On November 17, 2011, Institutional Shareholder Services (ISS) released updates to its proxy voting guidelines. The updated policies will apply to all publicly-traded companies holding shareholder meetings **on or after February 1, 2012**. The key changes are described below and are available on the ISS website http://www.issgovernance.com/policy, under the Policy Gateway.

METHODS TO DETERMINE ALIGNMENT BETWEEN PAY AND PERFORMANCE

ISS has updated its policies to provide a more focused review of a company's alignment between pay and performance. The new updates emphasize long-term trends in pay versus performance and attempt to narrow a company's peer group. The new framework is essentially comprised of the two following components.

1. ISS will consider the alignment between a company's total shareholder return (TSR) rank and the CEO's total pay rank within a peer group, as measured over one-year and three-year periods, weighted forty percent and sixty percent, respectively. The peer group will generally consist of 14-24 companies that are selected based on market cap, revenue (or assets for financial firms), and their specific industry group (as assigned within the Global Industry Classification Standard). ISS will seek to place the company being evaluated close to the median of the peer group in revenue/asset size. The CEO's relative pay rank among the peer group will then be compared to the company's weighted TSR rank.

2. ISS will evaluate the trend in annual CEO pay changes against the trends in the company's annual TSR over the prior five fiscal years.

Based on these two tests, if the pay-performance alignment is unsatisfactory, ISS will consider causal or mitigating factors. These could include a review of the ratio of performance-based to time-based equity awards, the impact of a newly hired CEO, the rigor of performance goals, and the company's grant and benchmarking practices.

Absent such mitigation or justification, ISS may recommend against the company's Say-on-Pay proposal.

BOARD RESPONSES TO SAY-ON-PAY AND SAY-ON-FREQUENCY ADVISORY VOTES

Say-on-Pay. If the company's previous Say-on-Pay proposal earned less than 70% of shareholder support, ISS will review the election of compensation committee members (and in extreme cases, the full board) and the new Say-on-Pay proposal on a case by case basis. This review will consider the company's disclosure of efforts to engage with major investors regarding the issues that resulted in low-level support, its efforts to address those issues, whether those issues are recurring or isolated, and the company's ownership structure. The new ISS guidelines emphasize the need for new and meaningful responses to low level Say-on-Pay support and warn that companies with such low level support should avoid repeating existing practices and boilerplate responses.

Say-on-Frequency. ISS will recommend a vote "against" or "withhold" from the entire board of directors (except new nominees, to be evaluated on a case-by-case basis), if the board implements an advisory Say-on-Pay vote less frequently than the frequency desired by the majority of votes cast at the most recent annual shareholder meeting with a Say-on-Frequency vote. If no single proposal received a majority of shareholder support, where the board implements an option that is less frequent than the option receiving a plurality of votes cast, ISS will review the board's rationale on a case-by-case basis. In so doing, ISS will evaluate the board's reasons for disregarding the plurality opinion, the company's ownership structure, shareholder support for the previous year's Say-on-Pay proposal, and the company's other compensation concerns.

EQUITY PLAN APPROVALS WITH SECTION 162(m) FEATURES

ISS has also updated its policies to clarify its position regarding compensation plan proposals related to Section 162(m) in order to exempt compensation from taxes under such section if no increase in shares is also requested. ISS will generally recommend in favor of proposals to approve or amend executive incentive plans if the proposal does one or more of the following: (i) includes only administrative features, (ii) caps the annual grants any single participant may receive to comply with Section 162(m), (iii) adds performance goals to existing compensation plans to comply with Section 162(m), unless clearly inappropriate, or (iv) covers cash or cash and stock bonus plans submitted to shareholders.

Proposals will likely meet ISS disapproval if the compensation committee does not fully consist of independent directors or if the plan contains provisions that ISS considers to be problematic.

A new issue this year, is that ISS will evaluate proposals on a case-by-case basis if the company has an evergreen provision and an equity plan is being submitted to shareholders for re-approval within the four-year time period required by the IRS after its initial public offering (IPO). Thus, ISS will compare the shareholder value cost of the evergreen provision to the good corporate governance features in the plan. This differs from past practice, where ISS almost always voted for re-approval without performing a case-by-case analysis. In light of this new guidance, we recommend that companies that have had recent IPOs consider submitting equity plans for re-approval at the first meeting following the IPO, at a time when venture funds may still have a substantial stake in the company.

TAKE-AWAY

With the 2012 proxy season approaching, companies should monitor their pay practices in light of these updated ISS guidelines. These updated policies reinforce ISS' concern that pay practices should align with the company's long-term performance and shareholder return. These updates also suggest that companies should meaningfully consider the results of non-binding Say-on-Pay and Say-on-Frequency shareholder votes.

For more information, you may contact any attorney in the Executive Compensation and Employee Benefits Group.

Scott P. Spector (650.335.7251–sspector@fenwick.com)
Shawn E. Lampron (650.335.7642–slampron@fenwick.com)
Blake W. Martell (650.335.7606–bmartell@fenwick.com)
Gerald Audant (415.875.2362–gaudant@fenwick.com)
Elizabeth A. Gartland (415.875.2361–egartland@fenwick.com)
Grace Chen (650.335.7676–gchen@fenwick.com)
Marshall Mort (650.335.7131–mmort@fenwick.com)
Adriana Sherwood (415.875.2364–asherwood@fenwick.com)