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Alert
SEC Disclosure and Corporate Governance

Required Reading: ISS Issues Policy Updates for 2012 Proxy Season

Focuses on Pay-for-Performance and Board Response to Say-on-Pay

On November 17, 2011, Institutional Shareholder Services Inc. (ISS) issued updates to its proxy voting policies applicable to shareholder meetings held on or after February 1, 2012. This Alert summarizes and discusses implications of those updates for US companies. The ISS proxy voting guidelines and the updates are available at http://www.issgovernance.com/policy.

ISS is generally considered the most influential proxy advisor in the US. Recent studies have found that ISS is able to influence shareholder votes by 6% to 20%.[1] In preparing for 2012 annual meetings, corporate counsel, corporate secretaries, and directors (particularly those serving on compensation or nominating and governance committees) should review the ISS policy updates and consider how the changes may affect ISS' evaluation of director re-elections, executive compensation matters, and other matters for shareholder vote. Note that for the 2012 proxy season, ISS has identified over 50 circumstances that may support a negative vote recommendation (either "against" or "withhold") in uncontested director elections. A summary of these circumstances is included in Appendix A.

Summary of Key Changes for the 2012 Proxy Season

1. Revised Policy on Pay-for-Performance Evaluation

Under a revised policy, ISS has refined its methodology for determining pay-for-performance alignment.

Discussion: Previously, if a company in the Russell 3000 index fell in the bottom half of its GICS industry group in total shareholder return over both a one-year and three-year period, and CEO pay was not aligned with shareholder performance over time (with special emphasis on the immediately preceding year), ISS would recommend a negative say-on-pay vote.

Under the revised policy, ISS will select a narrower peer group of 12 to 24 companies, using as guidelines market cap, revenues (or assets for financial firms), and GICS industry group. Additional guidance on the new approaches for selecting companies for peer groups will be provided in December.

ISS will now focus on: (i) the relative alignment between CEO pay and company TSR within the peer group for a one- and three-year period (with a 40% emphasis on the one-year period and a 60% emphasis on the three-year period); (ii) the multiple of CEO pay relative to the peer group median, and (iii) the absolute alignment between CEO pay and company TSR over a five-year period. The system for evaluating differences in rates of change to identify weak or strong alignment will be provided in additional guidance to be issued in December.

Where the alignment is perceived to be weak, ISS will consider how a number of qualitative factors affect alignment of pay with shareholder interests, including:

- The ratio of performance- to time-based equity awards;
- The ratio of performance-based compensation to overall compensation;
- The completeness of disclosure and rigor of performance goals;
- The company's peer group benchmarking practices;
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (e.g., biennial awards); and
- Any other factors deemed relevant.

Implications: Companies should study the additional guidance that ISS plans to issue in December and assess how their alignment of compensation and performance is likely to be assessed under ISS' new methodology. Companies should take special care to focus their CD&As on the alignment between compensation and performance, and explain any anomalies.

2. Revised Policy on Board Response to Say-On-Pay Vote

Under a revised policy, ISS will recommend votes on compensation committee members and the current year say-on-pay proposal on a case-by-case basis where, in the previous year, the company's say-on-pay proposal received the support of less than 70% of the votes cast.

Discussion: Previously, ISS would recommend a negative vote for compensation committee members "in egregious situations" or when the board "failed to respond to concerns raised in prior [management say-on-pay] evaluations." When evaluating ballot items related to executive pay, ISS considered the board's responsiveness to investor input and engagement on compensation issues (for example, failure to respond to majority-supported shareholder proposals on executive pay topics, or concerns raised in connection with significant opposition to prior year's say-on-pay vote) on a case-by-case basis.

Under the revised policy, ISS' case-by-case analysis will take into account: (i) the company's response to the concerns expressed by shareholders in the previous year, including disclosed engagement efforts with major institutional investors and specific actions taken to address the issues that led to the "low" level of support, as well as other recent compensation actions taken by the company; (ii) whether the issues raised are recurring or isolated; (iii) the company's ownership structure (for example, significant insider ownership); and (iv) whether the support level was less than 50%, which ISS notes will "warrant the highest degree of responsiveness."

ISS has indicated that the new policy does not establish a bright line test, and that it may apply its case-by-case analysis to companies where the say-on-pay proposal received the support of more than 70% of the votes cast, including companies with significant insider ownership.

