FREDERIC W. COOK & CO., INC.
NEW YORK • CHICAGO • LOS ANGELES • SAN FRANCISCO • ATLANTA • HOUSTON • BOSTON

December 2, 2015

Proxy Advisory Firms Release 2016 Policy Updates

Institutional Shareholder Services ("ISS") and Glass Lewis recently released their 2016 policy updates, which will apply to 2016 annual meetings held on or after January 1 for Glass Lewis and February 1 for ISS. The compensation-related policy changes for the U.S. and Canada are, for the most part, relatively minor or apply to only a limited number of companies. One major change is ISS' Canadian roll-out of its equity plan scorecard for stock plan proposals, similar to the one unveiled in the U.S. for 2015, to companies listed on the Toronto Stock Exchange ("TSX"). The full ISS and Glass Lewis policy updates for 2016, which also include various governance items (e.g., director "overboarding"), are available on their websites.[1]

Both groups have also set the dates for issuers to update their peer groups in 2015: ISS – December 11, and Glass Lewis – December 31.

ISS Equity Plan Scorecard – UNITED STATES

In 2015, ISS adopted its equity plan scorecard for evaluating equity plan proposals. In contrast to the previous approach of pass/fail tests, the scorecard is a multi-factor approach that weighs a variety of positive and negative factors according to a scoring methodology. The plan factors evaluated are grouped under three "pillars": Plan Cost, Plan Features, and Grant Practices. Each factor within the pillars is assigned a maximum potential score (i.e., weighting), with 53 out of a maximum 100 total potential points required to "pass" the ISS model.

As included in ISS' equity plan scorecard FAQs, the 2016 ISS policy updates include five adjustments to equity plan scorecard evaluations, effective for meetings as of February 1, 2016, as follows:

- The "IPO" model, generally applicable to recent IPOs and bankruptcy emergent companies with less than three years of disclosed equity grant data, is re-named "Special Cases."
- Previously, the Grant Practices pillar did not have any weighting under the IPO model. Beginning in 2016, Russell 3000/S&P 500 companies falling under the Special Cases category will be under a new model that includes Grant Practice factors other than Burn Rate and Plan Duration.

[1] http://www.issgovernance.com/policy-gateway/2016-policy-information/
http://www.glasslewis.com/resource/guidelines/

- The Plan Features factor "Automatic Single-Trigger Vesting," which previously provided no points for a plan with automatic vesting of outstanding awards upon a change in control ("CIC") and full points for a plan that did not contain an automatic single-trigger, is renamed "CIC Vesting," with the following scoring levels:
    - Full points if plan provides for: (A) with respect to outstanding time-based awards, either (i) no accelerated vesting or (ii) accelerated vesting only if awards are not assumed/converted; AND (B) with respect to performance-based awards, either (i) forfeiture or termination of outstanding awards or (ii) vesting based on actual performance as of the CIC and/or (iii) on a pro-rata basis for time elapsed in ongoing performance period(s).
    - No points if plan provides for: automatic accelerated vesting of time-based awards OR payout of performance-based awards above target level.
    - Half points if plan provides for any other vesting terms related to a CIC.
- The period required to receive the maximum points with respect to a Post-Vesting/Exercise Holding Period has been increased to 36 months (versus 12 months previously) or until employment termination; companies with a holding period of 12 months or until the ownership guidelines are met will receive half points.
- The weighting of the various factors (i.e., maximum points allocated to the factors) have been adjusted.

Our expectation is that the change to the "CIC Vesting" factor will be the most significant for a majority of companies, as many of those who would have received full points for their plans not containing automatic single-trigger vesting may receive only half points (or less) in 2016 for their treatment of performance awards as many plans leave this entirely to be specified within award agreements. Our interpretation of the treatment of outstanding performance awards required to receive full points for this feature is a default within the plan document which provides for (1) forfeiture or termination, (2) vesting based on actual performance as of the CIC, or (3) vesting on a pro-rata basis (at target or actual performance) for time elapsed as of the CIC.

