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COMPETITIVENESS

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Mr. Gary Retelny
Managing Director, MSCI Inc.
President, Institutional Shareholder Services
One Chase Manhattan Plaza
44th Floor
New York, NY 10005

Re: Comments on ISS's 2013 Draft Corporate Governance Voting Policies

Dear Mr. Retelny:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. To achieve this objective it is an important priority of the CCMC to advance an accountable and transparent corporate governance system. The CCMC welcomes this opportunity to comment on Institutional Shareholder Services' ("ISS") 2013 benchmark proxy voting guidelines available for comment.

CCMC appreciates the valuable role proxy advisory firms play in the proxy voting process. Proxy advisors are in the unique position to serve their institutional shareholding clients by synthesizing corporate governance information from regulatory filings and other sources to aid in proxy voting. This specialization has the potential to improve institutional investors' decision making processes by providing an efficient mechanism to evaluate proxy proposals over a wide number of public companies in an institutional shareholder's portfolio. However, all stakeholders stand to benefit from a more transparent and accountable proxy advisory industry. With true transparency and accountability comes stakeholders' confidence that their views are fairly accounted for, even when their views do not prevail in a particular situation.

This, in turn, fosters constructive dialog on the issues and ensures that ISS produces a better product for its clients.

This letter provides both recommendations on the specific proxy voting policies ISS is considering as well as comments on the need for significant changes to enhance the transparency, accountability and effectiveness of ISS proxy voting guidelines.

General Comments on Survey Design and Use

We appreciate that ISS has sought to get input through its annual survey from both investors and issuers. We also welcome the initial steps to begin to include questions about ways to enhance ISS's operational procedures and transparency. However, despite these efforts, the survey sample remains too small to effectively represent the opinions of a full range of investors and other users of ISS proxy advisory services.[1]

Moreover, ISS's policy survey is a survey of *opinions* and does not purport to collect actual evidentiary data. The opinions reflected in the survey results may indeed be mere initial reactions or impressions, undisciplined by any actual diligence or serious thought or analysis. And, while the survey can be a useful source of input, it is only one limited source of investor input.[2]

More importantly, the policy survey is not a substitute for the essential work ISS must begin to solicit and develop empirical evidence to guide its policymaking agenda and processes. Indeed, apparently uninformed by empirical evidence, many of ISS's policies appear to be influenced by factors other than maximizing shareholder value. To illustrate the apparent divergence between ISS policies and shareholder value, we bring to your attention a recent academic article by David Larcker, Allan

[1] ISS's 2012-13 policy survey received responses from only 97 institutional investors, of which 71% were located in the United States. Thus, the ISS survey is based on the responses of less than 70 U.S. based institutions. Compare this to ISS's claim that it has more than 1,300 clients, and the policy survey which serves as the primary—or in many cases sole—justification for ISS's policy updates appear to not have the broad based input that is representative of the client base or needed to develop realistic governance policies.

[2] While we reference ISS's survey data in this letter, we qualify such references with our concern that the survey's results do not appear to be representative of the preferences of institutional investors broadly.

McCall, and Gaizka Ormazabal, which found that companies experienced a negative stock price reaction related to the adoption of compensation policies favored by proxy advisors.[3]

The absence, in many cases, of any bona fide effort to develop empirical evidence should be particularly concerning to fiduciaries of retirement plans that rely on ISS for voting recommendations. As ISS is undoubtedly aware, ERISA requires such fiduciaries to vote plan shares solely on the basis of beneficiaries' economic interests.[4]

Moreover, while we have commented in past years that ISS's selective formulation and phrasing of survey questions, and use of survey results, undermines its own claims of transparency and independence, we note that many of the 2013 draft policies do not even attempt to explain how survey data supports ISS's policy determinations, instead simply vaguely stating that survey responses somehow were taken into account ("The proposed revisions take into account feedback from both investors and issuers based on ISS' 2012-13 policy survey and in-person and telephonic roundtable discussions").

