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Alert
SEC Disclosure and Corporate Governance

Heads Up for 2015 Proxy Season: Two Proxy Advisory Firm Developments

ISS and Glass Lewis Update Proxy Voting Policies

ISS Releases QuickScore 3.0

Last week, Institutional Shareholder Services Inc. (ISS) and Glass Lewis released updates to their proxy voting policies for the 2015 proxy season.[1] ISS also released an update to its QuickScore product, known as "QuickScore 3.0," to be launched on November 24, 2014.[2]

This Alert provides guidance to US companies on how to address ISS and Glass Lewis policy changes, as well as changes to questions and methodology under QuickScore 3.0.

Key Dates:

- November 14, 2014 – Deadline for company verification of QuickScore data (8pm EST)
- Until November 24, 2014 – QuickScore reports no longer accessible
- November 24, 2014 – QuickScore 3.0 to be launched and reports available (9am EST); data verification to become available
- Early December 2014 – QuickScore 3.0 reports to be available on Yahoo! Finance and Bloomberg, and profile reports to be accessible to FactSet subscribers
- Mid-December 2014 – Anticipated release of proxy voting policy FAQs (compensation and non-compensation) and full set of ISS proxy voting summary guidelines
- January 31, 2015 – Deadline for S&P 500 companies holding meetings between March 1 and June 30, 2015 to elect to receive draft proxy voting reports by registering contact details with ISS (annual registration encouraged by ISS)

Changes to ISS and Glass Lewis Proxy Voting Policies

ISS and Glass Lewis proxy voting policy updates for the 2015 proxy season relate to:

- Unilateral bylaw/charter amendments
  - ISS and Glass Lewis have adopted new policies pursuant to which they will generally issue negative vote recommendations against directors if the board amends the bylaws or charter without shareholder approval in a manner that materially diminishes shareholder rights or otherwise impedes shareholder ability to exercise their rights
- Independent board chairs
  - ISS has revised its policy relating to shareholder proposals calling for an independent board chair – with more focus on whether the chairman/CEO roles are combined and less focus on the role of the lead director – which ISS states should lead to a higher level of shareholder support for independent chair shareholder proposals (presumably through more ISS recommendations to vote for the proposal)
  - Glass Lewis has revised its policy to provide that it will recommend against the governance committee chairman where the company has neither an independent chairman nor an independent lead director
- Litigation rights, including exclusive venue, fee-shifting and mandatory arbitration bylaws
  - ISS has revised its policy to apply to proposals relating to bylaws impacting litigation rights more broadly (not just exclusive forum bylaws) which have a material impact on shareholders' litigation rights, including bylaws which mandate fee-shifting or arbitration
  - Glass Lewis has revised its policy to provide that it will issue negative vote recommendations against directors where the board has unilaterally amended the company's governing documents to reduce or remove shareholder rights, including bylaws which mandate fee-shifting or arbitration; Glass Lewis policy is not tied to whether there is a shareholder proposal on the ballot

ISS has also adopted a new Equity Plan Scorecard and amended its policies applicable to shareholder proposals relating to political contributions and greenhouse gas emissions, as described below.

Glass Lewis has issued several additional policy updates, including in relation to proxy access and provisions adopted pre-IPO, as discussed briefly below.

The policy revisions relating to independent chair shareholder proposals and the scorecard approach to evaluating equity plans broadly reflect ISS' policy changes as proposed.[3] ISS did not preview the policy changes relating to unilateral bylaw/charter amendments, litigation rights, political contributions or greenhouse gas emissions. Glass Lewis does not release its proposed policy changes for comment in advance of adopting final policy changes.

1. Unilateral Bylaw/Charter Amendments

ISS Policy – NEW

Under its existing policy, ISS will issue negative vote recommendations against directors individually, committee members or the entire board due to "material governance failures." In previous years, ISS applied this policy to, among other things, unilateral bylaw amendments that ISS considered to be detrimental to shareholders. For example, in 2014, ISS issued negative vote recommendations against directors at companies that adopted bylaws prohibiting director nominees from receiving payments from third parties (such as activists).

For 2015, ISS has adopted a stand-alone policy codifying how ISS applies the “material governance failures” policy to board adoption of certain bylaw/charter amendments without shareholder approval (although note that charter changes typically require shareholder approval). ISS may continue to apply the umbrella “material governance failures” policy to other circumstances as it deems appropriate. Under the new stand-alone policy, ISS will generally issue negative vote recommendations against directors individually, or against committee members or the entire board (except new nominees, who it considers case-by-case) if the board amends the company’s bylaws or charter without shareholder approval in a manner that materially diminishes shareholders’ rights or that could adversely impact shareholders. ISS will consider the following factors in formulating its recommendation:

- The board’s rationale for adopting the amendment without shareholder approval
- Disclosure of any significant engagement with shareholders regarding the amendment
- Level of impairment of shareholders’ rights caused by the amendment
- The board’s track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions
- Ownership structure
- Existing governance provisions
- Whether the amendment was made prior to or in connection with an IPO
- Timing of the amendment in connection with a significant business development
- Other factors that may be relevant to determining the impact of the amendment on shareholders

It is unclear how ISS recommendations will be impacted by the factors listed above. It is also unclear whether certain bylaw/charter amendments will be considered by ISS to be so egregious as to warrant negative recommendations regardless of the existence of any counterbalancing or mitigating factors. Moreover, it is unclear whether ISS will only review *recent* unilateral board actions (which it is focusing on pursuant to its revisions to QuickScore, as discussed below), or whether it instead will take a fresh look every year at *all* bylaws unilaterally adopted by the board, no matter when they were adopted (as it does annually with respect to other governance features it considers problematic, such as whether the company has a shareholder rights plan in place).

