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Institutional Shareholder Services (ISS) Introduces Updated QuickScore Governance Ratings System

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ISS has introduced its updated governance ratings system in advance of the system's formal launch on February 18. The updated rating system, QuickScore 2.0, is designed to better assist institutional investors in identifying governance risk in their portfolio companies. This is the fifth iteration of ISS's governance rating system, following the Corporate Governance Quotient, the Governance Risk Indicators database (GRId 1.0 and GRId 2.0) and the original QuickScore, which was introduced just last year.

The updated ratings system retains the original **QuickScore's four governance "pillars" (Board Structure, Compensation/Remuneration, Shareholder Rights and Audit).** Companies will continue to be assigned a decile ranking of 1 through 10 for overall governance and for each of the governance pillars. The decile rankings for U.S. companies are based on raw scores in respect of 88 distinct governance factors, including eight newly introduced factors for U.S. companies, which are identified in bold on the downloadable attachment. Lower decile rankings for the pillars and overall governance scores denote lower governance risk.

The raw scoring system remains complex and opaque. According to ISS, the governance rating for each company is "derived from a scoring methodology that strikes a critical balance between quantitatively driven analysis based on correlations between governance factors and key financial metrics, the ISS voting policy that aligns the qualitative aspect of governance and ISS voting recommendations, and relevant global governance standards and best practices in each region." In other words, the relative correlations and weightings of the factors are determined by ISS and are tied to ISS's subscription product offerings, are applied on a "one-size-fits-all" basis within indices and industries, and remain opaque to the companies being ranked. The QuickScore ranking produces an overly simplistic metric for inherently complex and company-specific fact patterns. Companies should take this into account when considering corporate governance matters and their QuickScore rankings.

Companies should verify their governance data by February 7, and again before mailing their 2014 proxy statements. Companies should access the Governance Analytics platform on the ISS website to review and confirm the data used to determine their governance rating, and to request that ISS make any necessary corrections. ISS has undertaken to fully review and respond to requests for corrections to underlying data. Companies should submit any corrections not later than 8:00 p.m. (ET) on Friday, February 7 in order to ensure that correct data will be reflected in the launch of QuickScore 2.0 on February 18. Companies should also verify their data prior to filing their 2014 proxy statements. ISS has advised that data verification is not available during the period between the filing of a company's proxy statement and the publication of ISS's proxy analysis for the company's annual meeting.

ISS will now update QuickScore rankings on a timely basis to reflect publicly disclosed governance developments. ISS also announced that it will monitor U.S. companies' 8-K filings and other publicly disclosed information related to governance changes, and that these changes will be reflected in a company’s QuickScore ranking on a timely basis.

ISS expects that the most impactful event-driven updates, based on frequency, will be the independence classification of newly appointed directors. However, ISS will now designate a newly appointed director as "unclassified" unless it has sufficient publicly disclosed information regarding the new director. ISS has outlined the following disclosure guidelines for the director independence classification, some of which exceed the disclosure requirements of Form 8-K for director appointments:

- whether the board has made a determination as to the new director's independence, in accordance with Item 407(a) of Regulation S-K;
- whether there were transactions during the prior three years between the company and (i) the director, (ii) the director's employer, (iii) an immediate family member and (iv) an immediate family member's employer, in each case in excess of $10,000, together with the percentage of the recipient's revenues represented by the applicable amount;
- any family relationships, in accordance with Item 401 of Regulation S-K;
- any compensatory arrangements, in accordance with Item 402 of Regulation S-K;
- level of beneficial stock ownership, in accordance with Item 403 of Regulation S-K;

- previous employment with the company, a former parent company or an acquired company;
- whether the director is party to a voting agreement requiring him or her to vote in line with management on matters subject to shareholder vote;
- director and/or family interlocks involving members of the board or compensation committee; and
- whether the director is a founder of the company but not currently employed by the company, and if so, the level of operational involvement with the company.

As a result, unless a company publicly discloses detailed information regarding a newly appointed director beyond the scope of disclosure required by Form 8-K, such an appointment is unlikely to impact the company's scores related to director independence, family relationships and related-party transactions until the next proxy statement is filed. Accordingly, companies appointing new directors outside the annual meeting process with the expectation that such appointments would promptly enhance their QuickScore rankings should consider more expansive disclosure than is otherwise required by Form 8-K.

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