RADFORD ALERT

Institutional Shareholder Services (ISS) Announces *Potential* Changes to its Management Say-on-Pay Policies for 2013

In response to input gathered from its 2012-2013 policy survey, Institutional Shareholder Services (ISS) announced a number of potential changes to its policies for making recommendations on Management Say-on-Pay proposals. Several proposed policy changes have the potential to significantly alter future testing outcomes under the CEO pay-for-performance assessment system introduced by ISS last year. As a result, Radford recommends clients begin to assess the impact of proposed methodology changes to prepare for the upcoming proxy season.

At a glance, the three key proposed policy changes for 2013 announced by ISS include:

1. **Enhanced Peer Group Selection Processes** – ISS may begin to use a company's self-selected peers as an input in developing pay-for-performance comparator groups. ISS' newly proposed approach will not wholly eliminate the current peer group methodology, which focuses on industry (GICS code), company size and market capitalization. Rather, it would serve to enhance the existing policy. If implemented, consideration of company-selected peers should help to increase the rate of overlap between company- and ISS-selected comparators. *Please See Appendix A for more information on how ISS might begin to integrate client peer group characteristics into its future analyses.*

2. **Greater Consideration of Realized Pay** – ISS is considering the development of new quantitative analyses comparing realizable pay to grant date pay. Although specific details are scarce at this time, this approach could presumably follow a number of interesting paths. Theoretical applications include: (1) addressing situations where actual compensation is either well-above or well-below grant-date pay; and (2) considering the alignment of realized pay to performance over time, possibly as an enhancement to or replacement of the current five-year Pay-TSR Alignment (PTA) test. In the words of ISS, "realizable pay consideration may mitigate or exacerbate CEO pay-for-performance concerns."

3. **Expanded Problematic Pay Practices List** – Citing the findings of external research sources, ISS is currently considering the addition of *pledging shares* as a factor that may lead to negative recommendations under its existing problematic pay practices evaluation. A large number of companies have adopted similar internal policies in the past few years, and if implemented by ISS, this rule would likely serve to accelerate the adoption of anti-hedging and/or anti-pledging policies.

In keeping with past practice, ISS has asked interested parties to submit comments on the potential policy changes listed above by October 31, 2012. Final policy announcements are expected to arrive in November 2012, with implementation occurring on February 1, 2013.

Next Steps

Radford's consulting team communicates with ISS on a regular basis regarding policy issues, including a recent letter promoting greater consideration of company peer groups, and plans to develop a response on our client's behalf in this case as well. Clients interested in providing feedback to ISS via Radford are encouraged to send their thoughts to consulting@radford.com or to a member of their respective account team.

To provide comments directly to ISS, write to: policy@issgovernance.com

To read the full ISS policy announcement, click here: http://www.issgovernance.com/MSOP2013

Appendix A
Potential ISS Peer Group Methodology Updates

The following description of potential peer group methodology changes was provided directly by Institutional Shareholder Services (ISS) in its announcement covering potential policy changes for 2013.

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Proposed Peer Group Methodology Summary

The proposed peer group methodology maintains its focus on identifying companies that are reasonably similar to the subject company in terms of industry profile, size, and market capitalization.

The proposed methodology incorporates information from companies' self-selected pay benchmarking peer groups in order to identify and prioritize GICS industry groups beyond the subject company's own GICS classification. The methodology draws peers from the subject company's GICS group as well as from GICS groups represented in the company's peer group, while maintaining the approximate proportions of these industries in the final peer group where possible. The proposed methodology additionally focuses initially at an 8-digit GICS resolution to identify peers that are more closely related in terms of industry. Finally, when selecting peers, the methodology prioritizes peers that maintain the company near the median of the peer group, are in the subject company's peer group, and that have chosen the subject company as a peer.

Other proposed changes include using slightly relaxed size requirements, especially at very small and very large companies, and using revenue instead of assets for certain financial companies.

Peer Group Methodology

The following outcomes are observed between the new and current peer group methodology:

	New Methodology	Current Methodology
GICS precision — 8-digit	The average company has more than 80% of peer selections drawn from the company's 8-digit GICS group or the 8-digit GICS groups of self-selected peers	Only 40% of peers are drawn from the company's 8-digit GICS
GICS precision — 2-digit	No peer groups have members based on 2-digit GICS	12% of peer groups have members based on 2-digit GICS
Similarity with company's selected peers	42% of companies have a potential ISS peer group that overlaps at least 50% of their own On average, an ISS peer group contains 44% of company's chosen peers	20% of companies have a potential ISS peer group that overlaps at least 50% of their own
Size comparison	Over 90% of peer groups maintain the subject company within 20% of the peer group median size by revenue	82% of peer groups maintain the subject company within 20% of the peer group median size by revenue

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