ISS has not specified in its proxy voting policy what types of amendments it will view as materially diminishing shareholder rights, although in an email to subscribers announcing the policy changes on November 6, 2014, it mentioned as examples the unilateral extension of a poison pill or an increase in the percentage of shares required to call a special meeting. We anticipate that the forthcoming ISS FAQs will include more examples of amendments that ISS considers materially diminish shareholder rights. In the meantime, additional guidance can be gleaned from the recent addition to QuickScore of a question that mirrors this new stand-alone policy. In the QuickScore context, ISS considers the following amendments to be material, without limitation (some of which would typically require shareholder approval):

- Diminishing shareholder rights to call a special meeting or act by written consent
- Classifying the board
- Increasing authorized capital
- Lowering quorum requirements

In addition, we would also expect that bylaws that disqualify director nominees who receive compensation from anyone other than the company would result in negative vote recommendations from ISS, as described in ISS FAQs published in January 2014.[4]

Notably, unilateral board adoption of exclusive forum bylaws is *not* included in the list of actions that ISS considers to be material for QuickScore purposes. In recent nonpublic discussions, ISS has indicated that the list above was formulated bearing in mind the responses to its 2014-2015 policy survey, and most respondents to that survey did not view the adoption of exclusive venue provisions without shareholder approval to be of significant concern.[5]

Glass Lewis Policy – NEW

Glass Lewis has adopted a new policy for 2015 pursuant to which it will recommend that shareholders vote against the chairman of the governance committee – or the entire committee – where the board has unilaterally amended the company's governing documents to reduce or remove important shareholder rights, or otherwise to impede the ability of shareholders to exercise such rights. Examples include amendments that:

- Eliminate or limit the ability of shareholders to call a meeting or act by written consent
- Increase the vote requirements for charter or bylaw amendments
- Limit the ability of shareholders to pursue full legal recourse, such as bylaws requiring arbitration or fee-shifting/ loser-pays bylaws
- Classify the board
- Eliminate the ability of shareholders to remove a director without cause

As discussed below, Glass Lewis has a separate policy in relation to exclusive forum bylaws.

What To Do Now?

- Companies that have amended bylaws in a way that ISS may consider to materially diminish shareholder rights should prepare to engage with ISS and investors, and may wish to consider including disclosure in the proxy statement relating to the board's rationale for adopting the bylaw. Companies may also wish to contact their analyst at ISS in anticipation of or shortly after proxy statement filing to talk through this and any other issues that could cause ISS to issue a negative vote recommendation
- Consider modifying bylaw amendments in a way that passes muster under ISS and Glass Lewis (e.g., to require *disclosure* of third-party director compensation arrangements when nominating a director candidate, but not prohibiting such arrangements)
- Consider seeking shareholder approval or ratification for bylaw amendments that may be controversial under new ISS and Glass Lewis proxy voting policies

2. Independent Chair

ISS Policy Relating to Independent Chair Shareholder Proposals – *REVISED*

ISS' policy is to generally recommend that shareholders vote for shareholder proposals calling for an independent board chair unless the company satisfies *all* of the following criteria:

- The company designates a lead director, who is elected by and from the independent directors with certain clearly delineated and comprehensive duties
- The board is at least two-thirds "independent" (pursuant to ISS' classification of directors[6])
- The key board committees are fully independent
- The company has disclosed governance guidelines

- The company has not exhibited sustained poor total shareholder return (TSR) performance, defined as one-and three-year TSR in the bottom half of the company's four-digit Global Industry Classification Group (GICS) industry group unless there has been a change in the chairman/CEO position within that time
- The company does not have any problematic governance or management issues (such as egregious compensation practices, multiple related party transactions or other issues putting director independence at risk, corporate or management scandals, excessive problematic governance provisions, or flagrant actions by management or the board with potential or realized negative impacts on shareholders)

For the 2015 season, ISS is adding new governance, board leadership and performance factors to the analytical framework. As revised, ISS's policy will continue to generally recommend that shareholders vote for independent chair shareholder proposals after consideration in a "holistic manner" of the factors listed below, some of which are to be incorporated into its analysis for the first time. Moreover, under the revisions, any single factor that may have previously resulted in a for or against recommendation may be mitigated by other positive or negative factors.

- ***NEW:*** Scope of the proposal – Whether the proposal is precatory or binding and whether it seeks an immediate change in the chairman role or implementation of the policy at the next CEO transition
- ***REVISED:*** The company's current board leadership structure – ISS policy now states that it may support the proposal under the following scenarios absent a compelling rationale: the presence of an executive or non-independent chair in addition to the CEO; a recent recombination of the role of CEO and chair; or departure from a structure with an independent chair
    - ISS will also consider any recent transitions in board leadership and the effect such transitions may have on independent board leadership, as well as the designation of a lead director. ISS policy no longer lists the responsibilities it expects a lead director to have
- ***REVISED:*** The company's governance structure and practices
    - Consistent with existing policy, ISS will consider overall board independence (in accordance with ISS' classification of directors, which has not been amended for 2015), independence of key committees and whether the company has established governance guidelines. In addition, ISS will consider board tenure and its relationship to CEO tenure
    - ISS will continue to consider whether the company has any problematic governance or management issues (for example, poor compensation practices, material failures of governance and risk oversight, related party transactions or other issues putting director independence at risk, corporate or management scandals, and actions by management or the board with potential or realized negative impacts on shareholders)
- ***REVISED:*** Company performance
    - Whether the company has exhibited sustained poor TSR performance. This is defined as one-, three- and five-year TSR compared with the company's peers and the market as a whole. Under its existing policy, ISS considers whether one-year and three-year TSR is in the bottom half of the company's four digit industry group, unless there has been a change in the CEO position within that time

The policy changes do not elaborate on how ISS will incorporate the new factors into its analysis or when one of the new factors will be viewed as having a positive or negative impact. Nor does ISS indicate how it will weight each factor for "holistic" analytical purposes. For example, ISS has not indicated when lengthy board tenure would be considered problematic in this context, although ISS considers director tenure of nine years to be "lengthy" for purposes of its QuickScore governance ratings applicable to US companies.

