ISS QuickScore 2.0

Institutional Shareholder Services Inc. (ISS) has announced the governance factors and other technical specifications underlying its new Governance QuickScore 2.0 product, which ISS will apply to publicly traded companies for the 2014 proxy season. Companies have until 8pm ET on Friday, February 7th to verify the underlying raw data and can submit updates and corrections through ISS’s data review and verification site. ISS will release company ratings on Tuesday, February 18th, and the scores will be included in proxy research reports issued to institutional shareholders. While previous QuickScore ratings remained static between annual meeting periods, ISS has now committed to update ratings on an on-going basis based on a company’s public disclosures throughout the calendar year.

We have listed the individual factors used by QuickScore 2.0 in Annex A. However, the specific weightings and balancing between quantitative and qualitative factors remain undisclosed, and companies will not be able to calculate scores on their own. As we have previously noted, the relationship between ISS’s governance metrics and company financial performance has been dubious at best, and we continue to urge companies and boards to see QuickScore for what it is—a data point generated by an artfully marketed product, rather than a target or an ideal—and to consider their individual circumstances in establishing and evaluating appropriate corporate governance practices and compensation policies for their companies. No single metric or bundle of metrics can substitute for the informed business judgment of a well-advised board as to what is necessary to promote corporate and shareholder interests in dynamic, real-world circumstances.

Scoring under QuickScore 2.0 will continue to use the familiar “four pillar” approach that analyzes governance across Audit, Board Structure, Compensation/Remuneration and Shareholder Rights categories, and company-level and underlying pillar scores will continue to be presented on a 1 to 10 scale, relying upon “decile” comparisons of a company’s raw scores against the scores of other companies within the applicable index and region. Accordingly, ISS’s QuickScore 2.0 unfortunately continues to deploy an unproven and opaque methodology that reduces the complex realities of corporate governance into an easily digestible, but inherently misleading, decile system. Given the success to date of governance activists in driving companies towards one-size-fits-all governance structures, it is likely that only minor differences will separate the deciles, resulting in companies with no serious governance concerns receiving an unjustified “taint” by virtue of a lower score.

Although the new specification builds mostly upon the methodology used in previous years (which began as the CGQ Corporate Governance Quotient and then evolved into the GRId Governance Risk Indicators in 2010, which was then supplanted by QuickScore 1.0 in 2013), several new factors will be incorporated into the overall scoring model and a few additional “zero-impact” factors will be disclosed in the QuickScore report for informational purposes but will not, at this point, impact ratings.

New Factors that Impact Scoring

“Excessive” Director Tenure. Tenure of more than nine years will be considered “excessive” by QuickScore 2.0 on account of “potentially compromis[ing] a director’s independence” and negatively factor into weightings depending on the proportion of directors with such tenure. Given that ISS had recently announced a longer-term review of this issue for possible application to the 2015 proxy season and beyond, its inclusion in QuickScore for the 2014 proxy season may signal that ISS has already prejudged the issue. As we have previously stated, we do not believe that there is a sufficient basis to consider an extended tenure of board service in and of itself as indicative of a lack of director
independence. Given the significant differences in companies’ needs and directors’ attributes and experiences, this is a clear instance where a company-specific approach is superior to a rigid rule.

**Director Approval Rates.** In addition to continuing to consider whether one or more directors received 50% or greater “against” or “withhold” votes, QuickScore 2.0 will now consider the percentage of directors who receive “less than average” levels (as measured against the company’s industry index) of shareholder support for their election.

**Compensation of Outside Directors.** How a company’s outside director compensation compares to median levels of the ISS-determined peer group will now be considered. Specifically, QuickScore 2.0 will measure the prior year’s average outside director’s pay (based on total compensation reported for each director in the company’s proxy statement) as a multiple of the median pay of its ISS-determined comparison group for the same period.

**Alignment between Pay and TSR.** Consistent with ISS’s 2014 voting policy updates, QuickScore 2.0 will now incorporate the relative degree of alignment (RDA) between compensation and TSR based on a single, annualized RDA measure for a three-year measurement period, instead of the previous 40/60 weighted average of one- and three-year RDA. The previous QuickScore factors of three- and one-year RDA will still be included for informational purposes only and will be zero-weight factors on the scoring model.

**Say-on-Pay Support.** The level of shareholder support on the company’s most recent say-on-pay proposal and how such support compares to industry-index levels will also affect ratings.

**New Informational Factors with No Impact on Scoring**

Three new board composition-related factors will be included in the QuickScore report for informational purposes. According to ISS, these factors, however, will not currently impact overall scoring for the issuer.

**Board-Level Gender Diversity.** According to ISS, some academic and other studies have shown that increasing the number of women on the board correlates with better financial performance. As a result, QuickScore will now begin analyzing the number of female directors as well as the relative proportion of male to female directors on the board.

**Number of Financial Experts on Audit Committee.** QuickScore will provide information on the number of financial experts that serve on the board’s audit committee. This is a zero-weight issue for U.S. companies, most of which are required to have at least one financial expert serving on the audit committee due to stock exchange listing requirements.

**Board Size.** QuickScore will begin providing information on the number of directors on the board. According to ISS, boards should generally have no fewer than six directors and no more than 15. A board composed of nine to 12 directors is considered by ISS to be optimal.

