

# Alert

## SEC Disclosure and Corporate Governance

### Heads Up for 2014 Proxy Season:

### ISS Updates Proxy Voting Policies, Requests Peer Group Changes by December 9

On November 21, 2013, Institutional Shareholder Services Inc. (ISS) released updates to its proxy voting policies for the 2014 proxy season, effective for meetings held on or after February 1, 2014.<sup>1</sup> In addition, ISS has requested that companies notify it by **December 9, 2013** of any changes to a company's self-selected peer companies for purposes of benchmarking CEO compensation for the 2013 fiscal year.

This Alert provides guidance to US companies on how to address ISS policy changes and also highlights recent developments regarding potential regulation or self-regulation of proxy advisory firms.

The amendments to ISS proxy voting policies for the 2014 proxy season relate to:

- Board responsiveness to shareholder proposals that receive a majority vote in favor
- Pay-for-performance evaluation
- Shareholder proposals relating to lobbying disclosure
- Shareholder proposals relating to human rights risk assessments

The policy revisions relating to board responsiveness to majority-supported shareholder proposals and pay-for-performance evaluation reflect ISS' policy changes as proposed.<sup>2</sup> ISS did not preview the policy changes regarding lobbying disclosure and human rights risk assessment shareholder proposals.

Last week, ISS also announced the opening of a new consultation period relating to certain potential longer term policy changes, including in relation to director tenure, audit firm tenure and independent chairs.<sup>3</sup>

### Changes to ISS Proxy Voting Policies

#### 1. Board Responsiveness

Recall that last year, ISS had revised its policy relating to board responsiveness to shareholder proposals in two important respects:

- For the 2013 proxy season and beyond, in instances where the board failed to act on a shareholder proposal that received either support of (a) the majority of shares cast the previous year and also one of the two years prior to that, or (b) the majority of shares *outstanding* the previous year, it was ISS policy to recommend against individual directors, committees or the entire board as it deemed appropriate based on the circumstances, rather than automatically recommend against all directors

- Effective for 2014, ISS announced that a broader view of board non-responsiveness would apply: if a shareholder proposal receives a *majority of shares cast at a single shareholder meeting*, ISS will evaluate how the company responded

For the 2013 proxy season, ISS judged “responsive” to generally mean “full implementation” of the shareholder proposal. If the board’s response to the proposal involved less than full implementation, ISS would consider the following factors in determining its recommendation:

- Subject matter of the proposal
- Shareholder support and opposition to the proposal at prior meetings
- Board outreach to shareholders after the vote (as disclosed)
- Board actions in response to engagement with shareholders
- Continuation of the underlying issue as a voting item on the ballot (as either a shareholder or management proposal)
- Other factors as appropriate

### ***Policy Revisions***

ISS has emphasized that, for 2014, vote recommendations on director elections following majority-supported shareholder proposals will be made on a fact-specific case-by-case basis. ISS has expanded the list of factors to be considered to include the board’s rationale with respect to the level of implementation, as disclosed in the company’s proxy statement. ISS FAQs include examples of how ISS would treat certain actions taken in response to shareholder proposals on particular topics.<sup>4</sup>

### ***What To Do Now?***

- The ISS policy changes announced in 2012 that become effective in 2014 add significant pressure on boards to act in line with shareholder viewpoints, even where the vote result is non-binding. In this environment, it is important for boards and their counsel to apply the engagement techniques honed in the context of say-on-pay to shareholder proposals generally. This is especially critical prior to the annual meeting where a shareholder proposal relates to a topic that is likely to garner significant shareholder support, as well as where a shareholder proposal received majority support at last year’s annual meeting. In particular, boards should:
  - o Engage with their largest shareholders to gather viewpoints, explain the company’s rationale and seek support
  - o Consider ways of addressing shareholders’ expressed views that the board believes are in the company’s best interests
  - o Be prepared to negotiate with shareholder proposal proponents
  - o Consider enhanced solicitation efforts with respect to management proposals and director nominees, particularly where there may be circumstances or reasons to believe that a proposal and/or one or more directors may receive a significant negative vote
  - o Include disclosure in the proxy statement with respect to shareholder engagement efforts and any action taken in response to a majority-supported shareholder proposal, including why the board believes its response is in the best interests of the company and why the board’s viewpoint may be different to that of a majority of shareholders

