December 19, 2017

ISS RELEASES FINAL FAQS FOR THE 2018 PROXY SEASON

On December 14, ISS published (1) U.S. Compensation Policy Frequently Asked Questions (FAQs), (2) U.S. Equity Compensation Plans FAQs, and (3) Pay-for-Performance Mechanics, an updated "white paper." These documents follow the release of ISS' policy updates on November 16 and preliminary FAQs on November 21.[1]

Few new policies are introduced for 2018, but the FAQs update or clarify several outstanding compensation policies and the Pay-for-Performance Mechanics "white paper" provides detail on the methodology behind ISS' quantitative pay-for-performance test incorporating the new Financial Performance Assessment (FPA). These policies apply to public U.S. companies with annual shareholder meetings on or after February 1, 2018.

U.S. Quantitative Pay-for-Performance Test

ISS Policy Item[2]	2018 Policy Update
Quantitative Pay-for-Performance Test Thresholds	• Multiple of Median (MOM) threshold for Medium concern for S&P 500 companies reduced from 2.33 to 2.00 times. High concern threshold remains unchanged at 3.33. No change to thresholds for non-S&P 500 companies. • No changes to Relative Degree of Alignment (RDA) or Pay-TSR Alignment (PTA) thresholds for any companies.
Total Shareholder Return (TSR) Calculation Methodology	• ISS will calculate TSR for the RDA test component by averaging the closing prices across all trading days contained in the months closest to the fiscal year-end of the company, both at the beginning and the end of the TSR measurement period (three-year period ending closest to the fiscal-year end of the company). • ISS currently calculates TSR using only the ending stock price as of a company's fiscal year end. The change in methodology is intended to reduce the impact of point-to-point stock price volatility.

[1] See FW Cook Alerts dated November 20, 2017 and November 28, 2017.
[2] [New] denotes a new policy, all other items are updates or clarifications to existing policies.

ISS Policy Item[2]	2018 Policy Update
Financial Performance Assessment (FPA) Test New	• ISS adopted the FPA as a third relative assessment under the quantitative component of its pay-for-performance analysis. FPA will compare three-year CEO pay rank to three-year financial performance rank using ISS' peer group. • FPA will be applied as a secondary measure after the "initial" quantitative screen (i.e., RDA, MOM, and PTA), but will only affect the overall quantitative concern level if a company is (i) a Medium concern under any of the three initial measures, or (ii) a Low concern but bordering the Medium concern threshold under any of the three initial measures. See Appendix A for details. • When the initial three measures exhibit a High concern level or a Low concern level that is not bordering a Medium threshold, the overall score will not be impacted by FPA results. • ISS does not detail how the FPA score is applied to the initial quantitative screen and does not disclose how FPA metrics are weighted.
FPA Metrics	• Financial performance will be evaluated using four metrics (three for Banks and Diversified Financials) with the metrics and weighting varying by industry. • The metrics for 19 of the 24 industries covered are return on invested capital (ROIC), return on equity (ROE), return on assets (ROA), and EBITDA growth. • See the Appendix B for details on the financial metric measurement periods and a table of the metrics and weighting rank by industry using four-digit Global Industry Classification Standard (GICS) codes.

U.S. Compensation Policies

ISS Policy Item[3]	2018 Policy Update
Board Responsiveness to Low Support on Say-on-Pay (SOP) Proposal	• If a company's SOP proposal receives less than 70% support of votes cast, ISS will review: ➢ Details on breadth of engagement, including frequency and timing of engagement, number of institutional investors, and company participants (including whether independent directors participated); ➢ Disclosure on feedback received on concerns that led to "Against" vote, and specific and meaningful actions taken to address the issues; and ➢ In addition to the above, ISS has historically examined other compensation actions taken by the company, the persistence of problematic issues, whether the issues raised are recurring or isolated,

[3] [New] denotes a new policy, all other items are updates or clarifications to existing policies.

