The Clearing House℠
At the Center of Banking Since 1853

November 6, 2012

Via E-Mail to policy@issgovernance.com

Global Policy Board
Institutional Shareholder Services Inc.
2099 Gaither Road
Rockville, Maryland 20850

Re: 2013 Draft Policies—Board Response to Majority-Supported Shareholder Proposals

Dear Sirs:

The Clearing House Association L.L.C. ("The Clearing House"),[1] an association of major commercial banks, is pleased to comment on ISS's 2013 Draft Policies proposing updates to ISS's benchmark proxy voting guidelines. Although ISS has proposed a number of updates to the existing proxy voting guidelines, our comments in this letter address only the proposed update regarding board responsiveness to majority-supported shareholder proposals (the "Draft Policy").

Under the Draft Policy, ISS would recommend a vote "against" or "withhold" from the entire board (except new nominees, who would be considered "case-by-case") if the board failed to act on a shareholder proposal that received the support of a majority of shares *cast* in the previous year. Currently, ISS recommends "against" or "withhold" from the entire board (except new nominees) only if the board failed to act on a shareholder proposal that received the support of either (1) a majority of the shares *outstanding* in the previous year or (2) a majority of shares *cast* in the most recent year *and one of the two previous years*. We understand that the Draft Policy, if adopted, would take effect for all shareholder meetings held on or after February 1, 2013, taking into account the results of proposals voted on in 2012.

[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs, and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the United States. See The Clearing House's web page at www.theclearinghouse.org for additional information.

SUMMARY

1. The Clearing House believes that the Draft Policy should not be adopted because it is contrary to good corporate governance. We believe that this significant change would make it more difficult for directors, in the exercise of their fiduciary duties, to evaluate shareholder proposals in an informed and considered manner and to determine an appropriate response in a way that takes into account shareholder feedback and other relevant factors.

2. If ISS nevertheless adopts the Draft Policy, ISS should revise its interpretation of the term "acted on" to give the board more flexibility in addressing the concerns raised by the proposal, so long as there is a meaningful responsive action and shareholders are given appropriate disclosure.

3. The "votes cast" threshold should be modified to include abstentions in the denominator, which would make it consistent with the Delaware standard for action by shareholders and would appropriately reflect the lack of support for a proposal indicated by an abstention.

4. ISS should not make the Draft Policy effective for director recommendations in 2013. Immediate implementation would be unfair to directors at companies where shareholder proposals received the support of a majority of votes cast in 2012, but not a majority of shares outstanding in 2012 or a majority of votes cast in 2011 or 2010.

DETAILED COMMENTS

1. The Draft Policy is contrary to good corporate governance and would make it more difficult for directors, in the exercise of their fiduciary duties, to evaluate shareholder proposals in an informed and considered manner and to determine an appropriate response in a way that takes into account shareholder feedback and other relevant factors.

The Clearing House believes that the Draft Policy is inferior to the existing policy from the perspective of enhancing corporate decision-making and shareholder rights. We agree that precatory votes on shareholder proposals are an important mechanism for meaningful shareholder participation in the corporate decision-making process. We also believe, however, that shareholders benefit when boards of directors are encouraged to exercise their informed, professional, and good faith judgment on matters affecting the company. Under the current policy, the board of a company that receives a precatory shareholder proposal may very well determine to allow the proposal to come to a vote without taking immediate action and then, informed by the voting results, shareholder feedback, market trends, and other relevant factors, decide whether and how to take responsive action in the best interests of the company and its

shareholders. If the shareholders believe that these actions are insufficient, they can express that view at the next shareholder meeting.

In our view, this iterative and deliberative approach is one that ISS should—and that its existing policies appropriately do—encourage directors to pursue. Under ISS's existing policy regarding board responsiveness to shareholder proposals, directors can consider, evaluate, and refine their response to a shareholder proposal in light of all information available to them, even after the approval by a majority of the votes cast, without facing a threat that ISS will recommend "against" or "withhold" from their reelection if the directors do not implement the shareholder proposal in its exact form before the next annual shareholder meeting. The board might decide to implement the proposal consistent with its precise terms (as ISS's commentary accompanying the Draft Policy suggests they often do). Alternatively, the directors might decide to address the underlying concern of a proposal in a somewhat different way that they believe, in the exercise of their fiduciary duties, is more appropriate for the company and, in some cases, would command the support of a majority of the shareholders.[2] Finally, the board might determine that it should not make changes in response to the proposal, notwithstanding the affirmative vote results, and explain its reasoning to shareholders. This could include, for example, a case where a relatively low quorum has produced "majority" support from a very low percentage of all shareholders. If the same proposal is resubmitted in the following year, the level of shareholder support for the re-proposal will provide the board with valuable insight into whether the actions taken or explanations given by the board were sufficient to address the underlying concern, or whether shareholders continue to believe that the proposal should be implemented in the particular form proposed.

