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COMPENSATION PARTNERS, LLC

ISS 2015-2016 Policy Survey Summary of Key Items

ISS's recent Policy Survey previews potential changes in its 2016 proxy voting policies.

Each year, Institutional Shareholder Services (ISS) seeks feedback from institutional investors, public companies ("issuers") and the consulting and legal community on emerging corporate governance, executive compensation and other issues as part of its annual policy formulation process. Issuers and their advisors are collectively referred to as "non-investors" hereafter. Possibly reflecting concerns about the influence of ISS policies, 62% of Survey respondents were issuers, while only 27% of respondents were investors, generally large institutional shareholders.

The Survey was intended to provide feedback to ISS on a wide range of questions, including: non-GAAP performance metrics in incentive compensation programs, proxy access, overboarding and director independence for former executive officers, capital allocation and share buybacks, and certain other matters not covered in this Update.

Adjusted Performance Metrics in Incentive Compensation Programs

The Survey asked whether the use of adjusted or non-GAAP metrics in incentive compensation programs is acceptable.

Investors (81%) and non-investors (61%) agree that adjusted metrics are sometimes acceptable, depending on the nature and extent of the adjustment(s) and the degree to which disclosure of their purpose is transparent. Sixty-six percent of investors and one-half of non-investors (49%) believe that non-GAAP metrics are acceptable as long as performance goals and results are clearly disclosed and reconciled with GAAP metrics in the proxy statement, and the reasons for the adjustments are adequately explained. A sizeable minority of non-investors (42%) believe adjustments to GAAP metrics should be described and explained, but do not necessarily need to be fully reconciled to GAAP metrics.

The Survey also asked whether specific adjustments to GAAP metrics are appropriate. A majority of investors believe that it may be appropriate to adjust financial results for discontinued operations, non-recurring or extraordinary charges and foreign exchange volatility. However, a majority of investors also believe that adjustments for goodwill write-downs, litigation expenses and compensation expenses are **not** appropriate. Investors are evenly split as to whether adjustments for acquisition expenses may be appropriate.

A majority of non-investors (60%) also believe that adjusting financial results for compensation expenses is inappropriate, while majorities of non-investors believed that each of the other types of adjustments were appropriate. The following chart summarizes investor and non-investor responses.

Non-GAAP Adjustment	% of Respondents Believing Adjustments Are Inappropriate	
	Investors	Non-Investors
Compensation expenses	80%	60%
Expenses from lawsuits and related penalties	70%	42%
Goodwill write-downs or other impairments	58%	26%
Acquisition expenses	50%	13%
Charges deemed non-recurring or extraordinary	43%	9%
Impact of foreign exchange volatility	40%	32%
Impact of discontinued operations	33%	14%

Source: 2015-2016 ISS Global Policy Survey Summary of Results

Meridian Comment. ISS appears to be poised to assess the appropriateness of certain adjusted performance metrics as part of its qualitative assessment of a company's incentive plans. This evaluation ultimately may impact ISS's vote recommendation on a company's Say on Pay proposal. Specifically, the investor responses to the Survey indicate that ISS is likely to scrutinize adjustments for goodwill write-downs, litigation expenses, compensation expenses and may question adjustments for acquisition expenses. However, ISS may assess the appropriateness of these adjustments on a case-by-case basis rather than adopt a bright-line rule. ISS acknowledged in its Survey Summary of Results that "a number of investors commented that some types of adjustments may be common and reasonable in certain industries but not in others, and that a company's business model (for example, whether it is highly acquisitive) may determine whether acquisition expenses or goodwill write-downs are appropriate to exclude—and that it is therefore difficult to make blanket statements about what types of adjustments are appropriate or inappropriate in all cases." We do not believe that ISS has the expertise or intimate business knowledge on individual issuers to make appropriate judgments in this area and do not think they should supplant the board's informed business judgment on these matters.

Restrictions on Proxy Access

The Survey asked whether certain types of restrictions adopted by a company's board in response to a majority-supported shareholder proposal on proxy access should be viewed as sufficiently problematic to "call into question the board's responsiveness and potentially warrant 'withhold' or 'against' votes for directors."

A great majority of investors believe that each of the restrictions on proxy access identified by ISS (and which are identified in the chart below) in the Survey should be viewed as sufficiently problematic to warrant negative votes on directors at companies that impose such restrictions.

In contrast, a vast majority of non-investors believe that negative votes on directors are **not** warranted for imposing all but two of the restrictions on proxy access that are identified in the chart below. A slight majority of non-investors (52%) believe that negative votes on directors could be warranted if the company established an ownership threshold greater than 5%, while 44% of non-investors believe that negative votes could be warranted for an ownership duration requirement in excess of three years.

The following chart summarizes investor and non-investor responses.

Restriction on Proxy Access	% of Respondents Believing Restriction Warrants Negative Votes on Directors	
	Investors	Non-Investors
An ownership threshold in excess of 5%	90%	52%
An ownership duration greater than 3 years	90%	44%
Information disclosures that are more extensive than those required of the company's nominees, by the company, the SEC, or relevant exchanges	80%	39%
A cap on nominees set at less than 20% of the existing board	79%	25%
An aggregation limit of fewer than 20 shareholders	76%	23%
An ownership threshold in excess of 3%	72%	14%
Restrictions on compensation of access nominees by nominating shareholders	72%	26%
More restrictive advance notice requirements	70%	20%
Renomination restrictions in the event a proxy access nominee fails to receive a stipulated level of support or withdraws his/her nomination	68%	20%

Source: 2015-2016 ISS Global Policy Survey Summary of Results

Meridian Comment. Given the significant number of majority-supported proxy access proposals in 2015 and many voluntary adoptions of proxy access by mega-cap companies, unsurprisingly, ISS appears poised to adopt a voting policy on the actions that a board has taken to implement such proposals and to evaluate restrictions on the proxy access right on a case-by-case basis.

