

October 27, 2014

## ISS to Introduce QuickScore 3.0 on Friday

### **New Governance Factors Previewed; Details to be Published on October 31; Data Verification Period to Follow Through November 14**

#### **SUMMARY**

Institutional Shareholder Services, the proxy advisory firm, has announced that it will publish the details of an update to its QuickScore corporate governance rating system, styled as “QuickScore 3.0,” this Friday, October 31, including several new governance factors that will apply to U.S. companies for the 2015 proxy season.

This will be followed by a data verification period lasting from 9am EST on November 3 through 8pm EST on November 14. During this period, companies may access the underlying data that ISS will use to construct their QuickScore rating through ISS’s website. New scores will then be released on November 24 and begin appearing in ISS research reports. ISS indicates that the format of the reports will be revised to show historical scores, data changes and a trend analysis, rather than just a static rating.

Because some institutional shareholders may rely, in part, on a company’s corporate governance ratings to make voting and investment decisions, companies should take appropriate steps to ensure that the information on which these ratings are based is accurate. Information on QuickScore, including the technical documentation and information on data verification, is and will be made available on ISS’s website at [www.issgovernance.com](http://www.issgovernance.com).

#### **BACKGROUND**

In 2013, ISS introduced a new corporate governance metric, referred to as ISS Governance QuickScore, which replaced its Governance Risk Indicators, or GRId. This system provides each covered company with a risk score, from 1 to 10, in each of four governance-related categories or “pillars” (Board,

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Compensation, Shareholder Rights, and Audit), as well as an overall governance risk score. The scoring is such that “1” means lower governance risk and “10” means higher governance risk. The score is based on dozens of factors relating to governance structure. Unlike the GRId system, QuickScore is a relative measure, with the score indicating a company’s rank relative to other covered companies in its market index and/or geographic region. The weighting of the factors is not fixed but is based on an undisclosed formula measuring each factor’s correlation with various financial metrics. The scores are included in ISS’s proxy analyses and are made publicly available through Yahoo! Finance and Bloomberg. The factors were last updated in January.<sup>1</sup>

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### NEW AND AMENDED FACTORS FOR U.S. COMPANIES

ISS has circulated a table with short-form versions of its QuickScore 3.0 factors.<sup>2</sup> The table shows only the text of the factors; the detailed technical document to be released on Friday will contain more information about the application and assessment of these factors. Based on the table, ISS has made modest changes to the factors for U.S. companies. These changes are summarized below, and a list of the factors for U.S. companies, marked to show changes from QuickScore 2.0, is attached as Annex A.

**New factors.** The following new factors have been added:

- *“Has the board ... failed to address the issue underlying majority director [withhold votes]?”* This has been added as part of the existing factor assessing board implementation of a shareholder resolution supported by a majority of votes in the prior year.
- *“Has ISS’ review found that the Board of Directors recently took action that materially reduces shareholder rights?”* The addition of this factor is consistent with the results of ISS’s recent survey of institutional investors and public companies, which indicated strong responses from investors against boards that unilaterally adopt bylaw amendments that reduce shareholder rights. There is no indication whether this factor will be triggered only by substantive changes (e.g., limiting special meeting or written consent rights) or also by common procedural changes (e.g., enhancing advance notice requirements or adopting an exclusive forum provision, which the ISS survey showed as less of a concern for investors).

**Existing factors now applied to U.S. companies.** The following factors applied to issuers in other regions and will now be applied to U.S. companies as well:

- *“Does the company disclose a policy requiring an annual performance evaluation of the board?”* The existing factor on this topic looks at not just the existence of an evaluation process but also takes into account the nature of the evaluation (e.g., frequency, individual, outside assessment).
- *“Is there a sunset provision on the company’s unequal voting structure?”* This factor previously applied only to Canadian companies. The existing factor does not indicate any particular duration of a sunset provision that will be acceptable.

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<sup>1</sup> For a discussion of QuickScore 2.0, see our firm’s publication, dated January 30, 2014, entitled “[2014 Proxy Season Developments](#)”.

<sup>2</sup> This table is available at <http://www.issgovernance.com/file/products/g3-3-appendix-final.pdf>.

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- “Does the company have a controlling shareholder?” This factor, which previously applied only to Japanese companies, looks at “whether the company has a shareholder or shareholders acting in concert and holding a majority of the voting rights” on the basis that “[w]hen there is a controlling shareholder, the minority shareholders may face challenges in matters where their interests diverge from those of the majority shareholder.”