- Boards will need to be especially careful to ensure that they continue to apply fiduciary judgment with respect to matters that receive a majority of votes cast on issues for which shareholders do not have decision rights. Directors retain legal responsibility as fiduciaries for those decisions and cannot simply defer to the viewpoints of a majority of voting shareholders.

## **2. Pay-for-Performance Evaluation – Relative Degree of Alignment**

In making say-on-pay vote recommendations, ISS starts with an analysis of a company's pay practices and performance relative to an ISS-selected peer group. Under ISS policy applicable to 2013, the analysis considered:

- The relative degree of alignment (RDA) between the company's total shareholder return (TSR) rank and the CEO's total pay rank within a peer group, as measured over one-year and three-year periods (weighted 40/60)
- The multiple of the CEO's total compensation relative to the peer group median
- The absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years

In the event that the quantitative analysis above demonstrates "significant unsatisfactory long-term pay-for-performance alignment," ISS also reviewed various qualitative factors.

### ***Policy Revisions***

For 2014, ISS has modified its pay-for-performance evaluation methodology with respect to relative degree of alignment. The other factors are unchanged.

According to its revised methodology, ISS will use a single, annualized RDA measure for the three-year measurement period by calculating the difference between the company's TSR rank and the CEO's total pay rank within a peer group, as measured over a three-year period (or as many full fiscal years that the company has been publicly traded and disclosed compensation data). Each year of TSR will be weighted equally and calculated to produce the annualized TSR, thus providing a "smoother performance measure" that is less prone to being overwhelmed by periods of volatility (particularly in relation to the most recent year, which is most heavily weighted under the existing methodology).

### ***What To Do Now?***

- Consider whether the company may be at greater risk of ISS identifying a pay-for-performance misalignment under its revised policy (which may be exacerbated if the impact of good performance in the most recent year is "smoothed" and therefore less heavily weighted) and consider discussing with ISS and large shareholders in advance of the proxy season.
- Review existing compensation disclosures and practices in light of the qualitative factors listed in ISS' policy. For example, companies in the S&P 500 should consider including realizable pay disclosure where appropriate, to facilitate ISS' calculation of realizable pay.

## **3. Lobbying Disclosure**

Under its policy applicable to the 2013 proxy season, ISS made case-by-case recommendations on proposals requesting information on a company's direct, indirect and grassroots lobbying activities, policies or procedures. ISS said it considers, among other things, the company's disclosure of relevant policies and oversight mechanisms, and recent significant controversies regarding lobbying-related activities.

### *Policy Revisions*

ISS has expanded the list of factors to include:

- Executive level oversight of lobbying activity (in addition to board oversight)
- Disclosure regarding trade associations or other groups the company supports, or is a member of, that engage in lobbying activities

### *What To Do Now?*

- Consider whether it would be appropriate for the company to disclose additional information about the company's political activities (including involvement in trade associations and other groups that engage in lobbying).

## **4. Human Rights Risk Assessment**

### *New Policy*

ISS has adopted a new formal policy to vote case-by-case on proposals requesting that a company conduct an assessment of the human rights risks in its operations or in its supply chain, or report on its human rights risk assessment process. ISS says it will consider:

- The company's disclosure of existing relevant policies and practices, including information on implementation 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
- Company or supplier involvement in recent, significant controversies, fines or litigation regarding human rights, and any remedial steps taken
- Whether the proposal is unduly burdensome or overly prescriptive

### *What To Do Now?*

- Consider whether it would be appropriate for the company to disclose additional information about its policies and practices relating to assessment and mitigation of human rights risks.