Overboarding

In the Survey, ISS asked what constitutes an acceptable number of directorships on public company boards for non-employee directors, directors who are active CEOs and other directors.

As shown in chart on the following page, no clear consensus exists among investors as to an appropriate limit on the number of directorships that should be held by non-employee directors and directors who are active CEOs. In contrast, a large plurality of non-investors believes that no limits should exist.

Number of Directorships	Investors	Non-Investors
Non-Employee Directors		
▪ No limit	12%	41%
▪ No more than 4 directorships	34%	19%
▪ No more than 5 directorships	18%	7%
▪ No more than 6 directorships	20%	25%
Directors who are Active CEOs		
▪ No limit	12%	35%
▪ No more than 1 outside directorship	48%	20%
▪ No more than 2 outside directorships	32%	37%

Source: 2015-2016 ISS Global Policy Survey Summary of Results

ISS also asked whether a stricter standard on the number of directorships should apply to executive directors. Two-thirds of investors believe that a stricter standard on the number of directorships should apply to directors with "demanding full-time jobs," such as CFOs and law firm partners. According to ISS, investor comments suggested that stricter limits should also apply to board chairmen, lead directors and audit committee members. Only 37% of non-investors agree that a stricter standard should apply to such directors.

Finally, ISS asked whether there should be any exceptions to its standard for excessive directorships for directors' service on boards of non-operating companies or for services by investment holding company executives on boards of publicly traded companies in which the investment holding company has an interest. A majority of investors and non-investors believed that such exceptions should be made (58% and 74%, respectively).

Meridian Comment. ISS appears to be contemplating the adoption of a more stringent standard on overboarding, but may view some situations case-by-case based on a director's other professional time commitments and/or provide a limited exception where the director's role on the board is part and parcel to other professional responsibilities. As a general matter, the number of board seats that directors hold has declined in recent years, and therefore a new, more stringent ISS policy standard on excessive directorships may only affect a relatively small population of corporate directors.

Director Independence for Former Executives

Under current ISS policy, a former executive (other than a CEO) serving on the board of directors is considered to be a non-independent director for five years from the time the individual held an executive position at the company ("cooling off period"). After the cooling off period lapses, ISS will consider such a director to be independent. The policy applies to an individual who served on the board continuously for the period and to a director who reported to the company's current CEO while the director was an employee of the company.

In the Survey, ISS solicited input on when the “cooling off period” should start for former executives. Almost a majority of investors (46%) believe that the cooling-off period should begin to run only after the individual retires from the board as well as from all executive posts. In contrast, two-thirds of non-investors (68%) believe that the cooling-off period should begin to run as soon as the individual retires from the executive position.

ISS also asked whether a cooling-off period should apply to an individual who is a former employee of a firm providing significant professional services to the company, such as the company’s auditor or outside counsel. The vast majority of investors (82%) believe that a cooling-off period should apply to such an individual, while non-investors were evenly split on the question.

Meridian Comment. The responses from investors support ISS broadening the scope of directors subject to a cooling-off period, coupled with a heightened standard for when the cooling-off period starts for former executives. These potential policy changes would result in modest increases in the number of directors being classified as non-independent directors on the basis of a previous employment or professional services relationship with a company.

Capital Allocation and Share Buybacks

The Survey asked a series of questions regarding capital allocation and share buybacks. Specifically, the Survey asked whether certain five-year historical financial metrics would be helpful in assessing capital allocation decisions, share buybacks and the efficiency of board stewardship.

A majority of investors believe that five-year historical data on share buybacks (96%), dividends (95%), capital expenditures (93%) and cash balances (85%) would be helpful in assessing capital allocation decisions. Similarly, the majority of investors believe that data on current year share buybacks as a percentage of the company's market cap (95%) and cash balance (85%), as well as five-year cumulative buybacks as a percentage of the company's market cap (97%) and cash balance (84%), would be helpful. According to ISS, investors indicated that they would also find data on R&D expenditures, ROE, ROIC, and ROA to be helpful, particularly the relationship between capital expenditures and ROA and the relationship between cash balances and ROE. ISS noted in its Survey Summary of Results that some investors also expressed an interest in information on executive compensation and how it is affected by share buybacks.

A majority of non-investors also believe that five-year historical data on share buybacks (80%), dividends (79%), capital expenditures (61%) and cash balances (62%) would be helpful in assessments. Two-thirds of non-investors believe that current year or five-year cumulative share buybacks as a percentage of market cap would be helpful, while almost half of non-investors believe the same with respect to the ratios of buybacks to cash balances. According to ISS, some issuers echoed investor views that additional metrics, such as R&D spending, non-capital investment, acquisitions and growth in operating income would also be useful in assessing capital allocation decisions.

Meridian Comment. The Survey responses suggest that ISS might start to provide institutional shareholder clients historical data on a company’s capital allocation decisions for their independent review. We do not believe that a company’s capital allocation decision will impact ISS’s vote recommendations on director elections in 2016. However, this may be a precursor to ISS assessing whether a company’s Board of Directors has demonstrated effective stewardship over capital.

As we stated in our comment letter to ISS on the Survey, we believe that ISS is not in a position to substitute its judgment for that of a company's Board of Directors to evaluate capital allocation decisions. Capital allocation decisions do not lend themselves to universal benchmarks or ratios; they depend greatly on a company's unique circumstances and prevailing market dynamics. In our experience, Boards spend a significant amount of time carefully evaluating capital decisions, including share buybacks and dividend policies, and are cognizant of the potential effects that capital decisions may have on incentive plan goal setting. Given the complexities of these decisions, we believe that a company's board is in the best position to decide the best use of corporate resources.

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