The Draft Policy, by contrast, would discourage such a considered approach. By increasing the potential negative consequences to directors of the initial vote on a new shareholder proposal, the Draft Policy may encourage boards to take action that prevents these proposals from coming to a vote in the first place (*e.g.*, by implementing or proposing to implement policies that address the underlying concern in a different manner and seeking to exclude the shareholder proposal through the SEC no-action process). Such a result would reduce the level of shareholder input into corporate decision-making through the voting process and would not be a positive outcome for either companies or their shareholders.

We understand that ISS may have a concern that under the current policy companies have an incentive to prevent a proposal that passed from coming to a vote a second time—for example, by putting forth a conflicting management proposal. The

---

[2] It is clear that, under state law, the board of directors may not abdicate its fiduciary duties by simply delegating decisions to shareholders. *See, e.g.*, Paramount Commc'ns Inc. v. Time Inc, 571 A.2d 1140, 1154 (Del. 1989); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

Draft Policy, however, would not eliminate this incentive. Rather, it would accelerate the incentive one year by making the initial vote on a new proposal topic potentially more significant and giving companies an incentive to prevent it from coming to a vote and passing the first time.

Thus, rather than enhancing shareholders' interests, the Draft Policy could have the unintended, negative effect of actually undermining shareholder participation in corporate decision-making and making it more difficult for directors to act on a fully informed, considered basis. The Draft Policy has the effect of providing directors with a strong incentive, from a personal standpoint, merely to implement the specific terms of a proposal that has been approved by a majority of votes cast (which, of course, does not necessarily reflect the views of a majority of shareholders). In that regard, we believe that the Draft Policy is not supportive of the board's exercise of its fiduciary obligation to act on a fully informed basis in what it sees as the best interests of the company and its shareholders and is less likely than the current policy to encourage an iterative, flexible process of board decision-making that ultimately will be to the benefit of shareholders.

Essential to a thoughtful analysis of the Draft Policy is an understanding of the totally binary nature of shareholder proposals. Shareholders must vote for or against (or abstain). Shareholders who vote in favor are not concluding that the proposal cannot be improved, but only that it is better than the status quo. The Draft Policy would reduce the ability of shareholders to obtain a governance structure that they believe has been best crafted to meet their objectives.

For these reasons, The Clearing House urges ISS not to adopt the Draft Policy.

2. If ISS nevertheless adopts the Draft Policy, ISS should revise its interpretation of the term "acted on" to give the board more flexibility in addressing the concerns raised by the proposal, so long as there is a meaningful responsive action and shareholders are given appropriate disclosure.

If ISS determines to adopt the Draft Policy, The Clearing House believes that ISS could lessen the negative consequences discussed above by expanding its interpretation of what it means for a board to have "acted on" a majority-supported shareholder proposal.

ISS's detailed discussion of its existing benchmark policies regarding voting on directors in uncontested elections notes that, for example, "ignoring," "disregarding," or similar "inaction" regarding precatory shareholder proposals demonstrates a lack of board responsiveness that could warrant an adverse vote recommendation. The background section of the Draft Policy, by comparison, refers to an expectation that a board should "implement" a majority-support shareholder proposal.

The Clearing House believes there is a material distinction between outright "ignoring" a shareholder proposal and "failing to implement" one. If acting on a majority-supported shareholder proposal requires directors to implement the proposal wholesale, then the threat of an adverse recommendation on directors would induce the negative consequences discussed above. If, however, "acting on" a majority-supported shareholder proposal can, depending on the circumstances, mean some alternative measure of response to the general issues raised by the proposal, then directors would retain flexibility to address shareholder concerns in a manner consistent with their professional judgment of how to advance the best interests of the company. Put differently, the threat of an "against" or "withhold" recommendation should not be used to limit the range of options that directors have to demonstrate genuine responsiveness to the substance of a majority-supported shareholder proposal. As a result, directors acting in good faith could face less of a conflict between responding to shareholder recommendations, on the one hand, and their fiduciary duty to exercise informed, independent business judgment in the best interests of the company, on the other hand.

In particular, as noted in Section 1 above, there is no reason to think that the passing of a shareholder proposal by a majority of votes cast means that shareholders in general prefer the particular terms set forth in the shareholder proposal to other possible means of addressing the underlying concern. Shareholders are not voting on whether the terms of the shareholder proposal are the *ideal* way to address the underlying concern, but rather they are being given a binary choice between supporting the proposal and supporting non-action. If the Draft Policy is adopted, we believe that a board should be deemed "responsive" to a shareholder proposal that receives a majority of votes cast if the board takes meaningful action to address the concern underlying the proposal and explains in the next year's proxy statement why the actions it took deviated from the specific terms of the proposal. If shareholders are not satisfied with the actions or explanation, they will then be able to vote on any re-proposal on the topic.

Relatedly, ISS has requested comment on whether a commitment from the company for future implementation of a shareholder proposal that received majority support of votes cast in the previous year should be acceptable. The Clearing House believes that, consistent with the above discussion of the importance of giving the board flexibility in the manner of implementing a proposal, such a commitment should be acceptable. It is important to both companies and their shareholders that any implementation of a proposal be done in a careful and considered way that makes the most sense for the particular company. Allowing the company to announce a commitment for implementation will reduce the risk that the quality of implementation is undermined by adherence to an artificial time schedule driven by the concern over "against" or "withhold" votes.