ISS notes that backtesting of the new methodology using data for the companies targeted in 2014 resulted in a higher level of support for independent chair shareholder proposals – presumably through more ISS recommendations to

vote for the proposal. It seems likely that the presence of an independent lead director with robust responsibilities may no longer persuade ISS to issue a recommendation against such a proposal – unless the company can offer a rationale that ISS considers to be compelling. This risk is particularly acute where a company has recently transitioned to a combined chair/CEO where the roles were previously separated, or where the board has appointed a separate executive chair. ISS cites disapprovingly the recent decision of the board of directors of Bank of America to repeal a shareholder-sponsored binding bylaw amendment mandating an independent chair that received majority support from shareholders in 2009, to enable it to recombine the positions of chair and CEO. The policy updates also state (without citing a study or other support) that "it is debateable whether a lead independent director can act as an effective counterbalance to both a CEO and an executive chair."

Glass Lewis Policy Relating to Independent Board Leadership – *REVISED*

Glass Lewis has revised its policy to provide that it will recommend voting against the chairman of the governance committee where the company has neither an independent chairman nor an independent lead director. This policy will apply whether or not an independent chair shareholder proposal is on the ballot.

What To Do Now?

- Engage with key investors with respect to board leadership matters, especially if the company has or anticipates transitioning to a combined chair/CEO or separate executive chair
- If the company receives an independent chair shareholder proposal, ensure that the board leadership disclosure and the company's statement in response to the proposal included in the proxy statement explain the board's rationale for its leadership structure in the context of the company's own circumstances, and discuss feedback received from key investor outreach in connection with the issue

3. Litigation Rights (Including Exclusive Venue and Fee-Shifting Bylaw Amendments)

ISS Policy – REVISED

Under its policy applicable to the 2014 proxy season, ISS made case-by-case voting recommendations on exclusive venue proposals, taking into account whether the company had been materially harmed by shareholder litigations outside of its jurisdiction of incorporation and whether the company implemented certain good governance features. ISS' policy was silent on fee-shifting bylaws that require a shareholder who sues the company unsuccessfully to pay all litigation expenses of the defendant corporation.

For 2015, ISS has expanded its proxy voting policy to apply to proposals relating to other types of bylaws which have a material impact on shareholders' litigation rights, including bylaws which mandate fee-shifting or arbitration. ISS will now take into account the following factors when evaluating proposals relating to bylaws impacting litigation rights:

- ***NEW:*** The company's stated rationale for adopting such a provision
- ***NEW:*** The breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms
- ***NEW:*** Governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaw)
- ***REVISED:*** Disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or from shareholder lawsuits outside the jurisdiction of incorporation. Previously, ISS stated that it would take into account whether the company had been "materially" harmed by litigation outside its state of incorporation

- ***REVISED:*** Governance features such as the ability to hold directors accountable through annual director elections and a majority voting standard in uncontested elections. Previously, ISS also included the absence of a poison pill (unless the pill was approved by shareholders) as a factor to be considered, but this is no longer specified in the revised proxy voting policy

ISS states that it will generally recommend that shareholders vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., in cases where the plaintiffs are partially successful). Unilateral bylaw provisions that affect shareholder litigation rights will also be evaluated to determine whether they materially diminish shareholder rights or could adversely impact shareholders and therefore warrant negative recommendations against directors, as discussed above under "1. Unilateral Bylaw/Charter Amendments."

Glass Lewis Policy – REVISED

As discussed above, Glass Lewis may recommend that shareholders vote against the chairman of the governance committee – or the entire committee – where the board has unilaterally amended the company's charter or bylaws reducing or removing important shareholder rights, including by adopting bylaws limiting the ability of shareholders to pursue full legal recourse, such as bylaws that require arbitration of shareholder claims, or fee-shifting bylaws.

Note that Glass Lewis has not amended its existing policy in relation to exclusive forum bylaws, which continues to be that exclusive forum bylaws warrant a negative vote recommendation against the chair of the nominating/governance committee, irrespective of the terms of the bylaw or the company's litigation history; Glass Lewis policy is not tied to whether there is a shareholder or management proposal on the ballot in connection with such a provision.

What To Do Now?

- Even if the company has not received a shareholder proposal seeking to repeal a litigation-related bylaw, consider including disclosure in the proxy statement with respect to why a bylaw relating to litigation rights (such as an exclusive forum bylaw) is appropriate for the company under its circumstances (including any relevant litigation history), which may be of assistance when engaging with shareholders

4. ISS Equity Plan Scorecard – NEW

Under its existing policy, ISS recommends that shareholders vote against equity-based compensation plans if the plan fails *any one* of the following tests: the total cost of the plan is unreasonable; repricing is expressly permitted; a pay-for-performance misalignment is found; the company's three-year burn rate exceeds the burn rate cap of its industry group; the plan has a liberal change-in-control definition; or the plan is a vehicle for problematic pay practices.

For the 2015 season, ISS will use a new "scorecard" model (Equity Plan Scorecard, or "EPSC") for evaluating equity compensation plans by considering a range of positive and negative factors, rather than a series of "pass" or "fail" tests. Positive and negative factors can counterbalance each other. Scorecard factors will fall under three "pillars" and will be weighted by reference to company size and status (i.e., S&P 500, Russell 3000, Non-Russell 3000; additional models will be developed for companies that recently made an IPO or emerged from bankruptcy).

The three pillars and their respective weightings are as follows:

- *Plan cost (weighted 45% for S&P 500 and Russell 3000 companies):*
  - The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated shareholder value transfer (SVT) in relation to peers
    - SVT is currently measured using an ISS proprietary binomial option pricing model that assesses the amount of shareholders' equity flowing out of the company to employees and directors, and is expressed as a dollar amount and as a percentage of market value

  - SVT will now be calculated for both (a) new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants ("A+B+C" shares), and (b) only on new shares requested plus shares remaining for future grants ("A+B" shares), thereby eliminating ISS' option overhang carve-out policy; under its existing policy, SVT included the new shares proposed, shares available under existing plans and shares granted but unexercised