Implications: Companies whose say-on-pay proposal received a significant percentage of negative votes (even if the proposal was approved by more than 70% of the votes cast) should conduct outreach with their large institutional shareholders to discuss compensation concerns that contributed to negative votes and discuss what actions the board has taken, plans to take, or is considering in order to address these concerns (within the confines of Regulation FD). ISS notes that "these specific actions should ideally be new rather than a reiteration of existing practices." In the CD&A, companies should consider disclosing efforts to engage with shareholders and consider their viewpoints (for example, the percentage of shareholders contacted). There may be instances where the board, after considering all relevant facts and circumstances with due care – including the shareholder say-on-pay vote – may decide that no change is appropriate. Where this is the case, the basis for this conclusion should be presented in the CD&A.

Note that shareholder outreach efforts on compensation concerns may be useful in avoiding a shareholder derivative lawsuit alleging that directors breached their fiduciary duties in connection with a failed say-on-pay vote.

3. New Policy on Board Response to Say-on-Pay Frequency Vote

Under a new policy, ISS will recommend that shareholders vote against or withhold votes from all incumbent directors if the board implements a say-on-pay vote on a less frequent basis than the frequency that received a majority of the votes cast. When no frequency received a majority, ISS will apply a case-by-case analysis if a particular frequency received a plurality of the votes cast and the board implements a say-on-pay vote less frequently.

Discussion: Last year, US corporate issuers were required to afford shareholders an advisory vote on the frequency with which the say-on-pay vote should be held, and will have to revisit say-on-pay frequency at least once every six years thereafter. Under a policy issued last year, ISS recommended voting for annual say-on-pay votes, rather than biennial or triennial say-on-pay votes. It appears that many large companies are opting for an annual say-on-pay vote.

Where a frequency option received a majority of votes cast and the board implements a less frequent say-on-pay vote, ISS will recommend that shareholders vote against or withhold votes from the entire board (except new nominees, who will be considered on a case-by-case basis). In a situation where no frequency received a majority of votes cast in support, and the board implements a less frequent say-on-pay vote than the frequency that received plurality support, ISS will take a case-by-case approach and consider additional factors in determining its recommendations, including the board's rationale, the company's ownership structure and vote results, any compensation concerns or history of problematic compensation practices, and the say-on-pay support level from the prior year.

Although ISS' rationale for the new policy states that "[m]ajority support for a particular frequency should be viewed as a mandate to the board," ISS will not issue negative vote recommendations where even though the shareholder's "mandate" is for a frequency other than annual voting, the board implements a more frequent say-on-pay vote.

Implications: Companies that have disclosed they plan to implement a less frequent say-on-pay vote than the frequency option preferred by their shareholders should consider outreach efforts aimed at explaining why a less frequent say-on-pay vote is best for their circumstances. Some such companies may wish to revisit whether to implement the shareholder-preferred say-on-pay frequency.

4. Revised Policy on Incentive Bonus Plans and Tax Deductibility Proposals (Post-IPO Companies)

This year, ISS will apply a more rigorous analysis for the initial approval of equity plans under Section 162(m) of the Internal Revenue Code.

Discussion: Generally, ISS has recommended that shareholders support equity plan proposals solely for compliance with Section 162(m) of the Internal Revenue Code, due to the favorable tax deduction companies may take on performance-based compensation paid to named executive officers. Under the revised policy, ISS will evaluate, on a case-by-case basis, equity plans that are to be voted on for the first time following an IPO even if only for the purpose of obtaining favorable Section 162(m) treatment. ISS will perform a full analysis, taking into consideration total shareholder value transfer, burn rate (if applicable), repricing, and liberal change in control. If appropriate, ISS may also consider other factors such as pay-for-performance or problematic pay practices (such as perquisites). (See Appendix A, p. A-4, for a list of potentially problematic pay practices.)

ISS' rationale for the policy update explains that the revised policy aligns with the recently proposed Treasury rule related to Section 162(m). The proposed rule would require newly public companies to obtain shareholder approval before awarding certain performance-based restricted stock units to named executive officers before the end of the standard post-IPO transition period to qualify as performance-based compensation.

Implications: Newly public companies seeking initial shareholder approval of an equity plan for Section 162(m) purposes should expect ISS to perform a full analysis and should not consider a favorable ISS recommendation to be a foregone conclusion. Companies should consider this policy change in both plan design and pay practices.

5. Revised Policy on Proxy Access

ISS' revised policy expands and refines the factors it will consider in determining recommendations on proxy access proposals, and broadens the policy to apply to management proposals as well as shareholder proposals.