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### ISS QuickScore 2.0 Factors for U.S. Companies

1. Non-Audit fees represent what percentage of total fees?
2. Did the auditor issue an adverse opinion in the past year?
3. Has the company restated financials for any period within the past two years?
4. Has the company made non-timely financial disclosure filings in the past two years?
5. Has a securities regulator taken enforcement action against the company in the past two years?
6. Has a securities regulator taken enforcement action against a director or officer of the company in the past two years?
7. Is the company, or any of its directors and officers, currently under investigation by a regulatory body?
8. Has the company disclosed any material weaknesses in its internal controls in the past two years?
9. How many financial experts serve on the audit committee?
10. How many directors serve on the board?
11. What is the number / proportion of women on the board?
12. What is the independent director composition of the board?
13. What proportion of directors sit on the board for an excessive length of time?
14. What is the classification of the chairman of the board?
15. Has the company an identified senior independent director?
16. What percentage of the board consists of immediate family members of majority shareholders, executives, and former executives (within the past five years)?
17. What percentage of the board are former or current employees of the company?
18. What is the independent director composition of the board?
19. What is the independent status of the compensation committee members?
20. What is the independent status of the audit committee members?
21. Does the CEO serve on an excessive number of outside boards? / How many boards does the CEO sit on? (U.S. only)?
22. How many non-executives serve on an excessive number of outside boards?
23. Did any directors attend less than 75% of aggregate board & committee meetings without a valid excuse?
24. How many directors received withhold/ against votes of 50% or greater at the last annual meeting?
25. What percentage of directors received shareholder approval rates below the industry-index level?
26. Has the board failed to implement a shareholder resolution supported by a majority vote?
27. What is the average size of outside directors’ compensation as a multiple of the median of company peers?
28. What is the aggregate level of stock ownership of the officers and directors, as a percentage of shares outstanding?
29. Are directors subject to stock ownership guidelines?
30. Do all directors have more than one year of service own stock?
31. Did any executive or director pledge company shares?
32. Does the company have a robust policy prohibiting hedging of company shares by employees?
33. Does the company disclose board/governance guidelines?
34. What percent of the directors were involved in material RPTs [related party transactions]?
35. Do the directors with RPTs sit on key board committees?
36. Are there material related-party transactions involving the CEO?
37. Does the company have classes of stock with different voting rights?
38. Are there any directors on the board who are not up for election by all classes of common shareholders?
39. Are all directors elected annually?
40. Is the board authorized to issue blank check preferred stock?
41. Does the company have a poison pill (shareholder rights plan) in effect?
42. What is the trigger threshold for the poison pill?
43. Does the poison pill have a sunset provision?
44. Does the poison pill have a TIDE provision?
45. Does the poison pill have a qualified offer clause?
46. What is the expiration date of the poison pill?
47. Is the poison pill designed to preserve tax assets (NOL pill)?
48. When was the poison pill implemented or renewed?
49. Does the company's poison pill include a modified slow-hand or dead-hand provision?
50. If the company has a majority voting standard, is there a plurality carve-out in contested elections?
51. Does the company require a super-majority vote to approve amendments to the charter and bylaws?
52. Does the company require a super-majority vote to approve mergers/business combinations?
53. What is the percentage of share capital needed to convene a special meeting?
54. Can shareholders act by written consent?
55. Does the company have a majority vote standard in uncontested elections?
56. Are there material restrictions as to timing or topics to be discussed, or ownership levels required to call the meeting?
57. What is the degree of alignment between the company's cumulative 3-year pay percentile rank, relative to peers, and its 3-year cumulative TSR rank, relative to peers?
58. What is the degree of alignment between the company's cumulative 1-year pay percentile rank, relative to peers, and its 1-year cumulative TSR rank, relative to peers?
59. What is the size of the CEO's 1-year cumulative pay, as a multiple of the median pay for company peers?
60. What is the degree of alignment between the company's TSR and change in CEO pay over the past five years?
61. What is the ratio of the CEO's total compensation to the next highest paid executive?
62. What is the degree of alignment between the company's annualized 3-year pay percentile rank, relative to peers, and its 3-year annualized TSR rank, relative to peers?
63. Are any of the NEOs eligible for multiyear guaranteed bonuses?
64. What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) to Base Salary?
65. Do the company's active equity plans prohibit share recycling for options/SARS?
66. Do the company's active equity plans prohibit option/SAR repricing?
67. Does the company's active equity plans prohibit option/SAR cash buyouts?
68. Do the company's active equity plans have an evergreen provision?
69. Do the company's active equity plans have a liberal CIC definition?
70. Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?
71. Does the company grant equity awards at an excessive rate, according to ISS policy?
72. Did the company disclose a claw back or malus provision?
73. What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARS in the equity plans adopted/amended in the last 3 years?
74. What are the minimum vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' restricted stock/stock awards?
75. What is the holding/retention period for stock options (for executives)?
76. What is the holding/retention period for restricted shares/stock awards (for executives)?
77. What proportion of the salary is subject to stock ownership requirements/guidelines for the CEO?
78. Does the company disclose a performance measure for the short-term incentive plan (for executives)?
79. What is the level of disclosure on performance measures for the latest active or proposed long-term incentive plan?
80. Did the most recent say-on-pay proposal receive shareholders' support below the industry-index level?
81. What's the trigger under the change-in-control agreements?
82. Do equity based plans or other long-term plans vest completely upon a change-in-control?
83. What is the multiple of the change-in-control/severance payment for the CEO (upon a change-in-control)?
84. What is the basis for the change-in-control or severance payment for the CEO?
85. Does the company provide excise tax gross-ups for change-in-control payments?
86. What is the length of employment agreement with the CEO?
87. Has ISS' qualitative review identified a pay-for-performance misalignment?
88. Has ISS identified a problematic pay practice or policy that raises concerns?