**Amended factors.** A number of existing factors have been revised, in most cases to reflect more objective metrics:

- “What percentage of directors received shareholder approval rates below 80%?” Previously this factor did not specify a percentage, but referred to approval rates below “industry-index levels.”
- “Did the most recent Say on Pay proposal receive shareholders’ support below 70%?” Again, the prior factor did not specify a percentage, but referred to support levels below “industry-index levels.”
- “Does the company’s average 3-year equity grant rate exceed the greater of 2 percent and the average of its industry/index peers?” This factor previously referred to the granting of awards at “an excessive rate,” which was measured as the greater of 2 percent of outstanding shares over the past three years or one standard deviation from the 3-year industry mean.
- “Has a regulator initiated enforcement action against [the company or a director or officer of the company] in the past two years?” Previously, this factor referred only to securities regulators, and referred to the *taking*, rather than the initiation, of enforcement action. The ISS announcement notes that QuickScore 3.0 will include a “deeper dive view of investigations, including reviewing the type of regulatory investigation and the materiality of penalties or resolutions to such cases.”

Unlike the table that accompanied QuickScore 2.0, the new table does not distinguish between factors that affect the quantitative score and factors that are merely for informational purposes. For example, under QuickScore 2.0, a number of factors (including those relating to board size, gender diversity on the board, presence of former employees and family members on the board, the number of audit committee financial experts, and certain pay-for-performance metrics) are “zero-weight” factors that do not count toward the score. It is unclear whether all of these factors will now have a quantitative impact, but the ISS announcement indicates that, at a minimum, the gender diversity factor will be given a weight.

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## ANNEX A: QUICKSCORE 3.0 FACTORS (MARKED AGAINST QUICKSCORE 2.0 FACTORS)

The following is a list of the QuickScore 3.0 factors listed as applicable to U.S. companies in the ISS table made available at <http://www.issgovernance.com/file/products/qs3-appendix-final.pdf>, marked against the comparable list from QuickScore 2.0. The numbers below are part of ISS's internal numbering system, and will tie to the related explanation in the QuickScore technical document, which will be published on October 31.

### AUDIT

- 1 Non-Audit fees represent what percentage of total fees?
- 2 Did the auditor issue an adverse opinion in the past year?
- 3 Has the company restated financials for any period within the past two years?
- 4 Has the company made non-timely financial disclosure filings in the past two years?
- 5 Has a ~~securities~~-regulator ~~taken~~initiated enforcement action against the company in the past two years?
- 200 Has a ~~securities~~-regulator ~~taken~~initiated enforcement action against a director or officer of the company in the past two years?
- 201 Is the company, a director or any officer of ~~its directors and officers,~~ the company currently under investigation by a regulatory body?
- 8 Has the company disclosed any material weaknesses in its internal controls in the past two years?
- 6 How many financial experts serve on the audit committee?

### BOARD

- 9 How many directors serve on the board?
- 304 What is the number / proportion of women on the board?
- 10 What is the independent director composition of the Board?
- 13 What proportion of non-executive directors on the board has lengthy tenure?
- 14 What is the classification of the Chairman of the Board?
- 16 Has the company ~~an~~-identified ~~senior~~-a Senior Independent Director or an independent directorLead Director?
- 205 What percentage of the board consists of immediate family members of majority shareholders, executives, and former executives (within the past five years)?
- 206 What percentage of the board are former or current employees of the company?~~?~~?
- 19 What ~~percentage~~is the independent status of the nominating committee members-~~are independent based on ISS standards?~~
- 25 What is the independent status of the compensation committee members?
- 31 What is the independent status of the audit committee members?
- 37 Does the CEO serve on an excessive number of outside boards? ~~/ How many boards does the CEO sit on? (U.S. only)?~~
- 38 How many non-executives serve on an excessive number of outside boards?
- 45 Did any directors attend less than 75% of the aggregate board and applicable key committee meetings without a valid excuse?
- 49 How many directors received withhold/against votes of 50% or greater at the last annual meeting?
- 312 What percentage of directors received shareholder approval rates below ~~the industry index level?~~80%?
- 315 What ~~is~~was the average ~~size of~~ outside ~~directors'~~director's total compensation as a multiple of the peer median ~~of company peers?~~
- 144 Do all directors with more than one year of service own stock?
- 243 Did any executive or director pledge company shares?
- 41 Does the company disclose a policy requiring an annual performance evaluation of the board?

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- 46 Does the company disclose board/governance guidelines?
- 143 Are directors subject to stock ownership guidelines?
- 244 Does the company have a robust policy prohibiting hedging of company shares by employees?
- 50 What percent of the directors were involved in material RPTs?
- 51 Do the directors with RPTs sit on key board committees?
- 216 Are there material related-party transactions involving the CEO?