Management Say-On-Pay Proposals

Peer Group

ISS's approach to peer group selection has been criticized for many years, and during the 2012 proxy season prompted numerous issuers to take the extraordinary step of filing additional proxy materials following receipt of ISS's report to educate investors on the inappropriateness of the peer group chosen by ISS.[5]

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[3] Larcker, David F., McCall, Allan L. and Ormazabal, Gaizka, The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policies (July 5, 2012). Stanford Graduate School of Business Research Paper No. 2105. Available at SSRN: http://ssrn.com/abstract=2101453 or http://dx.doi.org/10.2139/ssrn.2101453

[4] Proxy-Voting May Not be Solely for the Economic Benefit of Retirement Plans. Report No. 09-11-001-12-121 (March 31, 2011). Available at: http://www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121.pdf

[5] *See* e.g., James D. C. Barrall, *Proxy Season 2012: The Role of Supplemental Proxy Solicitations*. Available at: www.lw.com.

The decision to incorporate companies' own reported peers into the ISS peer groups against which CEOs' compensation is measured is a step forward, but it is unclear whether it will fully address issuers' concerns that the group will include peers that are not in substance comparable. The details of how peers will be selected (or rejected) for inclusion in a peer group is not clear from the proposals. Nor is it clear how ISS will decide whether to retain (or eliminate) peers based on the GICS approach. If the process is a logical one, then it appears that the peer groups should become more comparable overall, but absent more details it would be a leap of faith to assume that to be the case.

In deciding between peer group candidates, the proposed policy acknowledges that ISS personnel will be engaged in making subjective judgments. We are concerned about this aspect of the proposed approach for two reasons: 1) because subjective judgments will be made, and; 2) the proposed policy does not indicate upon what basis such judgments would be made to ensure consistency and objectivity from one company to the next. Nor is there any indication of the steps that ISS plans to take to ensure that these judgments will be informed by data and other evidence. Most significantly, there is no indication that the making of such subjective judgments will be transparent, both as to the bases for the decisions, as well as to the identity of those making the decisions.

In our view the decision making process is flawed and lacks accountability and transparency.

The proposed approach of "mixing" two different approaches to peer group selection makes the overall approach unpredictable and irrational for issuers. Issuers' ability to satisfy ISS's policies on compensation may be undermined by that uncertainty—we believe this is ultimately as problematic to ISS as it is to the issuers in question. Accordingly, the Chamber recommends that ISS provide all companies in its research universe, upon request, with a list of peers that ISS plans to use in its evaluation of executive pay a reasonable time in advance of the proxy season. Further, companies should be afforded a reasonable opportunity to contest the inclusion of inappropriate peers before a recommendation is made. This request is entirely consistent with ISS's own survey data, in which more than 64% of investors and 96% of issuers responded that the opportunity to preview ISS pay data one or two weeks in advance of the full research report would be somewhat or very useful.

Realizable Pay

The inclusion of realizable pay in the qualitative review portion of ISS's pay-for-performance review appears to be a positive step towards a more holistic analysis of companies' compensation programs. Realizable pay is frequently an effective tool for understanding an executive officer's compensation, as the figures contained in companies' standardized summary compensation tables represent hypothetical future values as opposed to actual amounts received.

However, we are concerned that in its draft policy, ISS has not provided a clearer explanation of how it plans to define realizable pay. The proposed policy's definition of realizable pay raises more questions than it answers. For example, it is unclear whether the vaguely phrased policy includes pay that is as yet unearned and/or compensation for performance-based targets that have not been met. The devil is in the details, and ISS has not provided the details necessary to make clear the scope of its policy proposals. Accordingly, it is nearly impossible to provide useful commentary.

