I am writing to comment on the proposal to add pledging of company stock to the ISS list of problematic pay practices related to non-performance based compensation elements.
The rationales cited by ISS for the inclusion of pledging company stock as a problematic practice are paraphrased as follows:

1. Detrimental impact on shareholders as the forced sale of a significant amount of company stock may negatively impact a company's stock price;

2. Possible violation of insider trading policies; and

3. May be part of a hedging strategy that would potentially immunize the director or executive against economic exposure relating to down drafts in the company's stock price.

My comments on the rationales and how they can be addressed in alternate ways that would be more beneficial to shareholders are as follows:

1. In many cases, the amount of stock pledged by insiders is insignificant as compared to the number of shares outstanding or the related company's average daily trading volume. In those, cases, a margin call would have no negative impact on stock price.

Solution: Revise the proposed ISS policy to deem that a pledge of shares is a problematic practice at a company only if the aggregate of all shares pledged by executive officers and directors exceeds the greater of: (i) a percentage of the outstanding shares (2%); or (ii) a percentage of the average daily trading volume (150%).

2. Typically, margin calls do not violate insider trading policies because the executive or director does not control the timing or circumstances of the margin call but rather it is caused by a change in the market value of the margin account in relation to the securities purchased on margin. One circumstance where a margin call could be controlled by insiders is a non-recourse margin account. In that case, the insider could simply choose not to fund the call, causing the company's stock to be sold during a blackout period and/or when the insider was in possession of material inside information.

Solution: Revise the proposed ISS policy to provide that the pledge of shares is a problematic practice at a company if the company does not require all loans secured by company stock to be recourse to the other assets of the insider. Disclosure in the proxy statement that a company policy prohibits non-recourse margin loans and other pledges of company stock should remove the pledging of company stock as a poor pay practice.

3. In many cases, pledges of company stock are not part of a hedging strategy to minimize or eliminate economic exposure relating to the company stock. They are merely a method for directors and executives to access some of the current value of their stock without having to sell it. There is still financial exposure to the insider relating to downward movement of the stock price.

Solution: Again, if margin loans and other loans secured by pledges of company stock are required to be recourse, directors and executives retain full economic exposure to the company stock price variations. Disclosure in the proxy statement that a company has adopted a policy prohibiting more complicated hedging strategies such as puts and calls should eliminate the pledging of company stock as a poor pay practice.

Two additional points speak to why some changes to the proposed blanket inclusion of stock pledges as a poor pay practice are appropriate.

1. If a company were to adopt a policy prohibiting all pledges of company shares, those directors and executive officers who have already pledged shares would likely be forced to sell some of those shares to pay off the loans. This is counter to the general governance notion, supported by ISS that it is in the best interests of the shareholders for the directors and executive officers to retain significant holdings in the companies that they serve.

2. Again, there is a general governance notion that it is in the best interests of shareholders to align the interests of management with shareholders interests by encouraging management to own shares. This notion has caused compensation in the form of equity to be a favored pay practice. In companies where the percentage of total compensation in the form of equity is significant (30% or more), the fact that directors and executives are permitted to pledge shares to secure recourse loans should not be considered a poor pay practice.

I hope that the above demonstrates why the proposed policy should not be adopted as a “one size fits all” policy and should be more tailored as described above.

I am happy to discuss the above. Thank you for considering my comments.

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