ISS Policy Item[3]	2018 Policy Update
	company's ownership structure, and whether the support level was less than 50%. • In cases of inadequate responsiveness, ISS may recommend a vote "Against" the SOP proposal, compensation committee members, and/or the full board.
List of Problematic Pay Practices New	• While not highlighted by ISS as a new or materially updated item in the FAQs, the following problematic severance provision is included in this year's list but was absent from the prior year's list of problematic pay practices: ➢ A "Good Reason" severance definition that is triggered by company bankruptcy or other actions indicative of performance failures.
Problematic Pay Practices Most Likely to Result in Adverse Vote Recommendation	• "Any lifetime perquisites" were added to the list of items categorized as extraordinary perquisites. • New or extended executive agreements that provide for (in addition to several existing provisions under this category): ➢ Multi-year guaranteed awards that are not at-risk due to rigorous performance conditions; or ➢ Liberal change-in-control (CIC) definition combined with any single-trigger CIC benefits. • A catch-all provision was added to the list that includes any provision or practice, including any problematic pay practices, deemed to be egregious and present a significant risk to investors.
Excessive Levels of Non-Employee Director Pay New	• Adverse vote recommendations may be applied to directors responsible for approving/setting non-employee director compensation when there is a recurring pattern of excessive pay magnitude relative to the median of all non-employee directors at companies in the same index and industry (i.e., purpose is to identify extreme outliers, historically represented by pay figures above the top 5% of all comparable directors). • Negative recommendation is triggered only if there is a pattern (two or more consecutive years) of excessive pay without a compelling rationale. Since the policy is implemented in 2018, we anticipate this will not affect director elections until 2019.
CEO Pay Ratio New	• For companies required to disclose the CEO pay ratio in 2018, ISS will display in research reports (i) the median employee pay figure, and (ii) the CEO pay ratio. • The CEO Pay Ratio will not impact ISS' vote recommendations in 2018.

U.S. Equity Compensation Policies

ISS Policy Item[4]	2018 Policy Update
Grants of Time-based Restricted Shares in Consideration for Acquisition and Burn Rate Calculation **New**	• Companies may request that restricted shares granted in consideration for an acquisition be excluded from the ISS burn rate calculation (equity that vests based on performance is not eligible for this exclusion). • Companies must provide tabular disclosure to enable ISS to determine the shares used in each of the most recent three years in this context.
Updated Burn Rate Tables	• ISS issued updated burn rate benchmarks for S&P 500, Russell 3000 (non-S&P 500), and non-Russell 3000 companies. See Appendix C for details.
Burn Rate Commitments	• ISS no longer considers new burn rate commitments. As of 2017, all legacy burn rate commitments have lapsed.
Liberal Definition of CIC	• Acquisition of a low percentage of outstanding common stock is one of five legacy CIC definitions viewed by ISS as liberal. ISS modified the definition of "low percentage" from 20% and below to 15% and below. • CIC defined broadly so as to be triggered by ordinary course events (e.g., death or retirement of directors resulting in majority board turnover) is newly added as a liberal definition of CIC. • CIC triggered by the addition of new directors that were not nominated by the incumbent board (i.e., proxy contest) is not considered liberal.
Equity Plan Proposal Seeking Approval of One or More Plan Amendments	• ISS recommendation generally based on EPSC evaluation/score if: ➢ Amendments include an extension of the plan's term; or ➢ Amendments include the addition of full value awards as an award type when the current plan authorizes only appreciation awards. • This is in addition to ISS' historical practice of evaluating proposals based on EPSC evaluation when there is a material request for additional shares or if this is the first-time shareholders can opine on the plan. • Otherwise, ISS recommendation is based on the overall impact of the amendments (i.e., beneficial or contrary to shareholder interests) as opposed to the EPSC score; however, EPSC summary and scoring will be displayed for information purposes.

[4] [New] denotes a new policy, all other items are updates or clarifications to existing policies.

