

Meridian Client Update

ISS Issues Proposed Policy Updates for 2017

Last week, Institutional Shareholder Services (ISS) issued proposed policy updates. For the first time in many years, the proposed updates do *not* modify U.S. policy on compensation matters (e.g., policies relating to Say on Pay and equity plan proposals). However, ISS announced a material change in its U.S. pay for performance assessment that will take effect for the 2017 proxy season.

Proposed Policy Updates

The proposed policy updates would revise ISS proxy voting policies for U.S. listed companies in the following two areas relating to corporate governance:

- Restrictions on binding shareholder proposals, and
- Executive compensation proposals at certain companies listed in the U.S. but incorporated in another country ("U.S-listed cross-market companies").

If adopted by ISS, these policy updates would take effect on February 1, 2017.

Issuers and investors may submit comments via e-mail (<u>policy@issgovernance.com</u>) on the proposed policy updates to ISS no later than November 10, 2016. All comments received will be published by ISS, unless otherwise requested in the body of the e-mail submission.

ISS will release final 2016 policies in late November 2016.

Restrictions on Binding Shareholder Proposals

ISS is proposing to adopt a policy to recommend shareholders to vote AGAINST (or WITHHOLD from) members of a company's Board governance committee who are up for election in cases where a company's charter imposes "undue" restrictions on shareholders' ability to amend a company's bylaws. ISS identifies the following two examples of undue restrictions on shareholders' ability to amend bylaws: (1) an outright prohibition on the submission of binding shareholder proposals, and (2) share ownership requirements or holding periods in excess of the SEC Rule 14a-8 requirements (i.e., to continuously hold at least \$2,000 in market value or 1% of the company's shares for at least one year). ISS would continue to issue adverse vote recommendations until the restrictions are eliminated.

Executive Pay Assessments for U.S.-Listed Cross Market Companies

In response to the growing number of companies incorporated in a non-U.S. country but listed in the U.S., ISS is proposing to evaluate all compensation-related proposals on proxy ballots of such companies on a case-by-case basis applying the following principles:



- ISS would align its voting recommendations to avoid inconsistent recommendations on the same compensation program, and
- If ISS has adopted a U.S. policy for a compensation-related proposal on the ballot, then ISS would apply its U.S. policy. Conversely, if ISS has not adopted a U.S. policy for a compensation-related proposal on the ballot, then ISS will apply the foreign country policy applicable to the compensationrelated proposal.

Under these principles, Say on Pay proposals from most markets would be evaluated under ISS's voting policies related to U.S. Say on Pay proposals.

Modification to CEO Pay-for-Performance Assessment

At a recent conference in Houston hosted by TheCorporateCounsel.net, David Kokell, the head of ISS U.S. Compensation Research, announced modifications to ISS's CEO pay-for-performance evaluation.

Currently, ISS's pay-for-performance evaluation includes a quantitative analysis comparison of CEO total pay and company performance, as measured by total shareholder returns (TSR) over various time horizons on both a relative and absolute basis (Quantitative Analysis). If the Quantitative Analysis shows that significant pay misalignment exists, then ISS will perform a more in-depth qualitative assessment, taking into consideration a number of unweighted factors to determine whether a company's pay practices mitigate or facilitate the misalignment (Qualitative Analysis). When the qualitative assessment shows that the pay misalignment is facilitated by company pay practices, ISS will likely recommend an AGAINST vote on a company's Say on Pay proposal.

For 2017, ISS will expand the Qualitative Analysis to include a company's performance on up to seven financial metrics relative to the performance of companies in its four digit GICS code. In 2018, ISS will incorporate financial metric(s) other than TSR into ISS's quantitative pay-for-performance model as a better way to identify potential pay-for-performance misalignment.

Meridian Comment. For the overwhelming majority of U.S. listed public companies, ISS's proposed policy updates would not impact ISS's methodologies for evaluating pay-for-performance alignment and Say on Pay proposals. However, we expect that ISS will explain changes in how it will apply certain U.S. policies by issuing new FAQs on its existing policies later this year.

Other than the modification to its pay for performance evaluation, the absence of policy changes that relate to compensation matters is welcome relief to companies seeking greater predictability in ISS's assessment of their executive compensation programs and related corporate governance practices.

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