Discussion: Until now it had been ISS' policy to recommend that shareholders vote case-by-case on shareholder proposals asking for proxy access, taking into account (i) the ownership threshold proposed in the resolution, and (ii) the proponent's rationale for the proposal at the targeted company in terms of board and director conduct.

On September 20, 2011, the SEC's amendment to Rule 14a-8 took effect,[2] providing that companies may no longer automatically exclude from proxy materials shareholder proposals seeking to amend company by-laws to require future inclusion of shareholder-proposed director nominees in company proxy materials on the ground that such proposals relate to director elections. Of course, companies may seek no action relief for exclusion of such proposals on other grounds pursuant to Rule 14a-8, and some companies may decide to pre-empt shareholder action through management proposals on proxy access.

ISS' revised policy will apply a case-by-case approach to recommendations on proxy access proposals, taking into account a range of company-specific and proposal-specific factors, including: (i) the ownership thresholds proposed in the resolution, (ii) the maximum proportion of directors that shareholders may nominate, and (iii) the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. Because ISS supports proxy access in principle, the revised policy de-emphasizes the proponent's rationale for the proposal. ISS has indicated that its company-specific review will focus on the company's size and shareholder demographics, rather than the company's corporate governance profile and practices. ISS has also indicated that its analysis of the appropriateness of the core features of proxy access proposals will be more exacting in the case of binding bylaw amendments than for precatory requests for board actions, since precatory requests permit boards an opportunity to review and revise the proposed procedures and thresholds for proxy access prior to adopting a policy.

ISS' revised policy does not include any guidance on specific terms in a proxy access proposal that it considers to be favorable or unfavorable, noting that "the access debate is fluid and likely to gain more attention in 2012." ISS' executive summary of the updates, however, indicates that "[i]n January 2012, as part of [its] policy update process, ISS expects to provide additional guidance (via FAQs and/or through other reports) based on an examination of the specific proposal texts."

Implications: It remains to be seen how frequently proxy access shareholder proposals will be brought, whether they will be structured as precatory requests for board action or as binding bylaw amendments, and the range of ownership thresholds proposed in the resolutions (i.e., percentage and duration). Companies should closely monitor proxy access shareholder proposals, as well as corresponding ISS recommendations and shareholder support. As of November 15, 2011, two precatory shareholder proposals seeking proxy access had been filed by Ken Steiner, an individual shareholder involved with the U.S. Proxy Exchange (USPX), a coalition of individual retail shareholders. The proposals, submitted to Textron Inc. and MEMC Electronic Materials, Inc., were the first 2012 access proposals to be publicly disclosed. The Steiner proposals (which are substantially identical) provide a lower threshold of stock ownership for shareholder nomination of directors than that contemplated by the SEC's vacated Rule 14a-11, which required ownership of 3% of a company's outstanding shares for a period of three years in order to nominate one or more director (with a 25% cap). The Steiner proposals recommend that the company's proxy include nominees of "any party of one or more shareholders that held continuously, for two years, 1% of the Company's securities eligible to vote for the election of directors" or any party of 100 or more shareholders that satisfy SEC Rule's 14a-8(b) eligibility requirements ($2000, or 1% of a company's securities eligible to vote, continuously held for at least one year). Companies and boards should follow these developments closely.

6. Revised Policy on Risk Oversight and Director Elections

ISS has expanded the factors it will consider in recommending that shareholders vote against or withhold votes from individual directors, committee members or the entire board, to specifically include material failures of risk oversight.

Discussion: Previously, ISS would recommend, "[u]nder extraordinary circumstances," a negative vote for individual directors, committee members or the entire board due to "material failures" of "governance, stewardship or fiduciary responsibilities at the company." Although it would be reasonable to assume that the prior policy would capture material failures of risk oversight, ISS has revised the policy to add an explicit reference to risk oversight to highlight "the significance of risk oversight within the broader concept of directors' fiduciary responsibilities." ISS specifies that this addition is not intended to "penalize boards for taking prudent business risks or for exhibiting reasonable risk appetite, but is instead intended to address situations where there has been a material failure in a board's role in overseeing the company's risk management practices."

Implications: Companies that have experienced circumstances that could give rise to a perception of a material failure of governance, stewardship, risk oversight, or fiduciary responsibilities should be prepared to explain such circumstances in both disclosure materials and through outreach to their large institutional shareholders.