- *Plan features (weighted 20% for S&P 500 and Russell 3000 companies):*
  - Automatic single-triggered award vesting upon a change-in-control
  - Discretionary vesting authority
  - Liberal share recycling on various award types; this factor will no longer be incorporated in SVT calculations as is the case under existing policy
  - Minimum vesting period for grants made under the plan
- *Grant practices (weighted 35% for S&P 500 and Russell 3000 companies):*
  - The company's three-year burn rate relative to its industry/market cap peers, eliminating commitments from companies to adhere to specific future burn rate caps; burn rate benchmarks will be calibrated for respective index groups (i.e., S&P 500, Russell 3000 and Non-Russell 3000), with the relevant GICS industry classification used within each index group. ISS noted in its email blast to subscribers on November 6, 2014 that ISS will be implementing separate burn rate thresholds for the S&P 500, which tend to be significantly lower than the Russell 3000 burn rates
  - Vesting requirements in the most recent CEO equity grants (applying a three year look-back)
  - The estimated duration of the plan based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years; note that an ISS representative at a recent conference indicated that ISS expects that companies should be prepared to seek shareholder approval of equity plans every four to five years[7]
  - The proportion of the CEO's most recent equity grants/awards subject to performance conditions
  - Whether the company maintains a clawback policy
  - Whether the company has established requirements to hold shares after exercise or vesting

The revised policy states that ISS will generally recommend that shareholders vote against a plan if the combination of the above factors indicates that the plan is not, overall, in the shareholders' interests, or if any of the following "egregious" circumstances apply:

- Awards may vest in connection with a liberal change-in-control definition
- The plan would permit repricing or cash buyout of underwater options without shareholder approval (either by expressly permitting it (for NYSE and Nasdaq companies), or by not prohibiting it when the company has a history of repricing)
- The plan is a vehicle for problematic pay practices or a pay-for-performance disconnect
- Any other plan features are determined to have a significant negative impact on shareholder interests

ISS has stated that it will provide more information about the policy and weightings in its forthcoming FAQs.

What To Do Now?

- Review any equity compensation plan to be approved by shareholders through the lens of the new Equity Plan Scorecard approach and consider engaging with shareholders to explain the rationale underpinning the new plan
- Companies planning to include an equity compensation plan on the ballot of the next meeting should register to gain access to the ISS Equity Plan Data Verification Portal and review the data points that ISS considers as part of its new scorecard approach, each as discussed in our Alert dated October 17, 2014[8]

5. Political Contributions – *REVISED*

Under its policy applicable to the 2014 proxy season, ISS generally recommended voting for proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities. ISS considered the company's disclosure of policies and oversight mechanisms related to direct political contributions and payments to trade associations or other groups that may be used for political purposes (including information on the types of organizations supported and the business rationale for such support), and recent significant controversies, fines or litigation related to the company's political contributions or activities.

ISS has refined its current policy by indicating separately the factors considered regarding oversight and indirect political contribution activity, including by specifically noting that management and board oversight mechanisms are reviewed and considered, and broadening the disclosure that ISS will take into account. Specifically, for 2015, ISS will consider:

- The company's policies and management and board oversight related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes
- The company's disclosure regarding its support of and participation in trade associations or other groups that may make political contributions
- Recent significant controversies, fines or litigation related to the company's political contributions or activities

What To Do Now?

- Consider whether it would be appropriate for the company to disclose additional information about the company's political and trade association contributions

6. Greenhouse Gas (GHG) Emissions – *REVISED*

Under its existing policy, ISS made case-by-case recommendations on shareholder proposals that called for the adoption of GHG reduction goals from products and operations. ISS considered overly prescriptive requests for reduction in GHG emissions by specific amounts or within a specific time frame, the company's disclosure compared to industry peers, any significant fines or litigation or other controversy related to GHG emissions, the feasibility of GHG emissions reduction, and whether the company already provides meaningful disclosure on GHG emissions from its products and operations.

ISS has revised its list of factors to remove the factors relating to overly prescriptive requests and the feasibility of emissions reductions, and to expand the disclosure required. For 2015, ISS will take into account the following factors:

- Whether the company provides disclosure of year-over-year GHG emissions performance data
- Whether company disclosure lags behind industry peers
- The company's actual GHG emissions performance
- The company's current GHG emission policies, oversight mechanisms and related initiatives

- Whether the company has been the subject of recent, significant violations, fines, litigation or controversies related to GHG emissions

What To Do Now?

- Consider whether it would be appropriate to disclose additional information about company policies and practices relating to GHG emissions, and emission performance data

Overview of Additional Glass Lewis Policy Changes

1. Proxy Access – *NEW*

Glass Lewis previously refrained from establishing any specific parameters with regard to proxy access voting recommendations. For 2015, it has adopted a policy to generally support access to the proxy for significant, long-term shareholders. In evaluating a particular proxy access proposal, Glass Lewis will consider the following factors:

- Specified minimum ownership for shareholders to nominate one or more directors
- Holding requirement for shareholders to nominate one or more directors
- Company size
- Company performance
- Company responsiveness to shareholders

2. Board Responsiveness to Majority-Approved Shareholder Proposals – *REVISED*

Glass Lewis has expanded its policy to specify that in determining whether a board has sufficiently implemented a majority-supported shareholder proposal, it will examine the "quality of the right enacted or reasons proffered by the board" for any conditions that may unreasonably interfere with the shareholders' ability to exercise the right (e.g., overly prescriptive procedural requirements for calling a special meeting).

3. Vote Recommendations Following an IPO – *REVISED*

Glass Lewis is increasing its scrutiny of provisions adopted in a company's charter or bylaws prior to an IPO. Glass Lewis will now consider recommending that shareholders vote against all directors who served at the time of the adoption of an anti-takeover provision, such as a poison pill or classified board, if the provision is not subject to a shareholder vote following the IPO. In addition, Glass Lewis will recommend that shareholders vote against the entire governance committee if an exclusive forum or fee-shifting bylaw has been adopted pre-IPO, if such provision is not subject to a shareholder vote following the IPO.