Pledging of Company Stock

We commend ISS for providing some data to illustrate the issue it intends to address with its draft policy on executive pledging of company stock. However, the data cited in the draft policy only indicates the frequency and amount of stock pledged at certain companies, as ISS defines that term, without differentiating between the different purposes for the pledging of shares, such as pledges as collateral for loans versus pledges in connection with hedging activities. We recommend that the final policy take the purposes for pledging into account, as different purposes should have different implications for ISS' voting recommendations. For instance, if this policy goes into effect, company directors and employees who would otherwise pledge shares in order to obtain a personal loan may instead sell shares. A policy that tolerates a reasonable level of pledging supports a policy of encouraging share ownership by executive officers. If the purpose of ISS's draft policy is to enhance alignment between shareholders and employees, then ISS's draft policy in its current form may be counterproductive to its stated goals. Likewise, a carve out for indirectly owned shares such as by affiliated trusts, foundations and similar indirect entities would permit these entities to serve their short-term liquidity needs without depleting their shareholdings.

We believe an effort by ISS to conduct a reasonable degree of due diligence before adopting a policy on this subject will ultimately illuminate the distinctions it should make in formulating an appropriately nuanced policy. In any event, the final policy should clearly state the factors that will be considered in applying this policy, including any applicable thresholds (e.g., 5 or 10% of shares outstanding).

Along the same lines, we also recommend that the policy take into account forthcoming legislative and regulatory developments, including Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which will require companies to disclose information regarding hedging activities by directors and employees.

Say on Golden Parachute Proposals

The overwhelming 81-84%[6] majority support shareholders showed for golden parachute proposals suggests that survey respondents, by and large, are comfortable with current market practices in this area. The fact that the underlying corporate transactions received higher voting support is to be expected, given that shareholders voting on these transactions are essentially given a "free option" to vote against the golden parachute proposal in support of goals other than maximizing shareholder value, while still receiving the benefit of the transaction consideration.

Additionally, the draft policy claims that "a majority of ISS' institutional investor clients suggest that payments resulting from problematic severance features, such as single triggered equity, excise tax gross-ups, and modified single triggered cash severance, are objectionable *regardless of the timing of the arrangement*" (emphasis added). After a careful review of ISS's survey results, we do not find a single question that references the timing of any of the cited arrangements. The lack of even purported survey data to support this claim is concerning given that a "key change under consideration" is expanding the policy to all arrangements rather than to "new or

[6] The draft policy cites 81% average support for votes that occurred in 2012, while the survey results indicate the number was 84% for 2012 meetings.

extended arrangements." Therefore, this policy change appears to lack a substantive basis in ISS's own policy survey.

Environmental and Social Non-Financial Performance Compensation-Related Proposals

The explanation of the draft policy on Environmental and Social Non-Financial Performance Compensation-Related Proposals indicates that ISS would be more likely than in the past to support proposals to link compensation and sustainability "depending on the structure and the scope of the specific proposal and the particular circumstances at the company in question."

We believe that any such policy decision by ISS is premature at best.

First, there is no consensus how or if Environmental and Social Non-Financial Reporting metrics should be collected or disclosed. Second, there is no organic legal requirement that such disclosures be made. Third, some companies do provide such data for their investors on an ad-hoc basis to provide a better window for investors to understand the operation and direction of a company; however, most companies do not. Fourth, it is unclear what kind of information, metrics or subjects could provide decision useful information to investors. These concerns raise questions as to how or if these issues can even be reported, and if those threshold questions cannot be met, the CCMC doesn't understand how such reporting can be tied to compensation and performance standards.

In absence of a detailed explanation of how this policy will be applied, it threatens to inject further uncertainty into boards' and shareholders' decision making responsibilities, and creates the possibility that members of the ISS Staff will exercise discretion that is not transparent to the market, and indeed, may not be diligently informed by guiding principles and applicable data and analysis. Given ISS's historical claims about seeking to align executive pay with shareholder returns, this policy change is a significant departure from established practices as it inserts new criteria into the analysis of compensation programs that is likely in many situations at odds with the pay for performance philosophy.

We believe that social and environmental reporting should first be supported by data and analysis of that data, as well as of other empirical studies and evidence illustrating how it impacts a company's performance. Until that is done, the more appropriate and prudent policy is to align compensation directly with performance regardless of the nature of the events that materially affect performance. This latter approach is in fact closer to ISS's current pay for performance philosophy. It allows for truly material environmental and social factors to be reflected in performance based compensation, and it is consistent with the duty of many ISS clients to vote to maximize return for the participants and beneficiaries of retirement plans.

