

ISS Policy Survey Released with Insights into 2013 Policies - October 2012

October 5, 2012 | Client Update | 4-minute read

ISS has issued the [results](#) of its recent survey on corporate governance. The responses will form the basis for policy changes affecting the 2013 proxy season. Perhaps reflecting concerns about the influence of ISS policies, the bulk of the responses came from corporate issuers (74%) while only 26% of the respondents were institutional investors. The survey questions asked respondents to rank matters in terms of importance. It is unclear how the responses will translate into changes to ISS policies. Some of the key results, with particular focus on investor rather than issuer responses as those are likely to be the most significant for ISS, include:

Board matters.

- *Board nominees.* Investors consider a nominee's experience, qualifications, and skills and track record at other boards as the most important in evaluating nominees, and diverse skill sets were viewed to be more valuable than gender/race diversity.
- *Independent chair proposals.* The presence of a lead director is an important consideration when considering shareholder proposals for an independent chair. Unfortunately, investors appeared to view as relevant all of the attributes that ISS currently evaluates in making its recommendations, including whether the company's total shareholder return outranks its peers.
- *Responses to majority-supported shareholder proposals.* An overwhelming majority of investors indicated that they expect the board to implement a shareholder proposal that receives support from a majority of shares cast in the prior year. This is a meaningful difference from ISS' existing policy which recommends against board elections if the proposal receives a majority of shares outstanding in support in one year, or a majority of votes cast only in two out of three years. A policy change in this direction could have a major impact on companies, especially given how close the votes are on some shareholder proposals.
- *Proxy access.* Both investors and issuers seem to agree that several factors were important in evaluating access proposals, including minimum ownership thresholds in relation to a company's market cap, minimum ownership duration, whether the proposal is binding or non-binding, the number of nominees permitted and the company's governance practices.
- *Corporate lobbying.* Investors disagreed with issuers in finding as highly relevant greater disclosure of corporate lobbying policies, procedures, oversight mechanisms and expenditures.

Compensation matters.

- *Peer groups.* Investors and issuers' views diverged somewhat on peer groups, with investors encouraging ISS to continue to create its own peer group while providing the company's peer group as an alternative view. However, both agreed that the ISS-selected peer should be within a specified size range of the company (e.g. between 0.5 and

2 times the company's revenue) and that the company's size should be near the median of the selected peers. With respect to the much-maligned use of GICS peer groups by ISS, unfortunately investors seemed to indicate some support for this method, noting as highly relevant that ISS-selected peers should be in the same GICS group as the company. Investors were less interested in ensuring that the ISS-selected peer (a) be within the same GICS group as one or more of the company's published peers, (b) has chosen the company as a peer and (c) be included in the company's published peer group.

- *Performance metrics.* Investors encouraged the selection of alternatives to total shareholder return in evaluating say-on-pay, including EPS and revenues.
- *Realizable/Realized pay.* While half of the investors indicated that they would consider both granted and realized/realizable pay as an appropriate way to measure executive pay, without having a strong view about the benefits of a standardized calculation vs. using the company's calculation, about 25% indicated that ISS should consider realized/realizable pay only as part of a qualitative evaluation.
- *Problematic pay practices and hedging.* A significant number of investors considered several actions as problematic for CEO termination packages at a time of poor stock performance, including severance settlement when the executive is stated to be retiring or resigning, immediate acceleration of all unvested equity, cash severance exceeding 3X base salary and target bonus, a new severance agreement and large pension or SERP payouts. More than half of investors view pledging of shares by executives as problematic.

What is most unclear from these results is whether and how ISS will change its peer group formulation for say-on-pay. We will find out when the ISS draft policy is released, which is expected later this month.

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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