ALERT

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PROXY ADVISORY FIRMS RELEASE 2017 POLICY UPDATES

Institutional Shareholder Services Inc. ("ISS") and Glass, Lewis & Co., LLC ("Glass Lewis") recently published their 2017 policy updates, which will apply to issuers with annual meetings on or after January 1 for Glass Lewis and February 1 for ISS.

ISS' U.S. and Canadian compensation-related policy changes were few but far reaching, including highly anticipated changes to its pay-for-performance evaluation methodology. Glass Lewis reported no compensation-related U.S. policy changes, but did clarify that it expects clear reconciliations to GAAP financials when non-GAAP metrics are used. The full list of policy updates, including non-compensation-related governance updates, can be found on each proxy advisors' website.[1]

Summary of Key Compensation-Related Policy Changes – ISS

Area	Changes
Pay-for-Performance	• ISS will evaluate 3-year relative performance against six financial metrics as part of the qualitative evaluation • The metrics are: Return on Invested Capital, Return on Assets, Return on Equity, Revenue growth, EBITDA growth, and growth in Cash Flow from Operations
Equity Plan Scorecard [2]	• **Dividends**: added dividends payable as a new plan feature for evaluation under the scorecard. Full points will be earned for this factor if the plan prohibits payment of dividends before vesting, including time-based restricted stock/units • **Minimum Vesting**: modified how this existing plan feature will be scored. ISS now requires issuers to specify a minimum vesting period of one year on all award types to receive full points instead of on a single award type, as was allowed previously
Non-Employee Director [3] Compensation	• New policies for evaluating Say-on-Director-Pay proposals • Identification of problematic director pay practices • Broadened evaluation criteria for director equity plans

[1] [ISS] https://www.issgovernance.com/file/policy/2017-americas-iss-policy-updates.pdf;
[Glass Lewis] http://www.glasslewis.com/guidelines/

[2] Other changes pertaining to the application of current policies (e.g., burn rate and pay-for-performance concern thresholds) are typically announced through updated ISS FAQs in mid-December.

[3] References to "directors" in this memo are intended to reflect a company's non-employee directors of the board.

Pay-for-Performance (U.S. and Canada)

Issue: ISS' pay-for-performance evaluation is based on a quantitative and qualitative performance screen. The quantitative screen measures alignment between historical CEO pay and total shareholder return ("TSR") through three distinct tests: (1) Relative Degree of Alignment, (2) Multiple of Median, and (3) Pay-TSR Alignment. The qualitative screen is a holistic review of a company's pay programs and practices to identify any probable causes for pay-for-performance misalignment. Results from both performance screens are largely viewed as the determining factors behind ISS' Say-on-Pay vote recommendation.

Change 1: Beginning in 2017, ISS' qualitative performance screen will include an evaluation of companies' performance relative to peers on six financial metrics:

- Return on Invested Capital ("ROIC")
- Return on Assets ("ROA")
- Return on Equity ("ROE")
- Revenue growth
- EBITDA[4] growth
- Growth in Cash Flow from Operations

- Measured over 3-year periods relative to ISS' selected peer group; results will include an overall weighted financial performance metric
- Weightings will vary by industry (4-digit Global Industry Classification Standards ("GICS") industry group)
- ISS' quantitative performance screen is not impacted by this change
- Issuers that subscribe to ISS Corporate Solutions' ExecComp Analytics will be able to model their performance beginning in early December (against updated peer groups in mid-January)

Change 2: Relative Degree of Alignment ("RDA") assessment will be considered in the overall quantitative concern level only when the subject company has a minimum of two years of pay and TSR data. Companies that have only one year of data will receive an N/A (not applicable) concern for their RDA test.

Change 3 (Canada only): The ISS peer group construction methodology will now incorporate information from each company's self-determined peers for pay benchmarking purposes (similar to U.S. practices). Those peer selections, along with the GICS industry groups from which those peers are selected, will inform ISS' peer group construction process.

FW Cook Observations: The introduction of financial performance metrics in this analysis is a positive first step in addressing long-standing criticism by some issuers and investors of ISS' overemphasis on TSR as the sole measure of company performance. This move also aligns with Glass Lewis' pay-for-performance evaluation which has historically measured relative performance against five metrics (TSR, ROA, ROE, Earnings Per Share growth and Change in Operating Cash Flow). Assuming ISS can strike the right balance in applying an appropriate weighting to each metric, which will reflect differences between industries, we would anticipate the financial assessment to become a prominent component of the quantitative performance screen in future years.

[4] EBITDA = earnings before interest, taxes, depreciation and amortization.

Equity Plan Scorecard (“EPSC”) (U.S. and Canada)

Issue: For 2015 in the U.S. (2016 in Canada), ISS began evaluating equity-based and other incentive plan proposals under a scorecard approach based on three pillars: (1) Plan Cost, (2) Plan Features, and (3) Grant Practices. ISS will generally recommend a vote “against” a plan proposal if the combination of above factors indicates that the plan is not, overall, in shareholders' interests, or if the plan maintains egregious provisions that are deemed to have a negative impact on shareholders’ interests.

Change 1: Add “Dividends Payable Prior to Award Vesting” as a Plan Feature. Under this new factor, full points will be earned if the plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award; however, accrual of dividends payable upon vesting is acceptable.

Change 2: ISS also modified the “Lack of Minimum Vesting Period for Grants Made under the Plan” Plan Feature. To earn full points for this factor, the plan must specify a minimum vesting period of at least one year for all award types under the plan, and no points will be earned if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement. Previously, ISS allotted full points if the plan imposed a minimum vesting period to any one award type with no published penalty for individual award agreements that reduced or eliminated the requirement.

