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ISS Releases its 2017 Policy Survey

ISS's recent Policy Survey previews potential changes in its 2017 proxy voting policies.

Through its annual policy survey, Institutional Shareholder Services (ISS) seeks feedback from institutional investors, public companies, corporate directors and the consulting and legal communities on emerging trends in corporate governance and executive compensation and other matters as part of its policy formulation process. The policy survey often provides an advance read on where ISS is heading on a particular issue.

ISS recently released its 2017 Policy Survey ("Survey"), which includes questions covering director overboarding (with regard to Executive Chairs) and tenure, say on pay frequency and metrics used in ISS's pay-for performance quantitative model. These questions are summarized below.

The Survey will be open for participation until Tuesday, August 30. The Survey can be completed online by going to the following webpage: https://www.surveymonkey.com/r/2017 ISS Policy Survey. The results of the Survey are expected to be published in late September. To provide ISS with a corporate perspective, we recommend that companies complete and submit the Survey, and consider gathering input from board members, as appropriate.

Director Overboarding (relating to Executive Chairs)

Under current ISS policy, sitting CEOs are deemed to be overboarded if they sit on more than two outside boards in addition to their home company board. However, an Executive Chair currently falls under the overboarding policy that applies to non-executive directors, and is considered overboarded if he/she sits on more than five total boards. In cases in which a director is overboarded, ISS generally will recommend a vote against the director if he or she is standing for election.

In the Survey, ISS asks under what standard should an Executive Chair be evaluated for overboarding:

- The standard applicable to CEOs (no more than three total boards), or
- The standard applicable to non-executive directors (no more than five total boards)

Meridian Comment. If Survey responses show strong investor interests in applying the CEO overboarding standard to Executive Chairs, we believe ISS is likely to adopt such standard.

Director Tenure

Currently, ISS has no policy on director tenure.

To elicit views on appropriate length of director tenure, the Survey asks respondents to identify which of the following tenure factors would prompt concerns with a board's nominating and refreshment processes?

- The absence of any newly appointed independent directors in recent years (e.g., five years)
- Lengthy average tenure on the board (e.g., average director tenure greater than 10 years, or greater than 15 years)
- A high proportion of directors with long tenure (e.g. three-fourths of the board having tenure of 10 years or more)
- Tenure is not a concern
- Other (please specify)

Meridian Comment. Director refreshment and tenure continue to be hot button issues among some institutional investors and corporate governance advisors. Issues concerning lengthy director tenure often relate to board refreshment, diversity and independence. ISS has been studying director tenure issues for several years. If the Survey results should show strong investor concern about director tenure, ISS will likely adopt a policy covering director tenure. Such a policy could take a case-by-case evaluation of director tenure in consideration of the overall characteristics of the board of directors and other specific factors.

Frequency on Say on Pay Vote

Under its current policy, ISS will recommend that shareholders vote for annual say on pay voting. ISS is apparently revisiting this policy, as public companies that began holding say on pay votes in 2011 (majority of U.S. issuers) will be required to hold say on pay frequency votes in 2017.

To gauge current sentiment around vote frequency, the Survey asks respondents to identify which of the following say on pay vote frequency the favor:

- Annual
- Biennial (every other year)
- Triennial (every three years)
- It depends on the company
- Other (please specify)

If a respondent checked "It depends on the company," the Survey asks the respondent to identify which of the following factor or factors would the respondent consider in determining the appropriate say on pay vote frequency:

- Size of company
- Financial performance

- Presence or absence of recent problematic executive pay practices
- Level of shareholder support for say on pay votes at past meetings

Meridian Comment. Since the inception of say on pay voting, investors have shown a strong preference toward annual vote frequency. We expect the Survey results will mirror this preference. Therefore, ISS's policy on say on pay vote frequency is likely to remain unchanged.

Metrics Used in ISS Quantitative Pay-for Performance Model

Currently, ISS's quantitative pay-for-performance model is used to identify potential misalignments between CEO pay and company performance, as measured by total shareholder returns (TSR) over various time horizons on both a relative and absolute basis.

The Survey asks respondents to indicate their degree of support for the incorporation of **other financial metric(s)**, in addition to TSR, into the ISS's quantitative pay-for-performance model as a better way to identify potential pay-for-performance misalignment.

- Strongly support
- Support
- Neutral, neither support nor oppose
- Oppose
- Strongly Oppose

If a respondent answered the question above with one of the first three selections, the respondent is asked to identify which the following financial metrics would the respondent support being incorporated into the quantitative model (respondents may select up to two financial metrics):

- Revenue metrics (such as total revenue or revenue growth)
- Earnings metrics (such as EPS or EBITDA)
- Return metrics (such as ROA or ROE)
- Return on investment metrics (such as ROIC)
- Cash flow metrics (such as OCF or FFO)
- Economic profit metrics
- Other (please specify)

Meridian Comment. Many have criticized ISS's quantitative pay-for-performance model due to its use of TSR as the sole measure of company performance. ISS's consideration of other financial metrics may more accurately reflect the correlation between company performance and CEO pay. However, many investors believe other financial metrics are not as comparable across companies and may prefer the simplicity of ISS's current quantitative pay-for-performance model and therefore may not support the introduction of additional metrics. Given the complexity of selecting appropriate metrics to properly gauge company performance and likely continued investor sentiment toward TSR, we believe ISS is unlikely to change its pay-for-performance model to include additional measures.

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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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