7. Revised Policy on Dual-Class Structure

ISS will recommend that shareholders generally vote against proposals to create a new class of common stock, regardless of voting rights, unless there is a compelling rationale for the dual-class capital structure.

Discussion: Until now it has been ISS' policy to recommend that shareholders vote: (i) against proposals to create a new class of common stock with superior voting rights, and (ii) for proposals to create a new class of nonvoting or subvoting common stock if it is intended for financial purposes with minimal dilution to current shareholders and it is not designed to preserve the voting power of an insider or significant shareholder.

The revised policy applies to proposals to create a dual-class capital structure regardless of voting rights, and adds the issuer's rationale, economic condition, and the expected duration of the new class as new factors it will consider. Pursuant to the revised policy, ISS will evaluate proposals to create a new class of common stock on a case-by-case basis taking into account whether:

- The company discloses a compelling rationale for the dual-class capital structure, such as:
  - The company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or
  - The new class of shares will be transitory;
- The new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and
- The new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

Implications: ISS will support the creation of a dual-class capital structure only in the most compelling of circumstances -- generally occurring when a company is on the brink of liquidation or dissolution. Companies that are planning to implement a dual-class structure should be prepared to explain their compelling need to do so in both disclosure materials and through outreach to their large institutional shareholders.

8. Revised Policy on Exclusive Venue Proposals

ISS' policy to vote against exclusive venue proposals unless the company has in place certain good governance features has been revised to consider such proposals on a case-by-case basis, taking into account a refined list of governance features, as well as the company's litigation history.

Discussion: In recent years, in response to concerns about "forum shopping" by plaintiffs' lawyers in shareholder litigation, some companies have sought through bylaw amendments to adopt requirements that shareholder suits be brought in a competent court in the state of incorporation (usually Delaware). ISS will now evaluate such proposals on a case-by-case basis taking into account:

- Whether the company has been materially harmed by shareholder litigation outside its jurisdiction of incorporation, based on disclosure in the company's proxy statement; and
- Whether the company has the following "good governance" features:
  - An annually elected board;
  - A majority vote standard in uncontested director elections; and
  - The absence of a poison pill, unless the pill was approved by shareholders.

ISS updated its policy to reflect the results from its 2011-2012 Policy Survey and a recent policy roundtable discussion with seven institutional investors, which indicated that there was no uniform approach when voting on exclusive venue management proposals, and that large institutional investors would be likely to evaluate factors other than governance, including the company's litigation history. ISS removed the examination of the company's special meeting right from the policy, as it believes that this governance feature is less relevant to exclusive venue than it is to other proposals (such as those seeking to provide shareholders with the right to act by written consent).

Implications: Companies that are considering adopting exclusive venue provisions should consider whether they meet the criteria for ISS support and, if not, be prepared to expend extra effort to engage with their large institutional shareholders on this issue.

9. Revised Policy on Political Spending

ISS has shifted its policy with respect to shareholder proposals requesting greater disclosure of a company's political contributions from a case-by-case approach to generally supporting such proposals.

Discussion: Until now, ISS considered proposals requiring disclosure of political contributions and related spending on a case-by-case basis. This issue is receiving attention from the Center for Political Accountability, which has ranked the quality of disclosure of some of the largest S&P 500 companies based on their website disclosure. Pursuant to its revised policy, ISS will now recommend that shareholders generally vote in favor of proposals seeking enhanced disclosure of political spending. The revised policy also adds disclosure of the company's oversight mechanisms related to its political contributions and related spending to the list of factors it considers when evaluating such proposals.

Implications: Given the 2012 presidential election and the US Supreme Court's January 2010 decision invalidating restrictions on certain corporate political expenditures (*Citizens United v. Federal Election Commission*), companies should expect shareholder calls for improved transparency and board oversight of corporate political spending to intensify, resulting in an increase of related proposals. Companies should consider whether they have appropriate mechanisms in place for board oversight of political spending and should consider whether to voluntarily enhance disclosure both as to oversight processes and the focus of political spending. As in other areas of potential heightened shareholder activity, companies should be prepared to reach out to their large institutional shareholders to communicate about their approaches to these issues.

10. Revised Policy on Lobbying Activities

ISS has clarified the scope of its existing case-by-case approach with respect to proposals requesting information on a company's lobbying activities.

Discussion: ISS' revised policy has been amended to broaden its application to proposals seeking information on the company's lobbying activities generally (including direct lobbying as well as grassroots lobbying activities) and not only to those seeking information on its initiatives. The revised policy also clarifies that it applies to broader efforts to inform or sway public opinion as well as formalized, political lobbying activities.