## **Reminder: Updating Peer Groups – December 9, 2013 Deadline**

ISS considers a company's self-selected peers when constructing the peer group that ISS uses to evaluate pay-for-performance. ISS has requested that companies notify it by 5:00pm EST on **December 9, 2013** of any changes to a company's self-selected peer companies for purposes of benchmarking CEO compensation.

ISS has clarified in FAQs that it is seeking updated peer groups used for benchmarking CEO compensation for the fiscal year ending prior to the company's 2014 annual meeting (i.e., the peer group used for 2013 compensation decisions). However, if a company anticipates making changes to its peer group for 2014, ISS has indicated that an updated peer group would be helpful "if the anticipated 2014 changes are due to business events that have made companies in the 2013 peer group no longer relevant (e.g., significant business changes, mergers, spinoffs, or bankruptcies)."<sup>5</sup>

Note, however, that even though ISS has said that it will take into consideration a company's self-selected peers, the FAQs clarify that a company's self-selected peers may not always appear in the ISS peer group, even if they meet ISS' size constraints (for example, if inclusion would lead to over-representation of a particular industry in the ISS peer group).

**What To Do Now?**

- If changes have been made to the company's self-selected peer group, updated peer group information should be provided to ISS via its web form, available at [www.issgovernance.com/PeerFeedbackUS](http://www.issgovernance.com/PeerFeedbackUS). Note that ISS expects that the list of companies provided to it will match the list of benchmarking peers that are disclosed in the 2014 proxy statement. If there are any differences, ISS has stated that it may "apply additional scrutiny to this variance as part of its pay-for-performance analysis."<sup>6</sup>

**General Guidance for Preparing for 2014 Proxy Season**

ISS typically provides companies that are in the S&P 500 with prior warning if it intends to issue a negative vote recommendation. Companies then have a very narrow time window (48 hours) in which to engage with ISS on the issue. Companies that are not in the S&P 500 generally do not receive such prior warning. We encourage all companies to become familiar with the more than 40 circumstances in which ISS may recommend a negative vote regarding director re-election (set forth in the **Appendix**), or on other proposals that may be included in their proxy statement. Companies may also wish to contact their analyst at ISS in anticipation of or shortly after proxy statement filing to talk through any issues that could cause ISS to issue a negative vote recommendation.

In addition to the steps discussed above, we recommend:

- Reviewing the company's corporate governance and compensation practices for potential vulnerabilities under ISS' policy updates (for example, how shareholder proposals fared at the previous annual meeting)
- Assisting the company in developing outreach tactics to 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
- Reviewing last year's compensation and governance disclosure, and plan to make improvements in this year's proxy statement where appropriate

For a comparison of ISS' policies (as updated) against suggestions for board structure and practice by influential members of the corporate, institutional investor and legal communities, see our "Comparison of Corporate Governance Principles & Guidelines: United States," available at <http://www.weil.com/news/pubdetail.aspx?pub=12278>

**New Benchmark Policy Consultation Period -- Ends February 2014**

ISS is requesting feedback from governance stakeholders globally on potential longer term changes to several voting policies as part of a new, ongoing consultation period that will continue until **February 2014**. ISS has stated that it will take comments it receives into consideration as it formulates policy updates beyond the 2014 proxy season. The following important policies affecting US corporations under review are:

- *Director tenure* – ISS is considering whether to classify directors with lengthy tenure as non-independent or consider the mix of director tenures on a board when determining a vote recommendation on members of the nominating committee
- *Director independence* – ISS is evaluating whether to use more of a case-by-case analysis of facts and circumstances in determining director independence, focusing on former CEOs, familial relationships and professional relationships
- *Audit firm tenure* – ISS is exploring potential approaches to its auditor ratification policy, including whether to consider audit firm tenure as a factor in determining the vote recommendation on proposals to ratify auditors
- *Independent chairs* – ISS is examining alternative approaches to its policy on shareholder proposals seeking an independent chair, including whether to always vote for such proposals or generally vote for such proposals as a matter of best practice but taking into account certain company-specific circumstances on a case-by-case basis that may warrant a combined CEO/chair board leadership structure

