

The Impact of the ISS Policy Against Pledging

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ISS' policy change that it may withhold against boards for significant pledging and any hedging by boards and executive officers caused a stir at the beginning of the season. In addition, ISS also considers pledging and hedging in making its say-on-pay recommendation, thus potentially creating two ballot problems.

But it appears that the application of the new policy on pledging has been more muted than anticipated, at least for this season. In its pledging analysis, ISS will examine several factors, including the number of shares pledged and the value based on year-end stock price, the pledged shares as a percentage of outstanding shares or market value, the number of days it would take to unwind the pledged shares based on average daily trading volume over the past 30 days and the number of pledged shares as a percentage of total stock ownership.

As a means to thwart potential criticism from ISS, many companies provided additional disclosure regarding pledged shares. Besides noting the existence of either a policy to completely ban future pledges or permissible pledges only with preapprovals, some also indicated whether the executive or director with pledged shares had the financial capacity to repay the underlying loan without using the shares, that the pledged shares are not counted toward any stock ownership guidelines, and in particular, any trends highlighting a decrease in the overall amount of shares pledged over time.

If public statements are any indication, not many companies were negatively affected. There have been few company protests filed as additional soliciting materials regarding ISS negative recommendations due to pledging. At W.R. Berkley Corporation, ISS recommended against all directors due to the shares pledged by the founder and CEO, who owned about 19% of the company and pledged about 58% of those shares. The company argued in a separate [filing](#) that the CEO had not sold any shares for 40 years and only pledged shares as collateral for lines of credit for liquidity purposes because he did not want to reduce his ownership stake, separately owns about \$460 million worth of unpledged stock, and has reduced the amounts pledged by 19% in recent years. Support for the directors ranged from 77 to 83%, but the results were presumably helped by the fact that insiders own about 21% of the company.

It is not clear as to why ISS selected some of its targets. The lack of specific information regarding the pledges may have hurt Cypress Semiconductor, given that sizes of the share ownership by the executives were relatively small. ISS criticized the company for not disclosing the precise amounts pledged by the CEO and CFO, stating instead that a "substantial portion" of their shares were pledged. The soliciting materials indicated that 69% of the CEO's shares and 39% of the CFO's shares were pledged.

While it did not use its most potent weapon often, in many cases ISS included the equivalent of a warning in its reports for companies that did not have policies governing future pledges, citing a concern that lack of such policies may lead to an increase in pledged shares in the future. It remains to be seen whether the advisory firm will take a harder line next season.

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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