The 2016 scorecard differentiates the number of points allocated to each pillar based on the classification of the company, as follows:

Classification	Plan Cost	Plan Features	Grant Practices	Comments
S&P 500, Russell 3000	45	20	35	No change
Non-Russell 3000	45	30	25	For Grant Practices, includes only Burn Rate and Duration factors
Special Cases-Russell 3000/S&P500	50	35	15	For Grant Practices, includes all Grant Practices except Burn Rate and Duration
Special Cases-Non-Russell 3000	60	40	0	Does not include any Grant Practices factors

Interestingly, while it was expected that ISS would update the equity plan scorecard for 2016 to require that a minimum vesting requirement would need to apply to all award types in order to get full credit for that feature, there was no change made to this factor. Consequently, a minimum vesting requirement of at least one year applicable to only one award type (i.e., full value or appreciation), with exceptions for death, disability, CIC and a “carve-out” of 5% of shares authorized for grant, will still receive full points.

As in the past, certain plan features deemed egregious by ISS will continue to result in an “Against” recommendation regardless of scoring under the equity plan scorecard:

- A liberal CIC definition that could result in vesting of awards by any trigger other than a full double trigger;
- If the plan would permit repricing or cash buyout of underwater options or SARs without shareholder approval;
- If the plan is a vehicle for problematic pay practices or a pay-for-performance disconnect; or
- If any other plan features or company practices are deemed detrimental to shareholder interests (e.g., tax gross-ups related to plan awards or provision for reload options).

ISS Equity Plan Scorecard – CANADA

For 2016 in Canada, ISS is implementing an equity plan scorecard approach, similar to the one adopted in 2015 for U.S. stock plan proposals, to Canadian TSX companies. The current Canadian policy for equity plans consists of pass/fail tests related to plan cost, non-employee director participation, plan amendment provisions, and repricing without shareholder approval. Under the scorecard approach, the pass/fail plan cost test will be replaced by a scoring system that evaluates a range of positive and negative features of the equity plan proposal.

The key features of the proposed Canadian equity plan scorecard are:

1. Plan Cost: the estimated cost of companies’ equity plans relative to industry/market cap peers as measured by shareholder value transfer (“SVT”) and considering both (a) SVT based on new shares requested plus remaining shares available and outstanding grants, and (b) SVT based only on new shares requested and shares remaining available.
2. Plan Features: (a) reasonable share dilution, (b) absence of problematic CIC provisions, (c) no financial assistance for the exercise or settlement of awards, and (d) public disclosure of the full plan document.
3. Grant Practices: (a) reasonable three-year burn rate relative to market best practices, (b) meaningful time-vesting requirements for the CEO’s most recent equity grants (three-year look-back), (c) the issuance of performance-based equity to the CEO, (d) a clawback provision applicable to equity awards, and (e) post-exercise or post-settlement share-holding requirements (S&P/TSX Composite Index only).

In addition to the above, plans will continue to be assessed using ISS' Canadian policies regarding non-employee director participation, plan amendment provisions, and repricing without shareholder approval. Factors and weightings will be keyed to company size and status using separate models for the S&P/TSX Composite Index and the non-Composite TSX, and there will be special versions of both models where historic grant data is unavailable (e.g., IPOs or emergences from bankruptcy). More information about the policy and weightings will be included in the ISS equity plan scorecard FAQ to be published in December.

ISS Other Policy Changes

Externally Managed Issuer ("EMI") – Although uncommon, some publicly traded companies are managed by an outside firm rather than an employed executive team. As a result, there is usually limited or unusual disclosures around executive compensation at an EMI (which is permitted under the SEC reporting rules that govern disclosure of executive compensation in the registrant's proxy statement). ISS has not considered insufficient disclosure at an EMI to be a problematic pay practice, but has changed its position for 2016. According to ISS, without sufficient information, shareholders are not able to assess the pay programs and linkages to performance for the say-on-pay vote. There may also be conflicts of interest in the arrangements that shareholders are unaware of in the absence of full disclosure.