Implications: Companies should expect to see an increase in proposals relating to corporate political spending and lobbying in the 2012 proxy season, and should consider the activities outlined above in Item 9.

11. New Policy on Hydraulic Fracturing

ISS has adopted a policy generally supporting proposals requesting greater disclosure relating to a company's hydraulic fracturing operations.

Discussion: Hydraulic fracturing, also known as fracking, is a natural gas extraction technique that involves the high-pressure injection of water, sand, and chemicals into a gas-bearing shale rock formation. The pressure creates or exposes fissures, which then are kept open by the sand that remains after the water and chemicals are removed, allowing the formerly inaccessible natural gas to flow to the well for extraction. Fracking has attracted public attention and shareholder proposals due to concerns about its effect on the environment.

The new policy recommends that shareholders generally vote for proposals requiring disclosure of natural gas hydraulic fracturing activities, including measures the company has taken to manage and mitigate the potential community and environmental impacts of those operations. Factors to be considered in forming specific recommendations will focus on: (i) the company's current level of disclosure of relevant policies and oversight mechanisms; (ii) the current level of such disclosure relative to its industry peers; (iii) potential relevant local, state, or national regulatory developments; and (iv) controversies, fines, or litigation related to the company's hydraulic fracturing operations.

Implications: Companies that engage in hydraulic fracturing activities should assess their current level of disclosure of relevant policies and oversight mechanisms against ISS' policy and determine whether such disclosure should be enhanced and whether shareholder engagement efforts should be considered.

What You Should Do Now

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 circumstances in which ISS may recommended a negative vote regarding director re-election (set forth in Appendix A), 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 March 2011, ISS issued revised guidelines with respect to engaging with ISS on proxy voting matters, which are available at http://www.issgovernance.com/policy/EngagingWithISS. Note that at the November 18, 2011 meeting of the American Bar Association's Business Law Section, the Chief of the SEC Division of Corporation Finance's Office of Mergers and Acquisitions, Michele Anderson, stated that any written materials that companies provide to ISS in connection with such discussions (e.g., powerpoint presentations, memos, data, etc.) must be filed as proxy soliciting materials on the date of first use.

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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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Audrey Susanin, an associate in Weil's Public Company Advisory Group, assisted in the preparation of this Alert. Reid Powell, a Weil paralegal, assisted in the preparation of the attached Appendix.

[1] Stephen Choi, Jill Fisch & Marcel Kahan, The Power of Proxy Advisors: Myth or Reality?, 59 *Emory L.J*. 869, 886-887 (2010); Jie Cai, Jacqueline L. Garner & Ralph A. Walkling, Electing Directors, 64 *J. Fin*. 2389, 2404 (2009).

[2] On September 15, 2011, the SEC issued a notice of the September 20, 2011 effective date of the amendment to Rule 14a-8, and certain related amendments, once the stay it had previously imposed expired by its terms in the wake of the agency's decision not to appeal a decision by the D.C. Circuit Court striking down the SEC's mandatory proxy access rules, Rule 14a-11. (See SEC Rel. No. 33-9259, available at http://www.sec.gov/rules/final/2011/33-9259.pdf, and our earlier Alert, "Proxy Access Update: SEC Decides Not to Appeal But Companies May Receive Shareholder Proposals for 2012 Proxy Season," available at http://www.weil.com/news/pubdetail.aspx?pub=10450.)

Appendix A

Circumstances in Which ISS Will Make a Negative Vote Recommendation in Uncontested Director Elections in 2012

According to ISS proxy voting policies applicable to shareholder meetings held on or after February 1, 2012, ISS has identified over 50 circumstances that may support a negative vote recommendation. Those circumstances are outlined herein. Changes from ISS' 2011 policies are noted in italics.

Individual Directors

ISS will recommend a negative vote ("against" or "withhold") for an individual director who:

- Attends less than 75% of board and committee meetings (or missed more than one meeting, if the director's total service was three or fewer meetings) unless due to medical issues or family emergencies, and the reason for such absence is disclosed in the proxy statement or other SEC filing
- Sits on more than six public company boards
- Is CEO of a public company and sits on boards of more than three public companies in total (the negative vote recommendation will apply only to elections for the outside boards)
- Is responsible for a material failure of governance, stewardship, *risk oversight*, or fiduciary responsibilities at the company
- Has engaged in 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
- Is an inside or affiliated outside director that serves on the audit, compensation, or nominating committee

ISS may recommend a negative vote for a director who is the company's CEO if the company has problematic pay practices (see below).

