

November 3, 2016

# ISS RELEASES 2017 DRAFT POLICY CHANGES FOR COMMENT

On October 27, Institutional Shareholder Services (“ISS”) issued draft 2017 proposed policy changes for comment.<sup>1</sup> Feedback received during the solicitation period, which runs through November 10, will be used by ISS in finalizing changes to its benchmark policies. Draft policies are specific to country or geographic region (e.g., Europe, Asia) and approved changes will become part of the proxy voting guidelines used by ISS Research in developing vote recommendations for issuers with annual meetings on or after February 1, 2017.

ISS subjects some, but not all, draft policies for review and comment. Notably absent from the draft policies is a highly anticipated change to ISS’ pay-for-performance test. In September, ISS signaled the potential addition of a secondary metric to complement Total Shareholder Return in measuring quantitative pay-for-performance alignment.

## Background

The draft policy comment period is one of the final steps in ISS’ annual policy development process, which begins in August with a broad policy survey intended to elicit institutional investor and corporate issuer feedback on a wide range of corporate governance policies and practices. Final policy changes, which may include policies that were not issued as draft for comment, will be announced in the second half of November. 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. All changes will apply to issuers with annual meetings on or after February 1, 2017.

### ISS Policy Development Process Timeline



<sup>1</sup> Draft policy changes can be found at <https://www.issgovernance.com/policy-gateway/2017-benchmark-policy-consultation/>

## U.S. Policy – Executive Pay Assessment (Cross-Market Companies)

**Issue:** Foreign companies listed in the U.S. (U.S. Domestic Issuers) with multiple Say-on-Pay proposals

**Change<sup>2</sup>:** (1) Align vote recommendations to avoid inconsistent recommendations on the same pay program, and (2) use policy perspective of the country of listing. If there is no applicable U.S. policy related to a proposal on ballot, the policy of the country with the vote requirement would apply

**Request for Comment:** How should companies that are dual-listed or have dual incorporations fit into this framework?

## Canada Policy – Director Compensation

**Issue:** Problematic pay practices in non-employee director compensation (e.g., excessive inducement equity grants, awards of performance-based equity)

**Change<sup>2</sup>:** Potentially recommend to “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 identified) where pay practices pose a risk of compromising director independence or are otherwise viewed as problematic

**Request for Comment:** (1) At what point should an inducement grant be considered excessive (e.g. a multiple of the value of routine individual director equity grants, a multiple of total average individual director compensation, a fixed value, etc.)? (2) In the case of an inducement grant which may be considered problematic due to quantum, are there any terms or provisions which, if affixed to the grant, would mitigate such concerns? (3) In addition to excessive inducement grants to new non-employee directors and the issuance of performance-based equity awards to non-employee directors, are there other significant problematic non-employee director pay practices which ISS should highlight and oppose?

## Europe, U.K. & Ireland Policies – European Pay-for-Performance Methodology

**Issue:** Pay-for-performance alignment exists in principle, but no formal method to measure alignment

**Change:** Formalize reference in ISS’ voting guidelines of the pay-for-performance methodology, which was implemented in Europe in 2016 with specific reference to Peer Group Alignment and Absolute Alignment tests

**Request for Comment to Investors:** (1) What role does (relative) quantum of pay play in your assessment of pay packages? (2) In case of an issue with quantum of pay or an apparent misalignment between pay and performance, are your considerations the same whether it concerns either the short-term bonus or long-term incentives? (3) Would you consider voting against the board/remuneration committee members rather than the say on pay voting item in cases where abusive discretionary power appears to be driving any misalignment? (4) Do you believe that significant misalignment between pay and performance or pay substantially above median may reveal potential governance risks?

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<sup>2</sup> Proposals evaluated on a case-by-case basis.

**Request for Comment to Issuers:** (1) Do you believe that investors should consider both the quantum of pay and pay for performance alignment when voting on remuneration related resolutions at the general meeting? (2) What would you consider as a reasonable explanation by a company for justifying an apparent misalignment between pay and performance? (3) Do you believe that significant misalignment between pay and performance or pay substantially above median may reveal potential governance risks?

## U.K. & Ireland Policy – Executive Remuneration

**Issue:** Scrutiny over pay structures outside the typical U.K. model (e.g., Investment Association recently advocated structures that support company strategy and business needs even if it sits outside of U.K. practice)

**Change:** ISS will pay particular attention to the following points and may recommend “Against” the chair of the remuneration committee where a serious breach of good practice is identified

1. How far the proposals are consistent with the good practice principles set out in ISS voting guidelines;
2. The linkage between the proposals and the company's strategic objectives;
3. Whether or not the proposals have an appropriate long-term focus;
4. The extent to which the proposals help simplify executive pay; and
5. The impact on the overall level of potential pay. Any proposal which provides for a greater level of certainty regarding the ultimate rewards should be accompanied by a material reduction in the overall size of awards.

**Request for Comment:** (1) What other issues should ISS take into account when assessing unusual incentive structures, such as those proposed by the Executive Remuneration Working Group (e.g. how far should the overall remuneration package be reduced to reflect the greater certainty of reward introduced via non-performance related restricted share schemes)? (2) If serious concerns have been raised with pay practices over a number of years but the remuneration committee chair position is being rotated, do you support the view that the longest serving member of the Remuneration Committee should be held accountable? Would you sometimes consider that the board chair should also be held accountable?

## European Policy – Non-Executive Director Remuneration

**Issue:** Performance-based compensation for non-executive directors (cash or equity)

**Change:** Extend the current policy that provides for “Against” vote recommendations for grants of stock options or similarly structured equity compensation to cover all forms of performance-based compensation

**Request for Comment:** (1) In your organization's view, are there particular circumstances when granting performance-based cash or equity (incl. stock options) to non-executive directors may merit support on an exceptional basis? (2) In light of the abovementioned circumstances in the German market, would your organization favor a carve-out or delay on the implementation of the new policy on performance-based cash for German companies?

Details of all draft policy changes have been published on ISS' website.<sup>3</sup> Comments to these draft policy changes can be submitted through 6 pm EST on November 10 via email to [policy@issgovernance.com](mailto:policy@issgovernance.com).

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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](http://www.fwcook.com).

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<sup>3</sup> <https://www.issgovernance.com/policy-gateway/2017-benchmark-policy-consultation/>