ISS Policy Item[4]	2018 Policy Update
Repricing Provisions	• Repricing provisions that would be considered an overriding factor resulting in a negative vote recommendation regardless of EPSC score: ➢ Direct exercise price reduction of outstanding stock options; ➢ Cancellation of outstanding options in exchange for the grant of new options with a lower exercise price; ➢ Cancellation of underwater options in exchange for stock awards; or ➢ Cash buyouts of underwater options.
Equity Plan Amendment Proposal when the Updated Plan Document is not Disclosed **New**	• In the event a company presents a plan amendment proposal but does not disclose the revised equity plan document in the proxy and also does not indicate where the document is filed, ISS may recommend "Against" the proposal as the company has not provided sufficient information to fully evaluate the revised plan.
Qualitative Review of Director Pay for Director Equity Plan Approval	• Qualitative factors examined when a stand-alone director equity plan exceeds the plan cost or burn rate benchmarks: ➢ Magnitude of compensation relative to companies of a similar profile; ➢ Presence of problematic pay practices related to director compensation; ➢ Director stock ownership guidelines and holding requirements; ➢ Equity award vesting schedules; ➢ Mix of cash and equity-based compensation; ➢ Meaningful limits on director compensation; ➢ Availability of retirement benefits or perquisites; and ➢ Quality of disclosure surrounding director compensation.

U.S. Equity Plan Scorecard (EPSC)

EPSC Factor[5]	2018 Policy Update
Passing EPSC Score	• Total points required to receive ISS support on an equity plan proposal subject to the EPSC will increase from 53 to 55 for S&P 500 companies. • The total point requirement for non-S&P 500 companies will remain unchanged at 53.

[5] [New] denotes a new policy, all other items are updates or clarifications to existing policies.

<table>
<tr><th>EPSC Factor[5]</th><th>2018 Policy Update</th></tr>
<tr><td>Maximum Scores by EPSC Model and Pillars</td><td>There are five EPSC models based on the type and status of the company. See Appendix D for updated maximum scoring by EPSC model and pillar (Plan Cost, Plan Features, Grant Practices).</td></tr>
<tr><td>Change in Control (CIC) Vesting</td><td>Partial credit for CIC vesting provisions in an equity plan has been eliminated under the EPSC. Only full points or no points will be credited to this factor.
Full points will be credited if the equity plan includes the following provisions:
For performance-based awards, acceleration is limited to actual performance achieved, pro-rata of target based on the elapsed proportion of the performance period, a combination of both actual and pro-rata, or the performance awards are forfeited or terminated upon a CIC. In cases where there are no performance-based awards, points for this factor will be based solely on the treatment of time-based awards.
For time-based awards, acceleration upon a CIC cannot be automatic single-trigger or discretionary (unless awards are not assumed).
No points will be credited if the above requirements are not met, including the use of board discretion, which receives partial credit under the current (2017) policy.</td></tr>
<tr><td>Minimum Vesting Requirement</td><td>Full points will be credited if vesting period ≥ 1 year, but no points for plans that allow shares to vest over the course of the 1-year period (e.g., monthly ratable vesting). All award types issuable under the plan must be subject to this provision and the criteria must apply to no less 95% of the shares authorized for grant (i.e., 5% carve-out).
Unlike in prior years, a general statement of ratable vesting over a period of time (i.e., awards will vest over two years) will not suffice as ratable vesting could be daily, monthly, etc.</td></tr>
<tr><td>Holding Requirement</td><td>Partial credit for post-vesting or exercise holding requirements has been eliminated. Only full points or no points will be credited to this factor.
Full points will be credited for a 12-month holding period on shares received from grants (reduced from the current 36-month period requirement).
No points will be credited for holding periods of less than 12 months or if the holding requirement only applies until an ownership guideline is met.</td></tr>
<tr><td>CEO Vesting Requirement</td><td>Partial credit for CEO vesting requirements has been eliminated under the EPSC. Only full points or no points will be credited to this factor.</td></tr>
</table>

EPSC Factor[5]	2018 Policy Update
	• Full points will be credited for a minimum three-year vesting period, which is a change from the greater than four-year period required for full credit under the current policy. • No points will be credited for periods of less than three years, which is unchanged from the current policy. Partial credit is provided for minimum vesting of three to four years under the current policy.
Broad Discretion to Accelerate Vesting	• Full points credited if discretion to accelerate unvested awards is limited to cases of death and disability (CIC is no longer an acceptable reason).

