

ISS 2014 U.S. Policy Updates

■ By **Matt Vnuk** and **Dan Laddin**

On November 21st, ISS released its final 2014 policy updates which apply to shareholder meetings on or after February 1, 2014. The U.S. policy changes – related to the Relative Degree of Alignment pay versus performance test and majority supported shareholder proposals – were largely consistent with the proposal issued in October and reflect relatively modest changes from past practice.

ISS POLICY UPDATE – RDA TEST

For the past two years ISS has used three quantitative pay vs. performance tests related to CEO pay and company performance (absolute Pay-TSR Alignment / PTA; Multiple of Median / MOM; and Relative Degree of Alignment / RDA) to screen for companies where a potential pay-for-performance misalignment may exist. In addition to the quantitative screen, ISS will always conduct a qualitative analysis of the pay program. If Medium or High concern is identified through the quantitative pay vs. performance screen, the qualitative analysis will be more robust.

For 2014, ISS modified the RDA test. In the past the RDA screen had been calculated as the difference between the company's TSR rank and the CEO's total pay rank within a peer group, as measured over one-year and three-year periods. The one-year and three-year periods were weighted 40% and 60%, respectively. The new methodology is focused on three years only. In addition, the RDA policy updates indicates that companies with less than three years of pay and performance data will still be subject to the RDA test, which reflects a change versus past practice.

CAP Perspective: *We agree with ISS' decision to apply a longer-term focus to the quantitative RDA test; i.e., solely a three-year timeframe for both pay and*

performance. However, we believe that recent Committee decisions best relate to company performance over time.

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BOARD RESPONSE TO MAJORITY SUPPORTED SHAREHOLDER PROPOSALS

For 2014, ISS made three changes to its policy on Board responsiveness to majority-supported shareholder proposals.

1. ISS will review the responsiveness of a Board to any shareholder proposal that receives one year of a majority of votes cast support (rather than the previous "triggers" of either two years of a majority of votes cast in a three-year period, or one year of a majority of shares outstanding);
2. ISS adopted a case-by-case approach, including a list of factors for Analysts to consider, for assessing implementation of majority vote proposals;
3. Finally, ISS provided Analysts with broader discretion when determining which directors to hold accountable in the event the level of responsiveness is found to be insufficient.

We note here that ISS included “the Board’s rationale as provided in the proxy statement” as one of the factors in the case-by-case analysis.

CAP Perspective: *Using the proxy statement as a communication (marketing) document in addition to a compliance document has been an often stated best practice over the past few years, which gains additional support from this ISS policy update.*

This “comply or explain” policy update from ISS encourages the Board to enact a majority supported shareholder proposal, but gives an important second route. We believe there are instances where the Board should be able to exercise its discretion to respond in a manner that it believes is in the best interest of the company. However, we believe that providing rationale in these instances is also important.

CONCLUSION

ISS policies and tests should not determine, but rather be one input to the compensation program design and annual decision making process. Therefore, an understanding of ISS’ policies and tests, both retrospectively and prospectively (projection) is important. We encourage our clients to review how ISS’ 2014 policy updates are likely to impact them.

CAP submitted comments to ISS on the draft policy updates, which can be found at: <http://www.issgovernance.com/2014draftpolicycommentperiod>.

Reflecting a change with past practice, ISS is opening a new consultation period on approaches to certain benchmark policies for consideration for longer term policy changes (beyond 2014). An example of the type of area that this will cover is evaluation of new share requests. As more information on the consultation period and related topics becomes available, we will update our clients. The current consultation period closes in February 2014, which will eventually be followed by the more traditional process which includes a policy survey followed by release of draft policies for comment.



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