4. Standards for Addressing "Material" Transactions with Directors – *REVISED*

Regarding Glass Lewis' $120,000 threshold for directors employed by a professional services firm, Glass Lewis has clarified that it may deem such a transaction to be immaterial where the amount represents less than 1% of the other firm's annual revenues and the board provides a compelling rationale as to why the director's independence is not affected by the relationship.[9]

5. Say-on-Pay Consideration of One-Off Awards and Clawback Policies – *NEW*

Glass Lewis has added a discussion of its approach to analyzing "one-off" awards to executive officers granted outside of existing incentive programs, which it analyzes as part of its say-on-pay evaluation. Glass Lewis takes the position that shareholders should generally be wary of awards granted outside of the standard incentive plans, but recognizes that in some circumstances, additional incentives for executives may be appropriate, provided the company provides a thorough description of the awards, including a cogent and convincing explanation of their necessity and why existing awards do not provide sufficient motivation.

In addition, Glass Lewis has added a discussion of its approach to clawback policies applicable to current or former executives. Glass Lewis believes it is prudent for boards to adopt detailed and stringent bonus recoupment policies to prevent executives from retaining performance-based awards that were not truly earned. Specifically, such clawback policies should be triggered in the event of a restatement of financial results or a similar revision of performance indicators upon which bonuses were based, and should be subject to only limited discretion.

6. Employee Stock Purchase Plans – *REVISED*

Glass Lewis has added a discussion of its approach to analyzing employee stock purchase plans subject to a shareholder vote. Glass Lewis states that such plans can provide employees with a sense of ownership in the company and help strengthen the alignment between the interests of employees and shareholders. Except in extreme cases or where the plan includes an "evergreen" provision, Glass Lewis will generally support employee stock purchase plans within the regulatory purchase limit of $25,000 per employee per year.

ISS Releases Governance QuickScore 3.0

Late October 2014, ISS announced a revamp of its ISS Governance QuickScore rating product and the opening of its related data verification window. Information about QuickScore 3.0, including the revised technical document discussing the methodology and specific factors – including revisions to QuickScore 2.0 – is available at http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore/. ISS has added some new factors, modified existing factors and changed factors that were previously assigned "zero-weight" to now be scored, and has made other changes to its methodology. ISS provides companies with the opportunity to verify their data against QuickScore 3.0's revised methodology by **November 14, 2014**. ISS provides only minimum guidance – indeed, less guidance than it provided under QuickScore 2.0, as discussed below – as to how particular factors are weighted or the circumstances in which it will award a "red flag" or "green star" with respect to a particular factor.

1. *New Factors*

QuickScore 3.0 introduces three new weighted factors and one new zero-weight factor applicable to US companies:

- Weighted: ***Unilateral board action that materially reduces shareholder rights*** – Whether the board "recently" took action that materially reduces shareholder rights (e.g., through a bylaw amendment that was not approved by shareholders)
  - ISS considers the following amendments to be material, without limitation (some of which would typically require shareholder approval where such amendment is in the charter): diminishing shareholder rights to call a special meeting or act by written consent, classifying the board, increasing authorized capital and lowering quorum requirements. As discussed above, exclusive forum bylaws are not included in the list of unilateral board actions that ISS considers to warrant negative QuickScore treatment
  - ISS considers the following factors to be relevant in evaluating board accountability: the track record of directors, the level of board independence, other governance concerns, the type of amendment and the vote standard for amendments by shareholders; however, it is not clear how those factors are weighted and whether they could mitigate a negative score that would otherwise accompany a bylaw amendment that materially diminishes shareholder rights
  - It is unclear what time period ISS is considering when determining if a board action was taken "recently" (e.g., whether ISS is primarily concerned with actions taken since the last annual meeting or whether actions taken in prior periods will also be reviewed); see also the discussion above in relation to ISS' new proxy voting policy relating to unilateral bylaw amendments

- Weighted: ***Policy requiring annual board evaluations*** – Whether the company has disclosed a policy requiring an annual performance evaluation of the board
  - ISS is of the view that board evaluations should cover not just the board and its committees, but *individual directors* as well. According to ISS, an assessment should consider (a) in the case of the board or a board committee, its mandate or charter, and (b) in the case of an individual director, the applicable position description(s), as well as the competencies and skills each individual director is expected to bring to the board
  - This question will evaluate whether the company organizes board evaluations, as well as the nature of such evaluation (frequency, individual, outside assessment). Guidance is not provided as to how different approaches to board evaluation would be weighted (e.g., whether outside assessments will be viewed the same as or more favorably than internal assessments, and how ISS will view an approach to board evaluations that utilizes internal assessments some years and externally facilitated evaluations in other years)
- Weighted: ***Sunset on unequal voting structure*** – Whether there are conditions pursuant to which any unequal voting structure (excluding certain convertible securities with voting rights) will be terminated and an equal voting structure will take its place
- Zero-Weight: ***Controlling shareholder*** – Whether the company has a "controlling shareholder," which ISS defines to mean a shareholder or shareholders acting in concert and holding a majority of the voting rights. Whether or not a company has a "controlling shareholder" is a zero-weight factor that is noted on the QuickScore report but does not impact the numerical QuickScore

2. *Modified Factors*

ISS has modified certain factors applicable to US companies:

- *Shareholder support for say-on-pay* – QuickScore 3.0 will consider whether the company's most recent say-on-pay proposal received shareholder support ***below 70% of votes cast***, which is in line with ISS' proxy voting policy as to when ISS will review the board's responsiveness to a say-on-pay proposal. Under QuickScore 2.0, a company's say-on-pay result was compared to the average level of support across the company's industry (based on 4-digit GICS groups) and index (S&P 500, S&P 400, S&P 600 or Russell 3000 excluding S&P 1500).
- *Shareholder support for directors* – QuickScore 3.0 will consider the percentage of directors who received shareholder support ***below 80% of votes cast*** at the most recent shareholder meeting, instead of the previous threshold of 95% of votes cast.
- *Independence classification of directors elected outside of a shareholder meeting* – ISS has stated that for it to make a preliminary determination of whether a newly appointed director elected outside of a shareholder meeting is independent under ISS standards, it seeks public disclosure of the following information with respect to the director: (a) the director's current position, (b) the company's determination of whether the director is independent under applicable listing standards, (c) any previous employment at the company, (d) any familial relationships with the company's executives or directors, and (e) any related person transactions (per Item 404(a) of Regulation S-K) in the last fiscal year between the company and the director, the director's employer or the employer of an immediate family member of the director.
  - We believe that ISS will use the information disclosed on Form 8-K to ascertain the independence under its own standards of a newly elected director until the company files its proxy statement with more fulsome disclosure with respect to that director – and that the existence of any of the relationships referred to in (c), (d) or (e) above should not otherwise render a newly elected director not independent under ISS' bright-line independence standards
    - For example, ISS' director classification standards currently apply a five year look-back with respect to former employment (other than as CEO) and there is no bright-line test that would render a director not independent if he or she has a material interest in a related person transaction[10]