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Full details regarding ISS' 2018 policy updates, FAQs, and whitepapers can be found here.

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Appendix A

Quantitative Pay-for-Performance Concern Levels

(Source: ISS Pay-for-Performance Mechanics)

The table below shows the levels for each measure that indicate where a company would be considered to have a misalignment between pay and performance triggering a Medium or High concern level. The "Eligible For FPA Adjustment" thresholds displayed below indicate RDA, MOM and PTA that are deemed to be bordering the Medium concern threshold – companies with results in that band will be eligible for their Overall Quantitative Concern to be impacted by the FPA score.

	Quantitative Concern Thresholds: non-S&P 500		
Measure	Eligible for FPA Adjustment	Medium Concern	High Concern
Relative Degree of Alignment	-28.4	-40	-50
Multiple of Median	1.74x	2.33x	3.33x
Pay-TSR Alignment	-13%	-20%	-35%

Beginning with meetings on or after Feb. 1, 2018, S&P 500 companies will have a distinct set of thresholds from other Russell 3000E companies for the Multiple of Median (MOM) test. The lower threshold reflects increasing investor scrutiny regarding the escalating quantum of CEO pay among large-cap companies.

	Quantitative Concern Thresholds: S&P 500 only		
Measure	Eligible for FPA Adjustment	Medium Concern	High Concern
Relative Degree of Alignment	-28.4	-40	-50
Multiple of Median	1.64x	2.00x	3.33x
Pay-TSR Alignment	-13%	-20%	-35%

Appendix B

Relative Financial Performance Assessment (FPA)

(Source: ISS Pay-for-Performance Mechanics)

Metric Measurement Period

Financial metrics are generally measured over a three-year period (unless the subject company has only two years of data). For a three-year period, the metrics are calculated over the trailing 12 quarters (or 16 quarters for growth metrics) as of the applicable Quarterly Data Download (QDD) for each company, using quarterly financial data. ISS downloads the financial model inputs for all companies four times per year.

Shareholder Meeting Date Range		Data Download Date
From	To	
March 1	May 31	December 1
June 1	August 31	March 15*
September 1	November 30	June 1
December 1	February 29	September 1

Downloads occur on the dates as shown, with the QDD used for a given analysis depending on the shareholder meeting date.

*In 2018, the Quarterly Data for meetings occurring between June 1 and August 31 will be collected for FPA purposes only on March 15 instead of March 1 to capture a greater universe of companies' annual financial disclosures.