Under its U.S. policy change for 2016, ISS will generally recommend "Against" the say-on-pay proposal of an EMI where a comprehensive pay analysis is not possible because of insufficient disclosure. Structurally, ISS is implementing this policy by adding insufficient disclosure by an EMI to its list of problematic pay practices that may result in an adverse recommendation on say-on-pay.

ISS is also changing its EMI policy in Canada but in a different way due to governance and exchange rule differences from the U.S. In Canada, ISS' policy for 2016 is for a case-by-case vote on say-on-pay resolutions where provided, or on individual directors, committee members, or the entire board as appropriate, with respect to EMI situations involving minimal or no disclosure taking into consideration various factors such as performance, compensation and expenses paid in relation to peers, board and committee independence, conflicts of interest, and other pay-related issues.

As the compensation committee of an EMI typically has limited authority over the details of the compensation arrangements with the outside management firm, it will be interesting to see how ISS' policy change affects EMI disclosure, compensation committee involvement in the compensation decisions of individual executives of the external manager, and shareholder reactions to ISS say-on-pay vote recommendations.

Shareholder Proposals on Equity Holding Requirements – As a housekeeping item and not a change per se, ISS is also streamlining its U.S. policy on shareholder proposals asking companies to adopt policies requiring senior executive officers to retain all or a significant portion of shares acquired from compensation plans for a certain period of time in various situations. ISS will retain its current policy of reviewing such shareholder proposals on a case-by-case basis taking into account various factors including whether the company has any holding or ownership requirements, actual officer stock ownership, and problematic pay practices (current and past). The revisions, however, broaden ISS' policy to encompass equity retention proposals more generally, eliminating the need for a separate policy tied to a specific retention ratio (e.g., 75% of net shares). The revised policy also clarifies that the suggested retention ratio and the required duration remain two factors that ISS will strongly consider.

ISS Peer Group Updating

Companies wishing to update their compensation peer groups used for setting 2015 executive pay levels should do so by **December 11, 2015**, on ISS' website at http://www.issgovernance.com/u-s-company-peer-group-feedback/.

Glass Lewis Policy Updates

Glass Lewis made only minor clarifying changes to its compensation policies for 2016:

- Some additions were made to the broader discussion of "one-off" awards, which are not viewed favorably, added in 2015. Glass Lewis clarified that sign-on awards made in connection with executive transitions should be clearly disclosed with a meaningful explanation of the payments and the process by which the amounts are determined. This includes any "make-whole" payments for compensation forfeited from a previous employer.

- In regard to equity compensation plans, Glass Lewis explained that qualitative factors are used in addition to quantitative factors to analyze equity plans, and made some minor clarifications to the quantitative factors as well. Qualitative factors include the method and terms of exercise, repricing history, express or implied rights to reprice, and the presence of evergreen provisions. It also includes the choice and rigor of performance metrics and targets, if any. Significant changes to the terms of a plan should be explained for shareholders and clearly indicated.

Equilar Peer Group Updating

Glass Lewis partners with Equilar, a compensation data provider, to incorporate Equilar's market peers for a company in its pay-for-performance analysis. Russell 3000 companies wishing to update their compensation peer groups for disclosure to be in their 2016 proxy statements may do so by **December 31, 2015**, on Equilar's peer group update portal at https://insight.equilar.com/app/peer_update/.

* * * * * *

General questions about this letter can be addressed to Ed Graskamp at 312-894-0031 or edgraskamp@fwcook.com, Kathryn Neel at 212-294-0101 or klneel@fwcook.com, and Samantha Nussbaum at 310-734-0145 or snussbaum@fwcook.com. Copies of this letter and other related materials are available on our website at www.fwcook.com.