- *Investigations* – When evaluating whether the company or a director or officer is currently under investigation by a regulatory body, investigations will be categorized as "routine" or "non-routine" and weighted differently (although all investigations will be noted on the QuickScore report), for example:
  - "Routine" – generally includes civil investigation demands, billing/false claims investigations, promotion, market or sale of products investigations, and accounting and tax practices investigations – unless a "non-routine" classification is warranted because there is an indication that major fraud or risk is involved
  - "Non-routine" – generally includes Wells notices, FCPA-related investigations, investigations which raise serious ethical concerns, investigations into matters that pose potential risks to the broader financial system (e.g., LIBOR manipulation, mortgage fraud, high frequency trading or other serious one-off investigations), and investigations that would otherwise be classified as "routine" except for the scale and scope of the investigation
- *Enforcement actions* – When evaluating whether enforcement actions have been taken against the company or a director or officer, QuickScore 3.0 will review such actions by all regulators (not just securities regulators, as under QuickScore 2.0) and will apply a two *calendar* year look-back (instead of a look-back of the past two *fiscal* years). For the first time, QuickScore will assess the materiality of any penalties, considering the nature of the underlying investigation(s), the size of any monetary penalties (on an absolute basis and where levied against the company, relative to certain financial metrics), as well as any non-monetary penalties or requirements. QuickScore will also consider settlement agreements with regulatory bodies, even if the company, director or officer "denies the allegations underlying the investigation."

3. *Changes Relating to "Zero-Weight" Factors*

Several factors that were previously zero-weight factors under QuickScore 2.0 will now be weighted and factor into scoring under QuickScore 3.0:

- Number of women directors – ISS does not indicate a recommended number of women nor how this factor is weighted
- Number of audit committee financial experts – this is now a scored factor for companies with zero, one or two audit committee financial experts

In addition, QuickScore 3.0 now considers whether or not a company's shareholder rights plan requires a three-year independent director evaluation (i.e., a TIDE provision) to be a *zero-weight* factor. Other factors relating to shareholder rights plans are still scored. The remaining zero-weight factors under QuickScore 3.0 (which are unchanged) are listed below:

- Board size – ISS considers that boards should have between 6 and 15 members, and that 9-12 members is "ideal"
- Percentage of the board that consists of immediate family members of majority shareholders, executives or former executives (within the past five years)
- Percentage of the board that consists of former or current employees of the company (within the past five years for non-CEO employees; former CEOs will always be considered affiliated)
- Length of any employment agreement with the CEO
- Degree of alignment between the company's cumulative 3-year pay percentile ranks, relative to peers, and its 3-year cumulative TSR rank, relative to peers
- Degree of alignment between the company's one-year pay percentile ranks, relative to peers, and its one-year TSR rank, relative to peers
- Whether the company has a controlling shareholder (discussed above)

It is possible that ISS could transition these to be weighted factors in future iterations of QuickScore, as it did this time around with respect to board gender diversity and audit committee financial experts.

4. *Changes Relating to Methodology or Presentation*

Several additional changes have been made to QuickScore 3.0:

- The technical document no longer includes references to “quantitative testing” and “correlation with performance and risk measures” that were previously included in the QuickScore 2.0 document with respect to analysis for the US and Japanese markets. Instead, QuickScore 3.0 is “derived from a scoring methodology that focuses on the qualitative aspect of governance”, which was previously applied to markets other than the US and Japan. It is unclear whether ISS has changed QuickScore’s foundational methodology for the analysis of US companies (e.g., to no longer require hard data evidencing the benefits of particular governance practices) and, if so, whether this will result in differing weights being applied to certain factors
- ISS has renamed two of the four QuickScore pillars – “Shareholder Rights” is now “Shareholder Rights & Takeover Defenses” and “Audit” is now “Audit & Risk Oversight,” while “Board Structure” and “Compensation” remain unchanged. It is unclear whether the nomenclature changes signal that ISS may be weighting certain questions differently under those two pillars
- ISS has expanded QuickScore coverage to an additional 100 European companies and 400 companies in emerging markets. Brazil, Russia and South Africa and being added in November 2014, and China, India and South Korea are being added in February 2015

5. *Removal and Modification of Acceptability Thresholds*

ISS has removed several references to thresholds (or “magic numbers”) that ISS considers acceptable, thereby reducing transparency as to what ISS considers sufficient to raise a “red flag.” Other than as noted below, it is unclear whether the thresholds that were previously disclosed are still in effect or whether ISS is applying different thresholds to the impacted questions.