Metrics and Weighting Rank by Industry

GICS-4	Industry	Rank 1	Rank 2	Rank 3	Rank 4
1010	Energy	ROIC	ROA	ROE	EBITDA Growth
1510	Materials	ROA	ROE	EBITDA Growth	ROIC
2010	Capital Goods	ROIC	ROA	ROE	EBITDA Growth
2020	Commercial & Professional Services	ROIC	ROE	ROA	EBITDA Growth
2030	Transportation	ROIC	ROA	ROE	EBITDA Growth
2510	Automobiles & Components	ROIC	ROA	ROE	EBITDA Growth
2520	Consumer Durables & Apparel	ROIC	ROA	ROE	EBITDA Growth
2530	Consumer Services	EBITDA Growth	ROIC	ROA	ROE
2540	Media	ROIC	ROA	ROE	EBITDA Growth
2550	Retailing	ROE	ROIC	ROA	EBITDA Growth
3010	Food & Staples Retailing	ROA	ROIC*	ROE*	EBITDA Growth
3020	Food Beverage & Tobacco	ROA	ROIC*	ROE*	EBITDA Growth
3030	Household & Personal Products	ROA	ROIC*	ROE*	EBITDA Growth
3510	Health Care Equipment & Services	EBITDA Growth	ROIC	ROA	ROE
3520	Pharmaceuticals, Biotechnology & Life Sciences	ROIC	EBITDA Growth	ROA	ROE
4010	Banks	ROA	ROIC*	ROE*	
4020	Diversified Financials	ROIC	ROA*	ROE*	
4030	Insurance	ROIC*	ROA*	Cash Flow Growth	ROE
4510	Software & Services	ROIC	ROA	ROE	EBITDA Growth
4520	Technology Hardware & Equipment	ROIC*	ROA*	ROE**	EBITDA Growth**
4530	Semiconductors & Semiconductor Equipment	ROIC	ROA	ROE	Cash Flow Growth
5010	Telecommunication Services	ROA	ROE	ROIC	EBITDA Growth
5510	Utilities	ROIC	ROA	ROE	EBITDA Growth
6010	Real Estate	ROIC	ROA	ROE	Cash Flow Growth

Note: All references to Cash Flow reflect operating cash flow growth.

* Indicates equal weighting for two metrics within an industry. These metrics are listed adjacently in this table.

** For GICS 4520, metrics with rank 1 and 2 are weighted equally, and metrics with rank 3 and 4 are also weighted equally but less than the rank 1 and 2 metrics.

Appendix C
Updated Burn Rate Tables
(Source: ISS U.S. Equity Compensation Plans: FAQs)

S&P 500

GICS	Description	Mean	Standard Deviation	Burn Rate Benchmark*	
10	Energy	1.14%	0.54%	2.00%	*
15	Materials	1.06%	0.52%	2.00%	*
20	Industrials	1.24%	0.68%	2.00%	*
25	Consumer Discretionary	1.47%	0.94%	2.40%	
30	Consumer Staples	1.18%	0.51%	2.00%	*
35	Health Care	1.75%	0.77%	2.52%	
40	Financials	1.82%	1.42%	3.24%	
45	Information Technology	3.19%	1.65%	4.84%	
50	Telecommunication Services	0.91%	0.50%	2.00%	*
55	Utilities	0.70%	0.32%	2.00%	*
60	Real Estate	0.82%	0.68%	2.00%	*

Russell 3000 (excluding the S&P 500)

GICS	Description	Mean	Standard Deviation	Burn Rate Benchmark*
1010	Energy	2.27%	1.47%	3.74%
1510	Materials	1.64%	0.97%	2.61%
2010	Capital Goods	2.00%	1.70%	3.70%
2020	Commercial & Professional Services	2.60%	1.64%	4.24%
2030	Transportation	1.62%	1.04%	2.66%
2510	Automobiles & Components	2.02%	0.97%	3.00%
2520	Consumer Durables & Apparel	2.33%	1.47%	3.80%
2530	Consumer Services	2.76%	2.79%	5.55%
2540	Media	2.18%	1.42%	3.60%
2550	Retailing	2.38%	1.82%	4.20%
3010	Food & Retailing Staples	1.70%	0.95%	2.65%
3020	Food, Beverage & Tobacco	1.57%	0.81%	2.37%
3030	Household & Personal Goods	3.14%	1.80%	4.93%
3510	Health Care Equipment & Services	3.51%	2.17%	5.69%
3520	Pharmaceuticals & Biotechnology	4.70%	2.38%	7.08%
4010	Banks	1.62%	1.31%	2.93%
4020	Diversified Financials	4.03%	4.60%	8.63%
4030	Insurance	2.01%	2.34%	4.36%
4510	Software & Services	6.35%	3.88%	10.22%
4520	Technology Hardware & Equipment	3.76%	2.40%	6.16%
4530	Semiconductor Equipment	4.21%	2.11%	6.32%
5010	Telecommunication Services	3.69%	3.41%	7.10%
5510	Utilities	0.97%	1.12%	2.09%
6010	Real Estate	1.38%	1.45%	2.82%

*The benchmark is generally the Mean + Standard Deviation, subject to minimum benchmark of 2%. In addition, year-over-year burn-rate benchmark changes are limited to a maximum of two (2) percentage points plus or minus the prior year's burn-rate benchmark.

