified scoring process, with the previous weighting schemes eliminated. Each answer is assigned a positive, negative or zero score. Questions also work in tandem, so that while a poison pill will receive negative points, this may be mitigated if it was approved by shareholders. Scores are also capped by category in order to avoid having one area, such as termination agreements, overwhelm the entire compensation analysis.

Impact of GRId 2.0. It is difficult to tell what impact these changes may have, other than to suggest that companies may need be aware of the new focus from the additional questions. The technical document contains an appendix with the questions for scoring, rationales and scoring approach, which currently does not provide the actual scores that would be elicited by a certain response, making it difficult to anticipate the effect of a company's governance practices on the overall analysis. ISS indicates that more information is forthcoming.

Action plans for companies*:*

- Confirm that you already have the data-verification log-in (which has not changed). It can be obtained, for free, by contacting support@isscorporateservices.com.

- Since GRId information is obtained only from publicly available data, companies should ensure that the public information fully and accurately captures their governance practices.
- The data verification site will be updated with the GRId 2.0 methodology and data on February 20, 2012. Yahoo Finance pages will be updated as of March 1, 2012.

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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