

ISS Releases Proposed Policy Updates; Excludes Changes to US Executive Pay Issues

ISS released its 2017 proposed policy changes, opening the comment period. Executive compensation issues in the US are notably absent from the proposals, but European remuneration issues are included.

ISS released its proposed policy changes for the 2017 proxy season on October 27, which is the next step in the proxy advisory firm's annual policy formulation process. Comments on the draft policy updates are due by November 10 and can be submitted [here](#). The full proposed policy updates are available [here](#).

The topics addressed by the draft policy updates include:

- Director inducement equity grants (Canada)
- Use of pay-for-performance screens (Europe, UK and Ireland)
- New executive remuneration schemes (UK and Ireland)
- Director remuneration (Europe)
- Director overboarding (Europe)
- Dual-class stock in IPOs (United States)

The proposed policy updates do not include several executive compensation issues that ISS asked about during its policy survey process this summer. The firm had asked companies and investors about whether it should consider performance metrics beyond absolute and relative total shareholder return (TSR) when measuring pay and performance alignment in its CEO pay screening. Nearly 80% of investors and 70% of companies supported the use of other metrics. Given the widespread support for alternative performance metrics, we could see ISS use other metrics to inform its Say-on-Pay voting decisions during the *qualitative* pay-for-performance assessment.

Another key survey question for US companies that did not make its way into proposed policy updates relates to Say-on-Pay voting frequency. With most companies holding a Say-on-Pay frequency vote in 2017 (which is required at least every six years when voting went into effect in 2011), ISS solicited feedback on its standard policy to support annual voting. Two-thirds of investors and 44% of companies responding to the survey support annual votes as the default standard for ISS.

Compensation-Related Policies

Cross-Border Executive Pay Assessments (US-Listed Companies Incorporated Elsewhere)

For companies listed in the United States (US) and incorporated in another country, ISS proposes to use US policy to evaluate compensation proposals, on a case by case basis. This would align voting recommendations on

a pay proposal submitted in multiple countries and eliminate contradictory results. In cases where there is no US policy, ISS will use the policy of the country requiring the proposal on the ballot.

Pay-for-Performance Quantitative Screens (Europe, UK and Ireland)

ISS is proposing to conduct a US-style Pay-for-Performance quantitative screen for companies in Europe, UK and Ireland. The analysis will measure peer group and absolute alignment, and the outcome will serve as a contributing, but not definitive, factor in vote recommendations.

ISS is seeking specific feedback through the comment period on 1) whether the relative amount of executive compensation matters; 2) whether common concerns are raised by short-term incentives vs. long-term incentives; 3) whether misalignments driven by discretionary bonuses should affect vote recommendations on board members rather than Say-on-Pay recommendations; and 4) whether relative or absolute misalignment signals potential governance risk.

Non-Executive Director Initial Equity Grants (Canada)

Under the proposed policy updates, ISS will recommend a vote against the (re)election for the chair or other members of the compensation committee at Canadian companies that awarded “excessive” inducement grants or performance-based equity to new non-executive directors. ISS says these equity awards could compromise a director’s independence.

The firm is seeking input on a standard for what makes a grant excessive, whether there are any terms or conditions that would mitigate concerns of excessiveness, and whether there are any other problematic director pay practices.

Executive Remuneration (UK and Ireland)

In July 2016, a UK asset management industry working group recommended that remuneration committees choose a pay structure that is appropriate for the company’s industry and strategy, but that could differ from the traditional salary/bonus/long-term incentive pay model. Given that these types of non-conventional plans could become more common, ISS says when evaluating any such new remuneration programs, it will focus on: 1) whether the structure is consistent with ISS voting guidelines’ good practice principles; 2) whether there is a link between the company’s strategic goals and the proposed approach; 3) whether the proposed structure has appropriate long-term focus; 4) the extent to which the proposal simplifies executive pay; and 5) the effect on the overall level of pay.

ISS is asking whether there are other issues with new compensation structures that it should take into account. Additionally, ISS is asking if it is appropriate to recommend against the longest tenured remuneration committee member or board chair if there have been serious pay practice concerns over many years.

Non-Executive Director Remuneration (Europe)

Many European investors and companies have an unfavorable view of performance-based compensation granted to non-executive directors. As such, ISS’ draft policy update expands the types of grants covered to include all forms of performance-based compensation where previously the policy only addressed stock options.

ISS wants to know if there are any circumstances where performance-based compensation would be appropriate, and whether a carve out or delay in Germany — where there has historically been support for performance-based

cash — makes sense.

ISS Introduces New Governance Rating System

ISS has rebranded (again) its governance rating system from QuickScore to QualityScore. The name signifies the addition of a compensation-related item. QualityScore will give extra points to performance-based short- and long-term incentive plans that include relative performance metrics— the most common of which is relative total shareholder return.

Separately, ISS has opened the data verification period for QualityScore until November 11. This allows companies to verify their governance information ISS has collected is accurate. Click [here](#) for more information on how to verify your company's data.

While QualityScore data does not directly affect ISS' vote recommendations, it is marketed as a data set that investors use when flagging potential investment risk or when looking to benchmark governance and compensation-related data.

Governance Policy Updates

IPO Dual-Class Stock (US)

Under the draft policy update, ISS will recommend against directors at companies that go public with a multi class stock structure where the classes do not have equal voting rights. However, ISS will consider reasonable sunset provisions.

ISS asks for comment on the factors to be considered in evaluating a sunset provision, such as length and terms.

Director Overboarding (Europe)

ISS wants to refine its position on an “overboarded” director who holds only non-executive chair positions and directors who are executives of an investment company. Under the proposed policy update, if an individual is a non-executive chair of a company and either 1) holds more than three non-chair non-executive director positions; 2) holds more than one other non-executive chair position and one non-chair non-executive position; or 3) holds any executive position, ISS will recommend voting against that candidate on other company boards (except where they exclusively hold other chair and/or executive positions or where they are elected chair for the first time). ISS also will generally treat investment company officers similarly.

Next Steps

In past years, ISS has announced policy changes that were not circulated for review, and it would not be unexpected for that to happen again this year. ISS expects to release its final policy updates in the second half of November. We will publish an analysis of these final changes for our client community as soon as they are announced. In the meantime, if you have executive compensation or governance questions, please write to consulting@radford.com.

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