FW Cook Observation: The addition of a Plan Feature that focuses on the timing of dividend payments is not unexpected given ISS’ historical position on the payment of dividends on unearned performance-based awards. The amendment to the minimum vesting requirement closes a loophole that previously allowed issuers to earn full points even if the minimum vesting requirement only applied to a single award type. Further, the heightened scrutiny over plan terms and award agreements may have implications for companies that use language such as, “unless otherwise provided in individual award agreements.” We anticipate that ISS will maintain the historical exception guidelines, which include a 5% carveout to the minimum vesting requirement and vesting acceleration upon certain termination scenarios (i.e., death, disability, change in control), when they release their FAQs in mid-December.

Shareholder Ratification of Director Pay Programs (“Say-on-Director-Pay”) (U.S.)

Issue: A minority of issuers have put forth advisory proposals seeking shareholder ratification of their director compensation programs in response to the increasing shareholder scrutiny of excessive director compensation that may compromise the objectivity and independence of directors.

Change: Codify the evaluation framework applied to director pay programs. ISS will recommend votes on a case-by-case basis after a holistic review of the following factors:

- The relative magnitude of director compensation as compared to companies of a similar profile;
- The presence of problematic pay practices relating to director compensation;
- Director stock ownership guidelines and holding requirements;
- Equity award vesting schedules;
- The mix of cash and equity-based compensation;
- Meaningful limits on director compensation;

- The availability of retirement benefits or perquisites; and
- The quality of disclosure surrounding director compensation

FW Cook Observations: Historically, proxy advisors have refrained from commenting on the appropriateness of director pay levels, but recent high profile lawsuits questioning the reasonableness of director pay have drawn widespread attention to this topic. Arguably the most notable was the settlement in late January of *Espinoza v. Zuckerberg*, a case challenging the reasonableness of stock awards to Facebook's directors. In addition to attorneys' fees of $525,000 payable to the plaintiff's lawyers, which were considerably higher than past fees, the settlement can be read to require a shareholder vote every time there is an increase in director pay. This created a precedent of a "Say-on-Director-Pay" standard, which may have prompted ISS to develop a policy to address this issue.

Problematic Director Pay Practices (Canada)

Issue: ISS is introducing a policy for Toronto Stock Exchange listed companies to identify problematic pay practices in director compensation programs.

Change: ISS will generally recommend that shareholders "withhold" votes for the chair or other members of the committee responsible for director compensation (or board chair or full board if no such committee is identified) where pay practices pose a risk of compromising director independence or are otherwise viewed as problematic, such as:

- Excessive (relative to standard market practice) inducement grants issued upon the appointment or election of a new director to the board (consideration will be given to the form in which the compensation has been issued and the board's rationale for the inducement grant);
- Performance-based equity grants to directors which could pose a risk of aligning directors' interests away from those of shareholders and toward those of management; and
- Other significant problematic practices relating to director compensation.

FW Cook Observations: ISS notes this policy reflects best practices within the Canadian market as outlined by the Canadian Coalition for Good Governance's ("CCGG") *2011 Director Compensation Principles*.[5] The CCGG is a group of Canada's largest pension funds, mutual funds, and money managers that is largely attributed with persuading issuers to voluntarily adopt an advisory shareholder Say-on-Pay vote in Canada.

Equity Plans for Directors (U.S.)

Issue: Director stock plan proposals are not evaluated by ISS under the EPSC, but instead are evaluated through a combination of quantitative (Shareholder Value Transfer, Burn Rate) and qualitative factors.

Change: ISS clarified and broadened the various factors considered when assessing the reasonableness of director equity plans. ISS' vote recommendation will be case-by-case, looking holistically at all of the factors. The new qualitative factors include magnitude of compensation, presence of problematic pay practices, and meaningful limits on compensation.

[5] http://www.ccgg.ca/site/ccgg/assets/pdf/2011_Director_Comp_PolicyMarch25.pdf

Self-Selected Peer Group Update and Submission (U.S. and Canada) – ISS and Glass Lewis

Issue: Both ISS and Glass Lewis incorporate information from issuers' self-selected pay benchmarking peer groups in their proprietary peer group construction methodology. Issuers wishing to submit their compensation peer group used to set 2016 pay for proxy advisor consideration may do so at the following:

- **ISS:** https://www.issgovernance.com/company-peer-group-feedback/ (submission deadline Dec. 9, 2016)
- **Glass Lewis[6]:** https://insight.equilar.com/app/peer_update/ (submission deadline Dec. 31, 2016)

Issuer Data Report Enrollment – Glass Lewis

Issue: Historically, Glass Lewis has not made the company information used in their proxy analysis reports available in advance for companies to review and verify. Beginning in 2015 for the U.S. (2016 for companies in Canada, UK, and other European countries), Glass Lewis began providing a free Issuer Data Report ("IDR") to companies that enrolled, with 48 hours to review the accuracy and correct any errors (with supporting documentation). The IDR is not intended as a preview of the final Glass Lewis analysis – no voting recommendations are included. The enrollment period to receive an IDR for 2017 opened on November 17 and is on a first-come, first-served basis through January 6.[7]

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General questions about this summary can be addressed to:

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Copies of this summary and other published materials are available on our website at www.fwcook.com.

[6] Glass Lewis uses Equilar's Market Peers algorithm to generate peer groups. Equilar is a third-party data provider.
[7] http://www.glasslewis.com/glass-lewis-issuer-data-report-service-enrollment-opens-2017-proxy-season/