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Meridian Client Update

ISS 2016-2017 Policy Survey Summary of Key Items

ISS's recent Policy Survey previews potential changes in its 2017 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, 72% of Survey respondents were issuers, while only 28% of respondents were investors, generally large institutional shareholders.

The Survey was intended to provide feedback to ISS on a wide range of questions, including the metrics used in ISS quantitative pay-for performance model, Say on Pay frequency, director tenure and board refreshment, and director overboarding related to Executive Chairs.

Metrics Used in ISS Quantitative Pay-for-Performance Model

The Survey asked whether ISS should incorporate financial metric(s) other than total shareholder return (TSR) into ISS's quantitative pay-for-performance model as a better way to identify potential pay-for-performance misalignment. **Both investors (79%) and non-investors (68%) support using metrics other than TSR to measure pay-for-performance alignment**.

As shown in the following chart, among investors, capital productivity metrics are the most favored other financial metrics for measuring pay-for-performance alignment. A strong minority of non-investors support the use of earnings metrics.

	% of Respondents Favoring Use of Metric in Measuring Pay-for-Performance Alignment	
Financial Metric	**Non-Investors**	**Investors**
Return on investment metrics (such as ROIC)	23%	47%
Return metrics (such as ROA or ROE)	18%	35%
Earnings metrics (such as EPS or EBITDA)	38%	26%
Cash flow metrics (such as OCF or FFO)	20%	25%
Economic profit metrics	9%	22%
Revenue metrics (such as total revenue or revenue growth)	24%	18%

According to ISS, some investors and non-investors believe that the most appropriate metric(s) would depend upon company-specific or industry-specific factors.

Meridian Comment. As investors strongly favor using metrics other than TSR to measure pay-for-performance alignment, ISS may incorporate additional metrics in its quantitative pay-for-performance model. However, any metric other than TSR can prove challenging to compare across companies and industries due to differences in capital structure, life cycle and growth rate, among other factors. For that reason, as well as the lack of consensus among investors as to which additional metric(s) should be included in ISS's pay-for-performance model, we expect that any proposed change will be heavily debated and possibly delayed until 2018.

Frequency of Say on Pay Vote

The Survey asks respondents whether they favored annual, biennial or triennial Say on Pay proposals. A large majority (66%) of investors and a plurality of non-investors (42%) favored annual Say on Pay votes. However, one-half of non-investors disagreed, as they believe that the appropriate frequency is a triennial vote (19%) or that it depended on the company (31%).

Meridian Comment. Given the strong investor support for an annual say on pay frequency, ISS's policy on Say on Pay vote frequency is likely to remain unchanged.

Director Tenure and Board Refreshment

The Survey asked respondents to identify which director tenure factors would indicate concerns with a board's nominating and refreshment processes.

A slight majority of investors (53%) believe that the absence of any newly appointed independent directors in recent years as indicative of a problem. Over two-thirds of investors (68%) believe that a high proportion of long-tenured directors is problematic, while a bare majority (51%) of investors believe that lengthy average director tenure is a concern.

Only 34% of non-investors believe that tenure is not a concern. However, no consensus exists among non-investors as to what director tenure and refreshment factors are a cause for concern. The vast majority of non-investors do not believe that the absence of newly appointed independent directors, a high proportion of directors with long tenure or lengthy average director tenure would be cause for concern.

The following chart summarizes investor and non-investor responses.

	% of Respondents Believing Director Tenure Factor is Problematic	
Director Tenure Factor	**Non-Investors**	**Investors**
A high proportion of directors with long tenure	31%	68%
Absence of any newly appointed independent directors in recent years	26%	53%
Lengthy average tenure on the board	19%	51%
Tenure is not a concern	34%	11%

Meridian Comment. Given the strong investor concern about director tenure and refreshment, ISS is likely to adopt a policy to evaluate director tenure on a case-by-case basis, taking into consideration the overall characteristics of a board of directors and other factors.

Director Overboarding (Relating to Executive Chairs)

The survey asked about the overboarding standard that should apply to an Executive Chair. Investors and issuers disagreed on the appropriate standard. A majority of investors (64%) believe that ISS should adopt the same standard that applied to a sitting CEO (i.e., no more than three total board seats). In contrast, the majority of non-investors (62%) believe that the more lenient standard applied to a non-executive director (i.e., no more than five total board seats) should continue to apply to an Executive Chair.

Meridian Comment. ISS is likely to adopt the more stringent standard for director overboarding with regard to Executive Chairs based on the strong investor support for such a standard.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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