



Compensation & Benefits

ALERT

ISS 2013 Policy Updates

On November 16, 2012, Institutional Shareholder Services ("ISS") released its policy updates to its voting guidelines for the 2013 proxy season. The 2013 updates include a revised methodology for the selection of the ISS peer group, which includes the consideration of a company's self-selected peer group, for purposes of a company's quantitative pay-for-performance evaluation, the use of "realizable" pay as part of a company's qualitative pay-for-performance evaluation and a voting recommendation against directors of companies whose executives or directors have engaged in *any* hedging or *significant* pledging of company stock.

ISS will apply the updated policies to all publicly-traded company shareholder meetings on or after **February 1, 2013** and ISS has indicated that it will release updates to its Frequently Asked Questions with additional guidance next month.

Practical Advice

The 2013 updates to the quantitative pay-for-performance evaluation (i.e., the say-on-pay analysis) should result in greater alignment between a company's self-selected peer group and the ISS peer group so that companies do not need to run two separate CEO pay-for-performance tests. Further, the inclusion of realizable pay in the qualitative say-on-pay analysis is consistent with a growing practice by many companies to disclose realized executive compensation in order to more accurately reflect pay delivery. The pledging determination is performed on a case by case basis and the onus is now on board members as part of their risk oversight duties.

Changes to Pay-for-Performance Evaluation

Selection of ISS Peer Group

- Company selected peer group members will be used as an input to determine the ISS peer group.
- ISS peer group will be based on the subject company's 8-digit GICS group as well as the 8-digit GICS groups represented by the company's self-selected peer group.
- When selecting an ISS peer group, ISS will prioritize peers that (i) maintain the company near the median of the peer group, (ii) are in the subject company's peer group, and (iii) that have chosen the subject company as a peer.
- Other changes include slightly relaxed size requirements, especially for very small or very large companies, and using revenue instead of assets for certain financial companies.
- The revised ISS peer group will generally include 14-24 companies that are selected using market cap, revenue, GICS industry group and company's selected peers' GICS industry group with size constraints.

Realizable Pay

- For large cap companies, realizable pay will be an additional factor in the qualitative analysis comparing realizable pay to grant date pay.
- Realizable pay will include the value of (i) cash, (ii) equity awards and (iii) performance awards.
- Performance awards will be measured based on equity award values for actual earned awards, or target values for multi-year awards, calculated using the stock price at the end of the performance measurement period.
- Stock options or stock appreciation rights (SARs) will be re-valued using the remaining term and updated assumptions based on a Black-Scholes option pricing model. It is not clear whether this re-value approach applies to time-based stock options and SARs.

Changes to Director Voting Recommendations based on Hedging or Pledging of Company Stock

- *Significant* pledging of company stock by directors and/or executives is considered a failure in risk oversight and under extraordinary circumstances, result in a recommendation to vote AGAINST or WITHHOLD from individual directors, committee members or the entire board.
- Any amount of hedging will be considered a problematic pay practice warranting a negative voting recommendation.
- In determining whether existing pledges are a problematic pay practice, ISS will consider the following:
 - Presence in the company's proxy statement of an anti-pledging policy that prohibits future pledging activity;
 - Magnitude of aggregate pledged shares;
 - Disclosure of progress in reducing the magnitude of aggregate pledged shares;
 - Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
 - Any other relevant factors

For more information on these policy updates, contact Compensation and Benefits Practice Group Chair [Jon Ocker](#).

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