

Client Alert

Quick Summary of ISS's 2011 Policy Updates Related to Compensation

EXEQUITY

Independent Board and
Management Advisors

Today, Institutional Shareholder Services, Inc. (ISS) released its 2011 Policy Updates to its proxy voting guidelines. The purpose of this Alert is to provide a quick summary of these Policy Updates as they relate to compensation issues.

The 2011 Policy Updates will apply to companies with shareholder meetings occurring on or after February 1, 2011. There are not really any “new” policies included this year (other than those as a result of the new Dodd-Frank requirements which the draft policy updates released in late October addressed), but definitely some refinements that might cause some companies a bit of angst (if not trouble). Here is a quick summary of the 2011 Policy Updates related to compensation:

- **Equity Compensation Plans: Burn Rate**—ISS is making a change to the Burn Rate Policy so that the burn rate caps **cannot increase or decrease by more than two percentage points** from year to year. The 2011 Burn Rate Table will be released as part of ISS's 2011 Summary Guidelines in December 2010.
- **Say When on Pay Vote**—ISS will support **annual** advisory votes on compensation, as its draft policies released at the end of October suggested. However, it still remains unclear what ISS will do if a company recommends or implements a different frequency or the shareholder vote supports a different frequency.
- **Problematic Pay Practices**—ISS is revising the list of “major” problematic pay practices which alone could trigger application of the policy. The major problematic pay practices are now identified as:
 - Repricing or replacing of underwater stock options/stock appreciation rights 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 a secular trust or restricted stock vesting; and
 - New or extended agreements that provide for:
 - Change-in-control (CIC) payments exceeding 3x base salary and average/target/most recent bonus;
 - CIC severance payments without involuntary job loss or substantial diminution of duties (“single” or “modified single” triggers); and
 - CIC payments with excise tax gross-ups (including “modified” gross-ups).

As before in such cases, the presence of problematic pay practices will influence ISS's vote recommendations, as follows:

- First, ISS will recommend against management say on pay (MSOP) proposals;
 - Then, ISS will recommend against/withhold on compensation committee members (or in rare cases the full board) in: (i) egregious situations, (ii) when no MSOP item is on the ballot, or (iii) when the board has failed to respond to concerns raised in prior MSOP evaluations; and/or
 - ISS will recommend against an equity incentive plan proposal if excessive non-performance-based equity awards are the major contributors to a pay-for-performance misalignment.
- **Problematic Pay Practices Commitments**—ISS will no longer accept future commitments on problematic pay practices as a way of preventing or reversing a negative vote recommendation.
 - **Voting on Golden Parachutes**—ISS sticks pretty close to the draft policy issued in late October 2010. Such proposals will be evaluated on a case-by-case basis, but the presence of certain practices could lead ISS to recommend against the proposal.



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