- *Equity plan scoring* – ISS is considering adopting a “balanced scorecard” approach that allows the weighting of multiple factors in a holistic evaluation of equity compensation plans (for example, concerns associated with historical equity grants that might elevate a company’s burn rate and shareholder value transfer may be counterbalanced by a relatively small new share request and a declining burn rate trend)

Several of these topics were also addressed in the ISS policy survey for 2013-2014.<sup>7</sup>

### ***What To Do Now?***

- Consider commenting to ISS before the February 2014 deadline ([policy@issgovernance.com](mailto:policy@issgovernance.com)).

### **Recent Developments in Proxy Advisory Firm Regulation and Best Practices**

US and international efforts to review and reform the proxy advisory industry have intensified in recent months. Recent developments involving regulators, business-focused trade associations and the proxy advisory industry itself include:

- In February 2013, the European Securities and Markets Authority (ESMA) published a report recommending that the proxy advisory industry develop an EU Code of Conduct that focuses on identifying, disclosing and managing conflicts of interest, and fostering transparency to ensure the accuracy and reliability of advice provided.<sup>8</sup>
- In response, in October 2013, a global group of proxy advisory firms (ISS, Glass Lewis, IVOX, Manifest, PIRC and Proxinvest) announced a public consultation on draft principles for the provision of shareholder voting and analytical services.<sup>9</sup> These principles will be international in scope.
  - Deadline for comments is December 20, 2013; final principles scheduled for February/March 2014.
- In the US, concerns about proxy advisory firms have been reflected in the following:
  - An SEC roundtable will be held on December 5, 2013 to discuss proxy advisory firms, including their use by investment advisers and institutional investors, and suggestions for change.<sup>10</sup> The deadline for comments is January 10, 2014.<sup>11</sup>
  - In October 2013, NASDAQ filed a petition with the SEC seeking interpretive changes that would require proxy advisory firms to disclose the models, formulas and methodologies pursuant to which they make voting recommendations and all relationships that may pose conflicts of interest.<sup>12</sup>
  - In June 2013, a House subcommittee held a hearing on the proxy advisory industry, including the effect on corporate governance standards, proxy advisory firm voting policies and market power, and potential conflicts of interest.<sup>13</sup>
  - In March 2013, the US Chamber of Commerce’s Center for Capital Markets Competitiveness published a report focused on best practices and core principles for the development, dispensation and receipt of proxy advice.<sup>14</sup>
- In September 2013, the Canadian Securities Administrators (CSA) announced that it expects to propose a regulatory approach to proxy advisory firms in early 2014.<sup>15</sup>

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:

Howard B. Dicker	<a href="mailto:howard.dicker@weil.com">howard.dicker@weil.com</a>	+1 212 310 8858
Catherine T. Dixon	<a href="mailto:cathy.dixon@weil.com">cathy.dixon@weil.com</a>	+1 202 682 7147
Holly J. Gregory	<a href="mailto:holly.gregory@weil.com">holly.gregory@weil.com</a>	+1 212 310 8038
P.J. Himelfarb	<a href="mailto:pj.himelfarb@weil.com">pj.himelfarb@weil.com</a>	+1 214 746 7811
Ellen J. Odoner	<a href="mailto:ellen.odoner@weil.com">ellen.odoner@weil.com</a>	+1 212 310 8438
Lyuba Goltser	<a href="mailto:lyuba.goltser@weil.com">lyuba.goltser@weil.com</a>	+1 212 310 8048
Rebecca C. Grapsas	<a href="mailto:rebecca.grapsas@weil.com">rebecca.grapsas@weil.com</a>	+1 212 310 8668
Adé K. Heyliger	<a href="mailto:ade.heylinger@weil.com">ade.heylinger@weil.com</a>	+1 202 682 7095
Audrey K. Susanin	<a href="mailto:audrey.susanin@weil.com">audrey.susanin@weil.com</a>	+1 212 310 8413