Board Response to Majority-Supported Shareholder Proposals

Before adopting the draft proposals to recommend votes against the board in the year following majority supported shareholder proposals, we urge ISS to consider that there are many legitimate reasons for a board to take one or two years to act on such a proposal. One reason is that in exercising its judgment and fulfilling its fiduciary obligations, and armed with facts unavailable to shareholders, a board may conclude that another action would be better for shareholders and the company. In these cases, directors should have the leeway to implement alternative measures in the year following the majority vote—and/or make their case to shareholders as to why their actions were better than those prescribed by the shareholder proposal—without facing immediate censure from proxy advisors for acting in a manner that they believe is consistent with shareholders' best interests. Similarly, ISS should clarify what constitutes "failure to act" in the application of this policy, including what factors ISS will consider in making that determination. This is particularly important in those instances in which the board determines that company and shareholder interests would be best advanced through an alternative governance arrnagement that satisfies the purpose of the shareholder proposal in question.

ISS's current approach, requiring a majority vote in 2 out of 3 years before recommendations against the board, is a more reasonable approach to board responsiveness, as it provides an enforcement mechanism for responsiveness while permitting boards time to develop alternative approaches and/or make their alternative case to shareholders on the issue. The proposed approach will result in situations where ISS's policy will be at variance with the interests of shareholders.

Policies Not Addressed

Independent Chairman

Many companies have successfully used both a combined Chair and CEO and separate Chair and CEO arrangement at different times throughout their history. Companies have argued that the decision to employ either arrangement depends on the individual circumstances of a company at a particular time. ISS policy in this area places emphasis on the company's governance structure, with less emphasis on the company's reasons for its decision to combine or separate the roles. With this in mind, we direct your attention to a forthcoming paper by Ryan Krause and Matthew Semadeni from the Kelley School of Business at Indiana University, which finds that the roles of chairman and CEO should not be split as a matter of "best practice" for one-size-fits-all application, but rather only when there is a performance problem, and even then only under certain circumstances.[7] By contrast, ISS's policy will recommend for the separation of these roles if the company in question does not satisfy all of ISS's criteria, many of which have no bearing on company performance (e.g., whether the company exhibits any "problematic governance issues" which themselves have not to our knowledge been empirically tested for their relationship to shareholders' economic benefit). The findings of this study suggest that ISS should review its policy on proposals seeking an independent board chair, review the Kraus study along with other available empirical evidence, with a view to ensure that ISS's policy is in line with institutional investors' fiduciary duty to vote in line with beneficiaries' economic interests.

Political Contributions/Lobbying

Prior to the 2012 proxy season, ISS changed its policy position on shareholder proposals that advocate disclosure of political spending beyond what is required by law from a "case-by-case" determination to a position of "generally vote for" these proposals. However, it appears that in 2012, the average level of shareholder support for the proposals dropped significantly among Fortune 200 companies. In addition, the Manhattan Institute published in June 2012 a study that calls into question the

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[7] Krause, Ryan and Semadeni, Matthew. Apprentice, Departure, and Demotion: An Examination of the Three Types of CEO-Board Chair Separation (forthcoming). News Release summarizing the report available at: http://newsinfo.iu.edu/news/page/normal/23276.html.

argument that political activity heightens risk and jeopardizes shareholder value.[8] Therefore, there appears to be significant evidence to support a policy change in this area back to a "case-by-case" analysis.

Conclusion

Thank you for the opportunity to comment on ISS's 2012 draft policies. We look forward to our continued dialogue, and would be happy to discuss the issues here with you or the appropriate staff.

Sincerely,

David Hirschmann

David Hirschmann

[8] Robert J. Shapiro and Douglas Dowson. Corporate Political Spending: Why the New Critics Are Wrong. Manhattan Institute Legal Policy Report 15. Available at: http://www.manhattan-institute.org/html/lpr_15.htm.