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:

- The company's proxy statement indicates that one or more directors failed to attend 75% of board and committee meetings but the names of the directors involved are not disclosed
- The board failed to act on a shareholder proposal that received approval by a majority of shares outstanding the previous year (a management proposal related to the subject matter of the prior shareholder proposal with other than a "for" recommendation by management will be considered a failure to act)
- The board failed to act on a shareholder proposal that received approval by a majority of votes cast in the last year and one of the two previous years (a management proposal related to the subject matter of the prior shareholder proposal with other than a "for" recommendation by management will be considered a failure to act)

- The board failed to act on takeover offers where a majority of shareholders tendered their shares
- At the previous board election, any director received more than 50% negative votes of the votes cast and the company failed to address the underlying issue(s) that caused the high negative votes
- 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 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 structure, a non-shareholder approved poison pill, and will also assess the CEO's pay relative to the company's total shareholder returns over a time horizon of at least five years)
- There have been material failures of governance, stewardship, *risk oversight*, or fiduciary responsibilities at the company
- The board failed to replace management (as appropriate)
- The company has problematic pay practices (see below)
- *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*
- *On a "case-by-case" basis: when no 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:*
  - *The board's rationale for selecting a frequency that is different from the frequency that received a plurality*
  - *The company's ownership structure and vote results*
  - *ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices*
  - *The previous year's support level on the company's say-on-pay proposal*
- 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
- 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 severity, breadth, chronological sequence, duration, and the company's efforts at remediation or corrective actions

All Inside Directors and Affiliated Outside Directors

ISS will apparently 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

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

ISS will consider a negative vote for audit committee members on a "case-by-case" basis if 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 severity, breadth, chronological sequence, duration, and the company's efforts at remediation or corrective actions.

Compensation Committee Members

ISS will recommend a negative vote ("against" or "withhold") for compensation committee members (and potentially the full board) if:

- There is a negative correlation between CEO pay and company performance -- particularly for companies that have underperformed their peers over a sustained period
- The company fails to submit one-time transfers of stock options to a shareholder vote
- The company fails to fulfill terms of a burn rate commitment made to shareholders
- The company has "problematic pay practices." ISS' policy regarding problematic pay practices relates to its vote recommendations on re-election of compensation committee members as well as its recommendations on management say-on-pay proposals and equity incentive plans. Pay practices deemed "most egregious" that by themselves may result in negative vote recommendations include:
  - 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 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)

Pay elements that are not directly based on performance are generally considered on a "case-by-case" basis considering the context of the company's overall pay program and demonstrated pay-for-performance philosophy. Specific pay practices that ISS has identified as "potentially problematic" with potential for a negative vote recommendation include:

- Egregious employment contracts (contracts containing multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation)
- New CEO with an overly generous new-hire package (excessive "make whole" provisions without sufficient rationale or any problematic pay practices)
- 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)
- 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 awards in the pension calculation)
- Dividends or dividend equivalents paid on unvested performance shares or units
- Executives using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps, or other similar arrangements

- Excessive severance and/or change in control provisions (payments upon an executive's termination in connection with performance failure or a liberal "change in control" definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring)
- Reimbursement of income taxes on certain executive perquisites or other payments (e.g., personal use of corporate aircraft, executive life insurance, bonus, etc; see also excise tax gross-ups above)
- Overly generous perquisites, including personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances, executive life insurance
- Internal pay disparity (excessive differential between CEO total pay and that of next highest-paid named executive officer)
- 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)
- Other pay practices deemed problematic but not covered in any of the above categories

ISS will consider negative vote recommendations against compensation committee members on a "case-by-case" basis if the company's previous say-on-pay proposal received the support of less than 70 percent of votes cast, taking into account:

- *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*
- *Whether the issues raised are recurring or isolated*
- *The company's ownership structure*
- *Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness*

ISS will also assess company policies and practices related to compensation that could incentivize excessive risk-taking, for example:

- Guaranteed bonuses
- A single performance metric used for short- and long-term plans
- Lucrative severance packages
- High pay opportunities relative to industry peers
- Disproportionate supplemental pensions
- Mega annual equity grants that provide unlimited upside with no downside risk

Factors that potentially mitigate the impact of risky incentives include rigorous clawback provisions and robust stock ownership/holding guidelines.