*We thank our colleagues Rebecca Grapsas and Audrey Susanin for their contributions to this Alert.*

©2013. All rights reserved. Quotation with attribution is permitted. This publication provides general information and should not be used or taken as legal advice for specific situations which depend on the evaluation of precise factual circumstances. The views expressed in these articles reflect those of the authors and not necessarily the views of Weil, Gotshal & Manges LLP. If you would like to add a colleague to our mailing list or if you need to change or remove your name from our mailing list, please log on to [www.weil.com/weil/subscribe.html](http://www.weil.com/weil/subscribe.html), or send an email to [subscriptions@weil.com](mailto:subscriptions@weil.com).

## Appendix

### Circumstances in Which ISS Will Make a Negative Vote Recommendation in Uncontested Director Elections in 2014

According to ISS proxy voting policies applicable to shareholder meetings held on or after February 1, 2014, ISS has identified more than 40 circumstances that may support a negative vote recommendation. These circumstances are outlined below. Changes from ISS' 2013 policies are noted in italics.

#### Individual Directors, Committee Members or the Entire Board

ISS will recommend a negative vote (“against” or “withhold”) for directors individually, committee members or the entire board due to:

##### ***Governance failures:***

- Material failures of governance, stewardship, risk oversight (examples include bribery, large or serial fines or sanctions from regulatory bodies, significant adverse legal judgments or settlements, hedging of company stock, or significant pledging of company stock), or fiduciary responsibilities at the company
- Failure to replace management as appropriate
- Egregious actions related to service on other boards that raise substantial doubt about the director’s ability to effectively oversee management and serve the best interests of shareholders at any company

ISS will consider vote recommendations on a “case-by-case” basis for directors individually, committee members or the entire board due to:

##### ***Board responsiveness:***

- The board failed to act on a shareholder proposal that received approval by a majority of shares cast in the previous year.<sup>1</sup> Factors that will be considered are:
  - o Disclosed outreach efforts by the board to shareholders in the wake of the vote
  - o *The board’s rationale, as provided in the proxy statement, for the level of implementation of the proposal*
  - o Subject matter of the proposal
  - o Level of support for and opposition to the proposal at past meetings
  - o Board actions in response to *the majority vote and* its shareholder engagement
  - o Continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals)
  - o Other factors as appropriate
  - o *ISS’ 2014 policy updates clarify that its vote recommendations on director elections with respect to majority-supported shareholder proposals will be made on a fact-specific “case-by-case” basis, rather than generally recommending votes against*

---

<sup>1</sup> As announced last year, starting in 2014, ISS will review the responsiveness of a board to a shareholder proposal that receives one year of a majority of votes cast rather than the previous “triggers” of either two years of a majority of votes cast in a three-year period, or one year of a majority of shares outstanding.

- At the previous board election, any director received more than 50 percent negative votes of the votes cast and the company failed to address the underlying issue(s) that caused these high negative votes
- The board failed to act on takeover offers where a majority of shareholders tendered their shares
- The board implemented an advisory vote on executive compensation on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency
- When no say-on-pay frequency received a majority and the board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received a plurality of the votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency, taking into account:
  - o The board's rationale for selecting a frequency that is different from the frequency that received a plurality
  - o The company's ownership structure and vote results
  - o ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices
  - o *Prior to its 2014 policy updates, if a particular frequency received a plurality of the votes cast (but not a majority), ISS would consider vote recommendations on a "case-by-case" basis for the entire board, but not individual directors or committee members*

### **Individual Directors**

In addition to the circumstances discussed above, ISS will recommend a negative vote ("against" or "withhold") for an individual director:

#### ***Attendance:***

- Who attends less than 75 percent of board and committee meetings for the period of service (or missed more than one meeting, if the director's total service was three or fewer meetings) unless the absence was due to medical issues or family emergencies, and the reason for such absence is disclosed in the proxy statement or other SEC filing
- If the proxy disclosure is unclear and insufficient to determine whether the director attended at least 75 percent of board and committee meetings during the period of service

#### ***"Overboarding:"***

- Who sits on more than six public company boards, with boards of subsidiaries with publicly-traded stock counting as separate boards
- Who is CEO of a public company and sits on boards of more than three public companies in total, with boards of subsidiaries with publicly-traded stock counting as separate boards (the negative vote recommendation will apply only to elections for the outside boards but not the boards of controlled subsidiaries and affiliates of the CEO's own board)

#### ***Independence:***

- Who is an inside or affiliated outside director serving on the audit, compensation or nominating committee

**Entire Board**

In addition to the circumstances discussed above relating to the entire board, ISS will recommend a negative vote (“against” or “withhold”) for all directors (except for new nominees, who will be considered on a “case-by-case” basis) if:

***Problematic takeover defenses:***

- The board is classified and a continuing director responsible for a problematic governance issue at the board/committee level that would warrant a negative vote recommendation is not up for election (ISS may hold any or all appropriate nominees, except new nominees, accountable)
- The board lacks accountability and oversight, coupled with sustained poor performance relative to peers measured by one-year and three-year total shareholder returns in the bottom half of a Russell 3000 company’s four-digit Global Industry Classification Group (ISS will consider “problematic” governance provisions including a classified board structure, a supermajority vote requirement, a plurality vote standard in uncontested director elections or majority vote standard for director elections with no carve-out for contested elections, inability of shareholders to call special meetings or act by written consent, a dual-class capital structure, and/or a non-shareholder approved poison pill, and will also take into consideration the company’s five-year total shareholder return and operational metrics)
- A poison pill has a dead-hand or modified dead-hand feature, in which case a negative vote recommendation will be made every year until the feature is removed
- The board adopts a poison pill with a term of more than 12 months or renews any existing pill including a pill with a term of 12 months or less without shareholder approval (a commitment or policy that puts a newly adopted pill to a binding shareholder vote may potentially offset a negative vote recommendation)
- The company maintains a poison pill that was not approved by shareholders (ISS will review annually for companies with classified boards and at least once every three years for companies with declassified boards)
- The board makes a “material adverse change” to an existing poison pill without shareholder approval
- On a “case-by-case” basis: the board adopts a poison pill with a term of 12 months or less without shareholder approval, taking into account the following factors:
  - The date of the pill’s adoption relative to the date of the next meeting of shareholders (whether the company had time to put the pill on the ballot for shareholder ratification given the circumstances)
  - The company’s rationale
  - The company’s governance structure and practices
  - The company’s track record of accountability to shareholders

***Problematic compensation practices:***

- On a “case-by-case” basis: in exceptional circumstances, if the company’s previous say-on-pay proposal received the support of less than 70 percent of votes cast (see below)
- In the absence of a say-on-pay vote or in egregious situations if:
  - There is a significant misalignment between CEO pay and company performance (see below)
  - The board exhibits a significant level of poor communication and responsiveness to shareholders
  - The company fails to submit one-time transfers of stock options to a shareholder vote
  - The company fails to fulfill the terms of a burn rate commitment made to shareholders
  - The company maintains significant “problematic pay practices” (see below)
- The company has recently practiced or approved problematic pay practices (see below)

***Problematic audit-related practices:***

- On a “case-by-case” basis: poor accounting practices rising to a level of serious concern (such as fraud, misapplication of GAAP, and material weaknesses identified in Section 404 disclosures) are identified, taking into consideration the practices’ severity, breadth, chronological sequence and, duration, and the company’s efforts at remediation or corrective actions

**All Inside Directors and Affiliated Outside Directors**

ISS will recommend a negative vote (“against” or “withhold”) for all inside directors and affiliated outside directors when:

- The company lacks an audit, compensation, or nominating committee so that the full board functions as that committee
- The company lacks a formal nominating committee (even if the board attests that independent directors fulfill the functions of such a committee)
- The full board is less than majority independent

**Audit Committee Members**

In addition to the circumstances discussed above relating to committee members, ISS will recommend a negative vote (“against or withhold”) for audit committee members if:

- Non-audit fees paid to the auditor are excessive (e.g., non-audit fees are greater than audit fees plus audit-related fees plus tax compliance/preparation fees)
- The company receives an adverse opinion on its financial statements from its auditor
- There is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company or its shareholders to pursue legitimate legal recourse against the audit firm
- On a “case-by-case” basis: poor accounting practices, which rise to a level of serious concern (such as fraud, misapplication of GAAP, and material weaknesses identified in Section 404 disclosures) are identified, taking into consideration the practices’ severity, breadth, chronological sequence and, duration, and the company’s efforts at remediation or corrective actions

**Compensation Committee Members**

In addition to the circumstances discussed above relating to committee members, ISS will recommend a negative vote (“against” or “withhold”) for compensation committee members (and potentially the full board) if:

- On a “case-by-case” basis: the company’s previous say-on-pay proposal received the support of less than 70 percent of votes cast, taking into account:
  - o The company’s response, including:
    - Disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support
    - Specific actions taken to address the issues that contributed to the low level of support
    - Other recent compensation actions taken by the company
  - o Whether the issues raised are recurring or isolated
  - o The company’s ownership structure
  - o Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness

- In the absence of a say-on-pay vote or in egregious situations if:
  - o There is a significant misalignment between CEO pay and company performance, considering:
    - Peer group alignment (total shareholder return and CEO's total pay rank within a peer group as measured over one-year and three-year periods and considering the multiple of CEO total pay relative to the peer group median)
    - Absolute alignment (difference between the trend in annual CEO pay changes and the trend in annualized company total shareholder return over the prior five years)
    - Qualitative factors
  - o The board exhibits a significant level of poor communication and responsiveness to shareholders
  - o The company fails to submit one-time transfers of stock options to a shareholder vote
  - o The company fails to fulfill the terms of a burn rate commitment made to shareholders
  - o The company maintains significant "problematic pay practices," such as:
    - Repricing or replacing of underwater stock options/SARS without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options)
    - Excessive perquisites or tax gross-ups, including any gross-up related to personal use of corporate aircraft, executive life insurance, bonus, a secular trust or restricted stock vesting
    - New or extended agreements that provide for:
      - Change in control payments exceeding three times base salary plus bonus
      - Change in control severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers)
      - Change in control payments with excise tax gross-ups (including "modified" gross-ups)
- The company has recently practiced or approved "problematic pay practices," which include (in addition to those listed above):
  - o Egregious employment contracts (contracts containing multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation)
  - o Overly generous new-hire package for new CEO (excessive "make whole" provisions without sufficient rationale or any problematic pay practice)
  - o Abnormally large bonus payouts without justifiable performance linkage or proper disclosure (includes performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance)
  - o Egregious pension/supplemental executive retirement plan payouts (inclusion of additional years of service not worked that result in significant benefits provided in new arrangements or inclusion of performance-based equity or other long-term awards in the pension calculation)
  - o Dividends or dividend equivalents paid on unvested performance shares or units
  - o Excessive perquisites, perquisites for former and/or retired executives (such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements) or extraordinary relocation benefits (including home buyouts)
  - o Internal pay disparity (excessive differential between CEO total pay and that of next highest-paid named executive officer)

- o Voluntary surrender of underwater options by executive officers (may be viewed as an indirect option repricing/exchange program especially if those cancelled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or the executives subsequently receive unscheduled grants in the future)
- o Other pay practices deemed problematic but not covered in any of the above categories

