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US COMPANIES GET READY TO REACT: ISS LAUNCHES QUICKSCORE 2.0 WITH EXPANDED DATA POINTS IN THE AREA OF CORPORATE GOVERNANCE

February 2014

On February 18, 2014, Institutional Shareholder Services, Inc. (ISS) launched an updated and enhanced version of its governance risk assessment tool for Russell 3000 companies – "ISS Governance QuickScore 2.0" (QS 2.0). After its initial announcement in January 2014 regarding the launch of QS 2.0, ISS released a "technical" document that contains a number of new and notable items, articularly in relation to new corporate governance "data points."

Background

As we previously reported in January 2014, ISS' QS 2.0 contains various new features, including an event-driven monitoring system whereby ISS will track certain regulatory filings and other public information for relevant governance-related information and use that information to automatically revise and update QS 2.0 scores. Similar to its prior versions, however, QS 2.0 will continue to give companies five distinct ratings (each on a scale of 1-10, with 1 being the lowest governance risk), including an overall rating and separate ratings in four historical categories, or "pillars": (1) board structure, (2) executive compensation, (3) shareholder rights and (4) audit-related practices. Each of these ratings is based on 87 questions or "data points" for US public companies, most of which are assigned a relative weight by ISS (please note that ISS has not revealed its exact weighting methodology) that contributes to ISS' scoring system. Contained within those 87 questions are several new data points in the area of corporate governance (see Appendix III of the Technical Document; new questions are highlighted in bold).

New Governance Data Points

The key new governance questions/data points that apply to US companies include:

- **What is the number/proportion of women on the board?** ISS notes that studies reveal that increasing the number of women on boards correlates with better financial performance. ISS assigned a zero weight to this factor and it is included for informational purposes only.
- **What is the number of directors that sit on the board for an excessive length of time (director tenure)?** ISS states that tenure of more than nine years is considered excessive and could potentially compromise a director's independence. While ISS recognizes that there are divergent views on this point, it nonetheless includes this as a weighted factor.
- **What is the percentage of directors who received shareholder approval rates below the industry level**? ISS considers less than 95% shareholder approval to be indicative of a perception of a director's lack of accountability, responsiveness, independence and competence.
- **What is the average size of outside directors' compensation as a multiple of the median pay of the company's peers (as such peers are designated by ISS)?** This is based on the director compensation table as disclosed in a company's proxy statement.
- **What is the degree of alignment between the company's annualized three-year pay percentile rank relative to peers, and its three-year annualized Total Shareholder Return (TSR) rank relative to peers?** This question is intended to address pay-for-performance, e.g. whether CEO pay is commensurate with the performance of the company. ISS assigned zero weight to this factor and it is included for informational purposes only.
- **What is the level of shareholder support on the most recent say-on-pay proposal?** ISS will be using a comparison group that includes 4-digit GICs groups, and the S&P500, S&P400, S&P600, Russell 3000 – excluding S&P1500 indices.

Recommended Action

Companies should review the subject matter of each of these new data points carefully (even those that are expressly assigned a zero weighted factor) and consider whether and if so, how, the company plans to adjust to the changing ISS environment. Whether the solution is enhanced disclosures, a change in internal policies, or both, companies will fare better in their ISS assessment and related recommendations if these new data points are considered and accounted for in 2014 and going forward.

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