- *Number of directors failing to receive majority shareholder support* – ISS no longer provides guidance as to the level of concern associated with the number of directors receiving majority opposition; previously, it stated that two or more directors receiving majority opposition will raise a “moderate” level of concern, and one director receiving majority opposition will raise a “smaller” level of concern. ISS has also clarified that it is concerned with votes cast (i.e., For/(For + Against)), not including abstentions
- *Size of the CEO’s one-year total pay as a multiple of the median total pay for company peers* – ISS no longer states that “multiples of greater than 2.33” will begin to raise a pay-for-performance concern
- *Degree of alignment between the company’s TSR and change in CEO pay over the past five years* – ISS no longer provides that measures “below -30% may raise a moderate level of concern, rising to significant concern for measures below -45%”
- *Ratio of the CEO’s non-performance-based compensation (All Other Compensation) to Base Salary* – ISS no longer states that a greater than 75% ratio raises governance risk concern
- *Equity compensation plan burn rate* – ISS now states it will consider a company’s burn rate relative to the rate that is one standard deviation higher than the mean of the company’s applicable index and industry. Under QuickScore 2.0, burn rates were considered excessive where average annual option grants exceeded the higher of 2% of outstanding shares over the past three years or one standard deviation from the three-year industry mean

- *Basis for the change-in-control payment for the CEO* – ISS no longer states that payments based on salary plus target or actual bonuses are generally considered acceptable. Given that several companies received "red flags" under QuickScore 2.0 for change-in-control payments that were calculated by reference to salary plus target or actual bonuses, we believe that ISS is applying a more stringent threshold to this question
- *Shareholder rights plans* – QuickScore 3.0 provides that best practice is for a shareholder rights plan (other than a shareholder rights plan designed to preserve net operating losses) to have a trigger "no lower than 20%" and no longer provides that more recently implemented poison pills deserve additional scrutiny

6. *Other Changes*

Several other changes serve to more closely align the QuickScore questions with the corresponding proxy voting policy, while others are in the nature of clarifying amendments:

- QuickScore considers the boards of subsidiaries with their own publicly-traded stock to be "outside" boards for purposes of determining whether the CEO serves on an "excessive" number of outside boards
- ISS has added missing only one meeting to its list of "valid excuses" for directors who attend less than 75% of board and committee meetings, and clarifies that for US companies, this question will look at attendance at meetings of the board and all committees – not just the three key committees
- ISS has clarified that deferred share units are included in the determination as to whether all directors with more than one year of service own stock
- When considering whether any executive or director pledges company shares, ISS has clarified that QuickScore will consider pledging of shares of an institution or company where a director or executive has a beneficial ownership, presumably so that directors and executives cannot circumvent this factor by pledging shares via a holding company or other entity
- The QuickScore factor relating to whether the company has a policy prohibiting hedging of company shares by employees now states that hedging policies that have a pre-clearance or pre-approval requirement will be considered "not robust"
- In determining whether the board has adequately responded to a shareholder proposal receiving majority support, ISS has clarified that, in general, this determination will be based on disclosure in the proxy statement for the annual meeting after the majority vote was received
- ISS now provides that a "liberal" definition of change-in-control includes a trigger linked to shareholder approval of a transaction, rather than its consummation, or an unapproved change in less than a substantial proportion of the board, or acquisition of a low percentage of outstanding common stock (such as 15%)
- In determining the minimum vesting periods mandated in plan documents for options, stock appreciation rights and restricted stock, QuickScore 3.0 clarifies that ISS will only take into account vesting periods as specified in a shareholder-approved equity plan – and will not take into account actual vesting terms as disclosed in the proxy statement
- QuickScore 3.0 clarifies that convertible securities entitled to various voting rights that are equal to the number of converted common shares are excluded from the determination of whether the company has classes of common stock with different voting rights
- QuickScore 3.0 includes new guidelines for determining if a company has a material restatement and specifies examples of misstatements that are generally excluded (including segment changes, discontinued operations, M&A-related restatements, general accounting changes under GAAP and changes made for presentation purposes), and clarifies that it is focused on restatements that have taken place during the past two years (as opposed to restated periods that have occurred during the past two years)

What To Do Now?

- Provide feedback before the data verification website closes on ***Friday, November 14 at 8pm EST***, referencing public filings where appropriate (like QuickScore 2.0, QuickScore 3.0 relies on information contained in a company's public filings). Information about verifying data, how to obtain log-in information and a link to the data verification website is available at http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore/. As was the case with QuickScore 2.0, submissions of corrected or updated data factors can be made online through the platform
  - Check whether you have an individual user-name to access ISS' Governance Analytics platform and, if not, apply for one immediately so that login information will be provided in time to conduct data verification before the deadline. ISS has changed its login system so that company-wide verification accounts with numerical IDs that may have been used to verify data under QuickScore 2.0 will no longer be available for use. A user-name and password can be requested by sending an email to contactus@isscorporatesolutions.com
  - Companies that anticipate filing a proxy statement in the coming weeks should note that data verification is not available during the period between the filing of a company's proxy statement and the publication of ISS' proxy analysis for the company's annual meeting
  - Data can also be verified after QuickScore 3.0 has launched on November 24, 2014
- Consider providing information about QuickScore 3.0 at the next meeting of the Nominating and Governance Committee and potentially the Compensation Committee, particularly in relation to increased ISS focus on bylaw amendments without shareholder approval, board evaluations and board gender diversity
- Review the section relating to board evaluations in the Corporate Governance Guidelines and/or the proxy statement, and consider expanding to address the matters that ISS believes evaluations should cover
  - If the company does not already do so, consider requiring annual assessments of individual directors, as well as the board and its committees, and consider specifying that externally facilitated board evaluations will take place periodically
- Although not required where such a relationship does not exist, consider whether Form 8-Ks reporting new director appointments should include more detailed disclosure with respect to "independence" criteria as defined by ISS, in addition to definitions set forth in SEC rules and stock exchange listing standards

As with QuickScore 1.0 and 2.0, companies that have adopted many of the best practices advocated by ISS may find themselves with QuickScores that are in the middle of the pack or below average, as each QuickScore will reflect a company's relative rank. Directors and management should continue to make governance decisions in the best interests of the company, depending on the company's particular circumstances, rather than be driven by a desire to increase QuickScores in line with rigid one-size-fits-all prescriptions.