## End Notes

- <sup>1</sup> ISS, *US Corporate Governance Policy 2014 Updates* (November 21, 2013), available at <http://www.issgovernance.com/files/2014USPolicyUpdates.pdf>.
- <sup>2</sup> ISS, *Comments on 2014 Draft Policies* (accessed November 22, 2013), available at <http://www.issgovernance.com/2014draftpolicycommentperiod>.
- <sup>3</sup> ISS, *Benchmark Policy Consultation (NEW)* (accessed November 22, 2013), available at <http://www.issgovernance.com/benchmarkpolicyconsultation>.
- <sup>4</sup> ISS, *2013 US Proxy Voting Policies and Procedures, Frequently Asked Questions (Excluding Compensation-related Questions)* (April 11, 2013), available at <http://www.issgovernance.com/files/2013ISSFAQPoliciesandProcedures04112013.pdf>. For a discussion of these FAQs, please see our Alert, *Heads Up for 2013 Proxy Season: Guidance for How to Address ISS & Glass Lewis Policy Changes* (December 21, 2012), available at <http://www.weil.com/news/pubdetail.aspx?pub=11397>. Note that the FAQs relating to board responsiveness have not been amended since these FAQs were released in December 2012.
- <sup>5</sup> ISS, *2013 US Proxy Voting Policies and Procedures, Frequently Asked Questions on Peer Group Selection Methodology* (November 18, 2013), available at [http://www.issgovernance.com/sites/default/files/USPeerGroupFAQ\\_20131118FINAL.pdf](http://www.issgovernance.com/sites/default/files/USPeerGroupFAQ_20131118FINAL.pdf) (“Peer Group FAQs”).
- <sup>6</sup> Peer Group FAQs at 7.
- <sup>7</sup> ISS, *2013-2014 Policy Survey Summary of Results* (October 2013), available at <http://www.issgovernance.com/files/ISS2013-2014PolicySurveyResultsReport.pdf>.
- <sup>8</sup> ESMA, *Final Report: Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry* (February 19, 2013), available at <http://www.esma.europa.eu/system/files/2013-84.pdf>.
- <sup>9</sup> Best Practice Principles for Governance Research Providers Group, *Public Consultation on Best Practice Principles for Governance Research Providers* (October 28, 2013), available at <http://bppgrp.info/wp-content/uploads/2013/11/BPP-Group-Principles-Consultation.pdf>.
- <sup>10</sup> SEC Release No. 34-70929, *Proxy Advisory Firm Roundtable* (November 22, 2013), available at <http://www.sec.gov/rules/other/2013/34-70929.pdf>.
- <sup>11</sup> SEC Release No. 34-62495, *Concept Release on the US Proxy System* (July 14, 2010), available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>. The roundtable follows on from the SEC’s “proxy plumbing” concept release published in July 2010 that raised questions about the role of proxy advisory firms and the risks associated with apparent conflicts of interest and lack of transparency.
- <sup>12</sup> Letter from Edward S. Knight, Executive Vice President, General Counsel & Chief Regulatory Officer, NASDAQ OMX to Elizabeth M. Murphy, Esq., Secretary, US Securities and Exchange Commission, *Petition Related to Proxy Advisory Firms* (October 8, 2013), available at <http://www.sec.gov/rules/petitions/2013/petn4-666.pdf>.
- <sup>13</sup> US House of Representatives, Capital Markets and Government Sponsored Enterprises Subcommittee, *Hearing Entitled “Examining the Market Power and Impact of Proxy Advisory Firms”* (June 5, 2013). See <http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=335917>.
- <sup>14</sup> US Chamber of Commerce’s Center for Capital Markets Competitiveness, *Best Practices and Core Principles for the Development, Dispensation and Receipt of Proxy Advice* (March 2013), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf>.
- <sup>15</sup> CSA Notice 25-301, *Update on CSA Consultation Paper 25-401, Potential Regulation of Proxy Advisory Firms* (September 19, 2013), available at [www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20130919\\_25-301\\_update-25-401.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20130919_25-301_update-25-401.htm).