

# Alert

## SEC Disclosure and Corporate Governance

### Heads Up for the 2013 Proxy Season:

- **ISS Seeks Comment on Draft Proxy Voting Policies**
- **SEC Releases Technical Guidance on Shareholder Proposals**

On October 16, 2012, Institutional Shareholder Services (ISS) released proposed amendments to its proxy voting policies for the 2013 proxy season. ISS is seeking comments by end of day October 31, 2012.<sup>1</sup> ISS typically releases its final proxy voting policies in mid-November each year.

On the same day, the Securities and Exchange Commission (SEC) Division of Corporation Finance published Staff Legal Bulletin No. 14G (CF), which will make it more difficult for companies to exclude shareholder proposals on the basis of certain technical issues.<sup>2</sup>

#### Proposed Changes to ISS' Proxy Voting Policies

ISS has proposed the following changes to its proxy voting policies for US companies:

- **Board response to majority-supported shareholder proposals.** ISS would recommend a negative vote against the entire board (except new nominees, who would be considered on a case-by-case basis) if the board “failed to act” on a shareholder proposal that received the support of a *majority of votes cast* in the *previous year*.<sup>3</sup> This is a significant change from the current policy of negative vote recommendations against directors where the board failed to act on a proposal that received (a) support of the majority of shares cast not only the previous year but also one of the two years prior to that, or (b) support of the majority of shares *outstanding* the previous year.
- As in its current policy, ISS does not provide guidance on what would constitute “failure to act” by a board. Note also that ISS has not provided in its proposal any indication of whether it will recommend against the board if the company engages with its key institutional shareholders and takes an alternative action that is acceptable to them.
- This policy change will add significant pressure on boards to act in line with shareholder viewpoints on matters that state law clearly has reserved for directors, subject to their fiduciary responsibilities.
- **Advisory votes on executive compensation.** ISS would adjust its policy on how it evaluates management say-on-pay proposals as follows:
  - Incorporate the company’s selected peer companies into ISS’ peer group methodology. ISS’ construction of peer groups has been a source of concern for many companies. Under the proposed amendment, the peer group would continue to be generally comprised of 14-24 companies selected using market capitalization, revenue or assets and GICS industry group, but would also include the company’s selected peers’ GICS industry group with size constraints.<sup>4</sup>

- Potentially incorporate into the qualitative portion of its executive pay-for-performance evaluation a comparison of “realizable pay” to grant date pay, to reflect final payouts of performance-based awards or changes in value due to stock price movements. Realizable pay would be comprised of cash and equity-based grants and awards during a particular performance period, calculated using stock price at the end of the period, and would be based on equity award values for earned awards or target values for ongoing awards.
- Add pledging of shares as a “problematic pay practice” that may lead to a negative vote recommendation.<sup>5</sup>
- **Advisory votes on golden parachutes.** ISS would continue to analyze advisory votes on golden parachutes on a case-by-case basis, but would focus on existing change of control arrangements with named executive officers, as well as recently adopted or amended agreements that are the focus of the current policy. Recent amendments to agreements that incorporate problematic features would carry greater weight in ISS’ analysis and the existence of multiple legacy problematic features in change of control agreements (such as excise tax gross-ups and single or modified-single trigger cash severance) would be more closely scrutinized.
- **Shareholder proposals relating to sustainability metrics for compensation.** ISS would make recommendations on a case-by-case basis on proposals to link, or report on linking, executive compensation to sustainability (environmental and social) criteria, taking into account factors relating to the history of sustainability issues at the company, relevant management systems and oversight mechanisms, peer company sustainability metrics and disclosure regarding environmental and social performance. ISS’ current policy is to recommend that shareholders vote “against” such proposals.

Notably, ISS has not proposed policy changes relating to proxy access proposals. For example, it has not indicated acceptable minimum eligibility thresholds or change of control safeguards such as caps on board seats available to proxy access nominees. Such proposals will continue to be considered case-by-case in 2013.

### What To Do Now:

- Consider providing comments to ISS on the proposed policies.
- Review corporate governance and compensation practices for potential vulnerabilities under ISS’ proposed policy amendments (for example, how shareholder proposals fared at the previous annual meeting and pledging of company stock by executive officers or directors for margin accounts or other loans).
- Engage with key institutional investors on governance-related matters, especially if the company had a majority-supported shareholder proposal at its last annual meeting that has not been implemented.
- Consider the company’s policy on pledging (and perhaps, more broadly, hedging) of shares by executive officers and directors.
- Review the company’s existing compensation and governance disclosures and plan to make improvements where appropriate (e.g., to include realizable pay disclosure and any policy on pledging or hedging of shares).