General Guidance for Preparing for 2015 Proxy Season

ISS typically provides its proxy voting policies in draft form to companies that are in the S&P 500 and that have registered with ISS to receive draft reports. Companies then have a very narrow time window (48 hours) in which to correct any data errors or to otherwise engage with ISS on any issues. Companies that are not in the S&P 500 generally do not receive access to draft reports; ISS has not expanded the range of companies that are entitled to preview proxy voting reports. We encourage all companies to become familiar with the more than 40 circumstances in which ISS may recommended 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 that companies:

- If the company is in the S&P 500, ensure that it has elected to participate in the voting recommendation preview process by registering contact details with ISS before ISS' deadline, which is **January 31, 2015** for meetings held between March 1 and June 30, 2015; for meetings outside of this timeframe contact information must be provided at least 30 business days prior to the meeting. ISS requests that this information be provided on an **annual basis**
  - Company contact information can be provided using the form available at this link: http://www.issgovernance.com/iss-draft-review-process-u-s-issuers/
  - More information about the preview process is available in our Alert dated July 18, 2014[11]
- Carefully review proxy voting reports relating to the company (whether pursuant to the "preview" process discussed above or otherwise) – with input from outside counsel and compensation consultants, as appropriate – and notify the relevant proxy advisory firm of any errors as soon as possible
- Review the company's corporate governance and compensation practices for potential vulnerabilities under ISS' policy updates (for example, in relation to any equity compensation plans that may be up for a vote at the next annual meeting or an independent chair shareholder proposal) and decide what action, if any, to take in light of this assessment
- Develop 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, and/or a poor "say-on-pay" voting result (less than 70% of votes cast)
- Review last year's compensation and governance disclosure, and plan to make improvements in this year's proxy statement where appropriate – particularly if the company has received comments on this disclosure from the SEC staff
- Ensure that shareholder engagement efforts continue to focus on what is of importance to shareholders and why, as a general rule, shareholders should generally defer to the board's recommendations, given the fiduciary nature of board oversight, particularly where there are no performance issues or other red flags that would warrant special attention

* * *

ENDNOTES

1. ISS, "US Corporate Governance Policy 2015 Updates" (November 6, 2014), *available at* http://www.issgovernance.com/file/policy/2015USPolicyUpdates.pdf; Glass Lewis, "Guidelines for the 2015 Proxy Season" (2015), *available at* http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf (hereinafter, "GL 2015 Guidelines").
2. ISS, "Governance QuickScore 3.0: Overview and Updates" (October 2014), *available for download at* http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore-downloads/.
3. ISS, "2015 Benchmark Policy Consultation" (October 15, 2014), *available at* http://www.issgovernance.com/policy-gateway/2015-benchmark-policy-consultation.
4. ISS, "Director Qualification/Compensation Bylaw FAQs" (January 13, 2014), *available at* http://www.issgovernance.com/file/files/directorqualificationcompensationbylaws.pdf.
5. ISS, "2014-2015 Policy Survey Summary of Results" (September 2014) at 12, *available at* http://www.issgovernance.com/file/publications/ISS2014-2015PolicySurveyResultsReport.pdf.
6. For ISS' standards for classification of directors, *see* ISS, 2014 U.S. Proxy Voting Summary Guidelines (March 12, 2014) at 15-17, *available at* http://www.issgovernance.com/file/2014_Policies/ISSUSSummaryGuidelines2014March12.pdf.
7. Remarks of Carol Bowie, The Proxy Disclosure Conference, Las Vegas, NV (September 29, 2014).
8. Weil Alert, "Heads Up for the 2015 Proxy Season: ISS Spotlight on Independent Chair Shareholder Proposals and Equity Compensation Plans" (October 17, 2014), *available at* http://www.weil.com/~/media/files/pdfs/pcag_sec_discl_alert_oct_2014.pdf.
9. For Glass Lewis' standards for classification of directors, *see* GL 2015 Guidelines at 3-5.
10. Note that under the ISS director classification standards in effect several years ago (during the period ISS was known as "RiskMetrics"), a director who had a "related party transactional relationship to the company" was deemed *not* to be independent; however, this standard was removed pursuant to policy changes that took effect for the 2010 proxy season.
11. Weil Alert, "Two New Proxy Advisory Firm Developments: What They Mean for Corporate Issuers" (July 18, 2014), *available at* http://www.weil.com/~/media/files/pdfs/pcag_sec_discl_alert_july2014.pdf.

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 Weil's Public Company Advisory Group:

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We thank our colleagues Rebecca Grapsas and Reid Powell for their contribution to this Alert.

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Appendix

Circumstances in Which ISS Will Make a Negative Vote Recommendation in Uncontested Director Elections in 2015

According to ISS proxy voting policies applicable to shareholder meetings held on or after February 1, 2015, ISS has identified more than 40 circumstances that may support a negative vote recommendation in uncontested elections of directors. These circumstances are outlined below. Changes from ISS' 2014 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, or with respect to 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

Unilateral Bylaw/Charter Amendments:

- *Board amendment of the company's bylaws or charter without shareholder approval/ratification in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders, considering the following factors, as applicable:*
  - *The board's rationale for adopting the bylaw/charter amendment without shareholder approval or ratification*
  - *Disclosure by the company of any significant engagement with shareholders regarding the amendment*
  - *Level of impairment of shareholders' rights caused by the board's unilateral amendment to the bylaws/charter*
  - *The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions*
  - *The company's ownership structure and existing governance provisions*
  - *Whether the amendment was made prior to or in connection with the company's IPO*
  - *The timing of the board's amendment to the bylaws/charter in connection with a significant business development*
  - *Other relevant factors*

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 votes cast in the previous year. Factors that will be considered are:
  - Disclosed outreach efforts by the board to shareholders in the wake of the vote
  - The board's rationale, as provided in the proxy statement, for the level of implementation of the proposal
  - Subject matter of the proposal
  - Level of support for and opposition to the proposal at past meetings
  - Board actions in response to the majority vote and its shareholder engagement
  - Continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals)
  - Other factors as appropriate
- 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:
  - 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

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 of the company 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" the following governance practices – 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. ISS 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 (internal control over financial reporting) 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:
  - 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
- 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, 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
  - 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,” 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):
  - Egregious employment contracts (contracts containing multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation)
  - Overly generous new-hire package for new CEO (excessive "make whole" provisions without sufficient rationale or any problematic pay practice)
  - 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 or other long-term awards in the pension calculation)
  - Dividends or dividend equivalents paid on unvested performance shares or units
  - 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)
  - Internal pay disparity (excessive differential between CEO total pay and that of the 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