### SHAREHOLDER RIGHTS

- 99 Has the board failed to implement a shareholder resolution supported by a majority vote, [or failed to address the issue underlying majority director WHs?](#)
- 345 [Has ISS' review found that the Board of Directors recently took action that materially reduces shareholder rights?](#)
- 54 Does the company have classes of stock with different voting rights?
- 55 Are there any directors on the board who are not up for election by all classes of common shareholders?
- 56 [Is there a sunset provision on the company's unequal voting structure?](#)
- 77 Are all directors elected annually?
- 83 Is the board authorized to issue blank check preferred stock?
- 78 Does the company have a poison pill (shareholder rights plan) in effect?
- 79 What is the trigger threshold for the poison pill?
- 80 Does the poison pill have a sunset provision?
- 81 Does the poison pill have a TIDE provision?
- 82 Does the poison pill have a qualified offer clause?
- 91 What is the expiration date of the poison pill?
- 220 Is the poison pill designed to preserve tax assets (NOL pill)?
- 222 When was the poison pill implemented or renewed?
- 223 Does the company's poison pill include a modified slow-hand or dead-hand provision?
- 290 [Does the company have a controlling shareholder?](#)
- 224 If the company has a majority voting standard, is there a plurality carve-out in the case of contested elections?
- 89 Does the company require a super-majority vote to approve amendments to the charter and bylaws?
- 90 Does the company require a super-majority vote to approve mergers/business combinations?
- 97 What is the percentage of share capital needed to convene a special meeting?
- 98 Can shareholders act by written consent?
- 52 Does the company have a majority vote standard in uncontested elections?
- 225 Are there material restrictions as to timing or topics to be discussed, or ownership levels required to call the meeting?

### COMPENSATION

- 226 What is the degree of alignment between the company's cumulative 3-year pay percentile rank, relative to peers, and its 3-year cumulative TSR rank, relative to peers?
- 227 What is the degree of alignment between the company's ~~cumulative~~ 1-year pay percentile rank, relative to peers, and its 1-year ~~cumulative~~ TSR rank, relative to peers?
- 228 What is the size of the CEO's 1-year ~~cumulative~~ pay, as a multiple of the median pay for company peers?
- 229 What is the degree of alignment between the company's TSR and change in CEO pay over the past five years?
- 232 What is the ratio of the CEO's total compensation to the next highest paid ~~active~~ executive?
- 329 What is the degree of alignment between the company's annualized 3-year pay percentile rank, relative to peers, and its 3-year annualized TSR rank, relative to peers?
- 156 Are any of the NEOs eligible for multiyear guaranteed bonuses?

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- 237 What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) to Base Salary?
- 129 Do the company's active equity plans prohibit share recycling for options/SARs?
- 138 Do the company's active equity plans prohibit option/SAR repricing?
- 238 Does the company's active equity plans prohibit option/SAR cash buyouts?
- 239 Do the company's active equity plans have an evergreen provision?
- 240 Do the company's active equity plans have a liberal CIC definition?
- 139 Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?
- 130 Does the ~~company grant~~ company's average 3-year equity ~~awards at an excessive grant rate, according to ISS policy~~ exceed the greater of 2 percent and the average of its industry/index peers?
- 155 Did the company disclose a claw back or malus provision?
- 131 What are the ~~minimum~~ vesting periods mandated in the plan documents for executives' stock options or SARS in the equity plans adopted/amended in the last 3 years?
- 132 What are the ~~minimum~~ vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' restricted stock/stock awards?
- 134 What is the holding/retention period for stock options (for executives)?
- 135 What is the holding/retention period for restricted shares/stock awards (for executives)?
- 145 What proportion of the salary is subject to stock ownership requirements/guidelines for the CEO?
- 113 Does the company disclose a performance measure for the short-term incentive plan (for executives)?
- 246 What is the level of disclosure on performance measures for the latest active or proposed long-term incentive plan?
- 328 Did the most recent ~~say-Say on-pay~~ Pay proposal receive shareholders' support below ~~the industry index level?~~ 70%?
- 148 What's the trigger under the change-in-control agreements?
- 153 Do equity based plans or other long-term ~~plans~~ awards vest completely upon a change-in-control?
- 161 What is the multiple of ~~the change-pay in-control/~~ the severance ~~payment~~ agreements for the CEO (upon a change-in-control)?
- 247 What is the basis for the change-in-control or severance payment for the CEO?
- 162 Does the company provide excise tax gross-ups for change-in-control payments?
- 163 What is the length of employment agreement with the CEO?
- 300 Has ISS' qualitative review identified a pay-for-performance misalignment?
- 301 Has ISS identified a problematic pay practice or policy that raises concerns?

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