February 9, 2012

ISS Provides FAQ Guidance Regarding Compensation Policies for the 2012 Proxy Season

Institutional Shareholder Services, Inc. (ISS) recently published Frequently Asked Questions (FAQs) regarding its U.S. compensation policies for 2012. The FAQs (1) provide further guidance regarding ISS' pay-for-performance testing methodology (which ISS began to apply on February 1, 2012), (2) outline the potential impact of a perceived pay-for-performance "disconnect" on voting recommendations for a company's equity plan proposal and (3) describe how ISS evaluates a company's response to the company's most recent management say-on-pay (MSOP) voting results.

Pay-for-Performance Testing Methodology. In assessing the degree of alignment between CEO pay and total shareholder return (TSR) relative to ISS' selected peer group companies, ISS will compile total CEO pay for each company for the one- and three-year periods ending closest to each company's fiscal year-end, regardless of whether the periods coincide for such companies or whether any company in the group had one or more CEOs during any period. For a company with two CEOs who served during the same year, ISS will use the pay (including annualized base salary) of only the CEO on the last day of the applicable year and, in the case of co-CEOs, that of only the higher-compensated CEO. In each case, ISS will use the most recently disclosed summary compensation table figures, which may be for earlier periods if more recent figures are not available.

If a subject company has not been publicly traded for a given testing period, ISS will apply the relative TSR test and multiple-of-median test for only the testing period during which the subject company has been publicly traded. ISS will generally only use companies with three full years of compensation data as peer companies, but in limited cases where a subject company has been publicly traded for less than three years, peer companies with less than three years of public trading may be used. The FAQs also note that ISS will consider certain anomalies (such as multiple CEOs in one year or increased pension values due to low discount rates) or a subject company's limited trading history (*i.e.*, less than five years) as part of its qualitative evaluation before it issues a negative recommendation.

Pay-for-Performance and Equity Plan Proposals. ISS may recommend a vote against a subject company's equity plan proposal if there is a pay-for-performance disconnect and a significant portion of CEO pay is attributed to non-performance-vesting equity awards. In making its recommendation, ISS will consider, among other factors, the magnitude of the disconnect, the contribution of non-performance-vesting equity awards to overall pay and the proportion of equity awards granted in the last three fiscal years to the company's named executive officers (a ratio exceeding 25% warrants additional scrutiny).

Response to MSOP Voting Results. The FAQs affirm that each company should "highlight key actions" taken in response to its most recent MSOP vote—regardless of the results. In evaluating a company's response, ISS considers all aspects, including proxy disclosure of shareholder engagement, any company action taken as a result of shareholder engagement and the nature of the problematic issue and its future impact on the subject company. Accordingly, a company should comprehensively disclose its actions taken in response to its most recent MSOP vote. Importantly, ISS will recommend voting against compensation committee (and, in rare cases, board) members under two conditions: (1) ISS deems a company's pay practice "sufficiently egregious" to warrant such a recommendation (even if an MSOP vote is on the ballot), and (2) ISS determines that the board failed to adequately address issues that led to high opposition in the company's most recent MSOP vote.

Adam J. Kaminsky
Timothy G. Moore