Appendix C (continued)

Updated Burn Rate Tables

(Source: ISS U.S. Equity Compensation Plans: FAQs)

Non-Russell 3000 GICS	Description	Mean	Standard Deviation	Burn Rate Benchmark*	
1010	Energy	3.04%	3.00%	6.04%	
1510	Materials	2.88%	2.75%	5.62%	
2010	Capital Goods	3.40%	2.46%	5.85%	
2020	Commercial & Professional Services	5.64%	4.01%	9.40%	*
2030	Transportation	4.14%	3.33%	6.51%	*+
2510	Automobiles & Components	3.59%	2.95%	6.23%	*
2520	Consumer Durables & Apparel	3.10%	2.16%	5.26%	
2530	Consumer Services	2.42%	1.75%	4.18%	
2540	Media	5.02%	3.69%	8.71%	
2550	Retailing	4.39%	2.14%	6.53%	
3010, 3020, 3030	Consumer Staples	4.10%	3.47%	7.57%	+
3510	Health Care Equipment & Services	5.16%	3.17%	8.33%	
3520	Pharmaceuticals & Biotechnology	5.19%	3.53%	8.72%	
4010, 4020, 4030	Financials	2.68%	3.02%	5.70%	+
4510	Software & Services	5.38%	4.10%	9.48%	
4520	Technology Hardware & Equipment	4.51%	3.25%	7.76%	
4530	Semiconductor Equipment	4.51%	2.77%	7.27%	
5010	Telecommunication Services	6.93%	3.15%	10.08%	
5510	Utilities	2.99%	2.77%	4.83%	*
6010	Real Estate	2.42%	4.33%	5.07%	*

*The benchmark is generally the Mean + Standard Deviation, subject to minimum benchmark of 2%. In addition, year-over-year burn-rate benchmark changes are limited to a maximum of two (2) percentage points plus or minus the prior year's burn-rate benchmark.
+Benchmark based on all companies in the 2-digit GICS average due to insufficient number of companies to analyze within the 4-digit GICS industry.

Appendix D

Maximum Scores by EPSC Model and Pillars

(Source: ISS U.S. Equity Compensation Plans: FAQs)

Pillar	Model	Maximum Pillar Score 2018	2017	Comments
Plan Cost	S&P 500, Russell 3000, Non-Russell 3000	45	45	All models include the same Plan Cost factors
	Special Cases – Russell 3000 / S&P 500*	50	50	
	Special Cases – Non-Russell 3000*	60	60	
Plan Features	S&P 500, Russell 3000	19 (New)	20	All models include the same Plan Features factors
	Non-Russell 3000	30	30	
	Special Cases – Russell 3000 / S&P 500*	33 (New)	35	
	Special Cases – Non-Russell 3000*	40	40	
Grant Practices	S&P 500, Russell 3000	36 (New)	35	The Non–Russell 3000 model includes only Burn Rate and Duration factors. The Special Cases model for Russell 3000 / S&P 500 companies includes all Grant Practices factors except Burn Rate and Duration. The Special Cases model for Non–Russell 3000 companies does not include any Grant Practices factors.
	Non-Russell 3000	25	25	
	Special Cases – Russell 3000 / S&P 500*	17 (New)	15	
	Special Cases – Non-Russell 3000*	0	0	

*Generally covers companies that recently had their IPO, were spun off, or emerged from bankruptcy that do not disclose 3 years of grant data.