### New SEC Staff Legal Bulletin 14G

Staff Legal Bulletin No. 14G (CF) provides the following guidance on issues relating to shareholder proposals made under Rule 14a-8 under the Securities Exchange Act of 1934:

- **Proof of ownership letters.** Where a proponent beneficially owns securities, the Staff will accept a proof of ownership letter from an affiliate of a DTC participant. The Division of Corporation Finance had previously clarified in Staff Legal Bulletin No. 14F that it would accept proof of ownership letters from DTC participants.<sup>6</sup>

- A shareholder can also provide a proof of ownership letter from a securities intermediary who is not a DTC participant or affiliate of a DTC participant, provided the shareholder also obtains a proof of ownership letter from the DTC participant or an affiliate of a DTC participant that can verify the holdings of the securities intermediary.
- **Defects in proof of ownership.** The Staff will no longer permit companies to exclude a proposal on the basis that the proponent's proof of ownership letter does not cover the one-year period required by Rule 14a-8, unless the company's notice of defect identifies the date the proposal was submitted and explains that the proponent must obtain a new proof of ownership letter verifying continuous ownership of the securities for one year preceding and including such date.
- **References to website addresses in proposals or supporting statements.** The Staff will not permit exclusion of a proposal that includes a website address where shareholders and the company can understand with reasonable certainty what actions or measures the proposal requires without reviewing the information on that website. However, if the information on the website is necessary for shareholders and the company to understand what the proposal requires, the proposal will be excludable as "vague and indefinite."
- **Non-operational websites.** The Staff will not permit exclusion of a reference to a non-operational website as long as the proponent provides the company with materials that are intended for publication on the website and represents that the website will become operational at or prior to the company filing its definitive proxy statement.
- **Website changes.** If the content of a website referenced in a proposal changes after the proposal has been submitted, the Staff may waive the requirement that reasons for exclusion be submitted no later than 80 calendar days before filing the definitive proxy statement, provided the changes constitute "good cause" for the company to file its reasons for exclusion.

### What To Do Now:

- Carefully review any shareholder proposals that are received in light of the new Staff guidance.
- Ensure that any defect notice sent to a shareholder complies with the Staff's position relating to proof of ownership letters (e.g., specifying the dates on which continuous ownership must be shown).
- Monitor website addresses that are included in shareholder proposals for any changes that could warrant a request for exclusion.

## Endnotes

- 1 ISS' draft policies, questions for comment and details around how to participate in ISS' comment process are *available at* <http://www.issgovernance.com/policycomment2013>.
- 2 SEC Division of Corporation Finance, Staff Legal Bulletin No. 14G (CF), *Shareholder Proposals* (October 16, 2012), *available at* <http://www.sec.gov/interp/leg/cfs/b14g.htm>.
- 3 This policy change would accord with the expectations relating to appropriate board response to majority-supported shareholder proposals of 86% of investor respondents and 47% of issuer respondents to ISS' most recent policy survey. ISS, 2012-2013 *Policy Survey Summary of Results* (September 2012) at 6, *available at* <http://www.issgovernance.com/files/private/ISSPolicySurveyResults2012.pdf> ("ISS Policy Results").
- 4 According to ISS, this amendment would increase the similarity in the company's selected peers and the ISS peer group, from 20% of companies having a potential ISS peer group that overlaps at least 50% of their own, to 42% of companies having such overlap.
- 5 According to ISS' most recent policy survey, 49% of institutional investor respondents and 45% of issuer respondents indicated that any pledging of shares by executives or directors is "significantly problematic." In contrast, 13% of institutional investors and 20% of issuers indicated that pledging is "not a concern." *ISS Policy Results* at 22.
- 6 SEC Division of Corporation Finance, Staff Legal Bulletin No. 14F (CF), *Shareholder Proposals* (October 18, 2011), *available at* <http://www.sec.gov/interp/leg/cfs/b14f.htm>.

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If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of the Firm's Public Company Advisory Group:

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