

Securities Regulation and Compliance Alert

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ISS Releases 2014 Proxy Voting Policy Updates; Opens Process for Peer Group Modification

On November 21, 2013, Institutional Shareholder Services (ISS) released updates to its proxy voting policies effective for shareholder meetings taking place on or after February 1, 2014. The changes to ISS' U.S. voting policies relate to its pay-for-performance quantitative screen and board responsiveness to majority-supported shareholder proposals and are consistent with the proposed updates issued by ISS on October 21, 2013. ISS also has updated its policy on shareholder proposals relating to lobbying disclosure and added a new policy to address proposals requesting a human rights risk assessment.

Pay-for-performance quantitative screen. ISS uses several pay-for-performance metrics to gauge the alignment between executive compensation and performance. For 2014, ISS' Relative Degree of Alignment (RDA) measure will compare a company's total shareholder return (TSR) rank with its CEO total pay rank within the company's peer group over a three-year period (or as many full fiscal years as the company has been publicly traded and disclosed pay data). The measure previously used a weighted average of TSR rank against CEO total pay rank over a one-year period (weighted 40 percent) and a three-year period (weighted 60 percent).

According to ISS, the previous weighted average method over-emphasized the most recent year, while the new method provides a better view of long-term pay and performance alignment that avoids being overwhelmed by periods of volatility and mean-reversion. The new method better addresses companies that have only two years of available data and reduces the mismatch that occurs when companies grant equity awards early in the year, before performance has been determined.

Board responsiveness to majority-supported shareholder proposals. In 2014, ISS will recommend votes case-by-case on individual directors, committee members or the entire board of directors as appropriate if, among other things, the board failed to act on a shareholder proposal that received the support of a majority of the shares 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;
- Rationale provided in the proxy statement for the level of implementation;
- The subject matter of the proposal;
- The level of support for and opposition to the resolution in past meetings;

- Actions taken by the board in response to the majority vote and its engagement with shareholders;
- The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
- Other factors as appropriate.

The “majority of the shares cast in the previous year” threshold is a previously announced departure from the previous triggers of either two years of a majority of votes cast in a three-year period, or one year of a majority of shares outstanding. While the previous policy recommended that shareholders “vote against or withhold from individual directors, committee members, or the entire board of directors as appropriate,” the new policy recommends votes on a case-by-case basis. As proposed, taking into consideration the board’s rationale as provided in the proxy statement for the level of implementation is a new addition.

Shareholder proposals relating to lobbying activities. For 2014, ISS will recommend votes on a case-by-case basis on proposals requesting information on a company’s lobbying (including direct, indirect and grassroots lobbying) activities, policies or procedures, considering:

- The company’s current disclosure of relevant lobbying policies, and management and board oversight;
- The company’s disclosure regarding trade associations or other groups that it supports, or is a member of, that engage in lobbying activities; and
- Recent significant controversies, fines or litigation regarding the company’s lobbying-related activities.

The update clarifies that ISS will consider both executive and board-level oversight. It also removes considerations that ISS felt were outdated and adds a new focus on trade associations.

Human rights risk assessment. In response to new human rights related shareholder proposals filed in 2013, ISS has adopted a new policy. For 2014, ISS will recommend, on a case-by-case basis, votes on proposals requesting that a company conduct an assessment of the human rights risks in its operations or in its supply chain, or report on its human rights risk assessment process. Among the matters to be considered when making these recommendations are:

- The degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms;
- The company’s industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
- Recent, significant controversies, fines or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and
- Whether the proposal is unduly burdensome or overly prescriptive.

Peer group feedback. For purposes of benchmarking CEO pay, ISS typically constructs peer groups taking into consideration company-selected peers disclosed in the previous year’s proxy. To provide more up-to-date information and take account of the fact that some companies may have changed their self-selected peers since the 2013 proxy season, ISS is soliciting submission of updated peer groups through **December 9, 2013**.

The electronic submission form can be found [here](#). Note that after submitting the electronic form, companies must confirm submissions by sending ISS an electronic copy (scanned PDF or equivalent) of the submitted list on the company's letterhead along with the submitter's name, email address and company name, to peerfeedback@issgovernance.com.

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An overview of U.S. Corporate Governance Policy 2014 Updates can be found [here](#). ISS has announced that it intends to release a complete set of updated policies and updated Frequently Asked Questions in December 2013.

In addition to updating its 2014 Proxy Voting Policies, ISS has begun seeking comments on longer-term changes to voting policies as part of an ongoing consultation process that will run until February 2014. Topics relevant to U.S. issuers include director tenure, director independence, independent chair shareholder proposals, auditor ratification and equity-based compensation plans. Further details on each of these areas and the consultation process in general can be found [here](#).