3. The "votes cast" threshold should be modified to include abstentions in the denominator, which would make it consistent with the Delaware standard for action by shareholders and would appropriately reflect the lack of support for a proposal indicated by an abstention.

The Clearing House believes that ISS's use of a "votes cast" standard—calculated by reference to the number of votes cast "for" or "against"—has the potential to create confusion by using a threshold that differs from the Delaware standard governing whether an action by shareholder has occurred. The standard for action by shareholders (other than with respect to director elections) under Delaware law is a majority of shares present or represented by proxy and entitled to vote.[3] The practical difference between the "votes cast" standard and the Delaware standard is that the latter includes abstentions (but not broker non-votes) in the denominator.

Making the ISS voting standard consistent with the state law threshold applicable to most public companies would avoid an inconsistency between whether a proposal has "passed" as a state law matter and whether ISS will view the proposal as having received a level of support that requires a response from the company. Even for proposals that are merely precatory, the state law backdrop creates an important framework for analyzing shareholder action, and ISS's policies should be consistent with the applicable law governing shareholder rights. Furthermore, as a substantive matter, we believe that a shareholder's determination to abstain from a vote on a shareholder proposal reflects a lack of support for the proposal that should be taken into account by ISS's policies (as it is taken into account under Delaware law).

4. ISS should not make the Draft Policy effective for director recommendations in 2013. Immediate implementation would be unfair to directors at companies where shareholder proposals received the support of a majority of votes cast in 2012, but not a majority of shares outstanding in 2012 or a majority of votes cast in 2011 or 2010.

The Clearing House believes it would be inappropriate in any event for the Draft Policy to take effect with respect to director recommendations for meetings to be held in 2013, as ISS currently intends. As ISS is aware, the Draft Policy contemplates retroactive application, insofar as ISS intends in 2013 to recommend "against" or "withhold" from directors who have not acted on shareholder proposals that received the support of a majority of votes cast in 2012, but not also a majority of shares outstanding in 2012 or a majority of votes cast in 2011 or 2010. As ISS is also aware, there are a number of companies for which the Draft Policy would trigger "against" or "withhold" votes in 2013, but for which the current policy would not.

---

[3] *See* § 216(2) of the Delaware General Corporation Law.

As discussed in Comment 1 above, many companies may have determined that it was beneficial to allow a shareholder proposal to come to a vote in 2012, even if there was a risk that it would pass by a majority of votes cast, because the directors believed they would have time under ISS's existing policies to consider the results of the vote and other factors in deciding how to proceed without being threatened with an "against" or "withhold" vote in 2013. For directors who, relying in good faith on ISS's existing policies, took such an approach in 2012, The Clearing House believes it would be unfair for ISS to recommend "against" or "withhold" votes in 2013 based on 2012 results. Because the Draft Policy would materially affect directors' options moving forward regarding how to approach shareholder proposals, both before and after a proposal receives the support of a majority of votes cast, ISS should not consider directors' past approaches to shareholder proposals as indicative of their responsiveness to majority-supported shareholder proposals in the future. Rather, a more accurate indication of directors' responsiveness to shareholder proposals requires an evaluation of the actions they took, or declined to take, with full knowledge of the various consequences those actions could have throughout the entire process.

In addition, it is not at all clear that these 2012 shareholder proposals would have received the same level of support if shareholders had known about ISS's prospective policy change. Shareholders, too, were acting within the framework of ISS's existing policies and did not necessarily anticipate that the board would be compelled to take action immediately in response to a proposal that passed by a majority of votes cast in 2012. For example, it is our members' experience that certain institutional investors have a practice of abstaining from voting on shareholder proposals being considered at Delaware corporations in full knowledge and with the intent that their votes will count against the proposal under a "shares outstanding" or "shares present or represented by proxy and entitled to vote" standard. If these shareholders knew that the most pertinent standard for ISS's purposes would be a "votes cast" standard, then they very well may have voted "against" in order for their views to be counted.

Finally, concerns over preparation time for 2013 meetings are particularly acute for directors that may face "against" or "withhold" votes in 2013 as a result of 2012 voting results under the Draft Policy. Many companies' preparations for 2013 shareholder meetings are already well underway. In our experience, the method of implementing governance or other changes raised by shareholder proposals is, and should be, an extended and detailed process by both management and the board, incorporating the evaluation of various alternatives, discussions with shareholders, assessment of market practices, and consideration of legal and other implications. There simply will not be sufficient time, in many cases, for boards to give proper attention to these matters in advance of the finalization of the 2013 proxy materials, given that ISS's final policy updates will not be released until November.

* * * * *

We hope this comment letter is useful. We appreciate the opportunity to comment on the Draft Policies and the attention that ISS gives to the comments it receives. If you would like to discuss these matters further, please do not hesitate to contact me at joe.alexander@theclearinghouse.org or212-612-9234.

Very truly yours,

Joseph R. Alexander
Senior Vice President, Deputy General Counsel, and Secretary