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ISS Publishes 2014 U.S. Voting Policy Updates and Seeks Comment on Possible Future Policy Changes

2014 U.S. Voting Policy Updates

Each November, Institutional Shareholder Services finalizes and publishes updates to its voting policies for the upcoming proxy season. This year is no different, although amendments are relatively few compared to the past. We highlight the key voting policy changes below.

- *Board Responsiveness to Majority-Supported Shareholder Proposals.* Comments from ISS' roundtable discussions and its 2013-14 policy survey reveal that companies and investors generally agree that boards should either implement a majority-supported shareholder proposal or provide a rationale for less than full implementation. The 2014 policy update responds to this comply-or-explain approach by specifying that if a board fails to act on a shareholder proposal that received majority support in the prior year, ISS will now also consider the rationale provided in the proxy statement for the level of implementation, in addition to other existing factors. ISS also clarifies that its vote recommendations with respect to individual directors, committee members or the entire board in the context of board responsiveness will occur on a case-by-case basis, thereby allowing analysts more flexibility to make voting recommendations. Finally, ISS fully implements a change from its 2013 voting policy updates that board responsiveness will be measured for shareholder proposals that received the support of a majority of the shares cast in the prior year, eliminating the previous requirement of either two years of a majority of the shares cast in a three-year period or one year of a majority of the shares outstanding.
- *Executive Pay Evaluation – Pay-for-Performance Quantitative Screen.* ISS is simplifying its methodology for calculating a company's relative degree of alignment (RDA), a measure used to identify companies where there is a potential pay-for-performance misalignment. Currently, the RDA is the weighted average of the degree of alignment between the company's TSR rank and the CEO's total pay rank within a peer group over a one-year period, weighted 40%, and over a three-year period, weighted 60%. Starting in 2014, the RDA will be a single annualized measure of the degree of alignment for the three-year period (or shorter period if pay and performance data are not available for all three years). ISS anticipates the advantages of the new model to include the following:
 - A smoother performance measure that weighs each year of TSR equally;

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- A better view of long-term pay and performance alignment that is less impacted by periods of volatility and mean-reversion; and
 - A more meaningful evaluation of companies that have at least two years, but not three years, of TSR data available.
 - *Social / Environmental Issues – Lobbying.* The 2014 policy implements changes to the factors ISS will consider when reviewing shareholder proposals requesting information on a company’s lobbying activities, policies or procedures. Factors to be considered in ISS’ analysis now also include:
 - Management (as opposed to just board) oversight of the company’s lobbying policies; and
 - The company’s disclosure regarding trade associations or other groups that it supports, or is a member of, that engage in lobbying activities.

Neither this policy change nor the change below regarding human rights risk assessment were included in ISS’ earlier proposed updates and are new in the final 2014 updates.

- *Social / Environmental Issues - Human Rights Risk Assessment.* ISS adopts a new case-by-case analysis of shareholder proposals requesting that a company conduct an assessment of the human rights risk in its operations or supply chain, or report on its human rights risk assessment process. Factors to be considered in ISS’ analysis include:
 - The degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms;
 - The company’s industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
 - Recent, significant controversies, fines or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and
 - Whether the proposal is unduly burdensome or overly prescriptive.

These policy changes apply to shareholder meetings held on or after February 1, 2014. For a copy of ISS’ 2014 voting policy updates, see http://issgovernance.com/policy/2014/policy_information.

Benchmark Policy Consultation

For the first time this year, ISS is seeking comment on “longer term policy changes” as part of a new Benchmark Policy Consultation process. The topics on which ISS is seeking feedback include the following:

- *Director Tenure.* ISS seeks comment on whether to keep the status quo and not consider director tenure in its classification of directors or as a factor in determining vote recommendations with respect to director elections and two possible new approaches:
 - To consider the mix of director tenures on the board as a key factor when determining a vote recommendation on members of the nominating committee (for example, if average tenure or any individual director’s tenure exceeds a specified level); or
 - To classify directors with lengthy tenures as non-independent and apply existing board-related voting policies as it relates to director independence.
- *Director Independence.* ISS seeks comment on whether to change its director independence definitions with respect to three specific categories of relationships: former CEOs, family relationships and professional relationships. Among other possible changes, ISS seeks feedback on whether a more case-by-case analysis should apply to its examination of independence with respect to these relationships and whether its definition of immediate family member should be expanded.
- *Independent Chair.* ISS seeks comment on whether to change its current policy to generally recommend a vote for independent chair shareholder proposals unless the company maintains a counterbalancing governance structure and has no governance or performance concerns. Among other possible changes, ISS seeks feedback on whether a more case-by-case analysis should apply to its examination of independent chair shareholder proposals and which company-specific circumstances may warrant a combined CEO/chair leadership structure.
- *Equity-Based Compensation Plans.* ISS seeks comment on whether to keep the status quo and evaluate a number of factors that may independently lead to a recommendation against an equity-based compensation plan or adopt a “balanced scorecard” approach that allows the weighting of multiple factors in a holistic evaluation of the plan. ISS seeks feedback on what positive factors, if any, can counterbalance high cost, dilution or burn rate and whether any particular factors would trigger votes against an equity plan regardless of other features.
- *Auditor Ratification.* ISS seeks comment on whether to keep the status quo or consider auditor tenure as a factor in determining vote recommendations with respect to ratifying auditors.

Comments are due February 2014. The benchmark policy consultation topics can be found at <http://issgovernance.com/benchmarkpolicyconsultation>.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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