Compensation
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# ISS and Glass Lewis Policy Updates for the 2018 Proxy Season

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Institutional Shareholder Services (ISS) and Glass Lewis & Co. (Glass Lewis) recently announced updates to their proxy voting guidelines for the 2018 proxy season. These updates will take effect for shareholder meetings beginning on February 1, 2018 for ISS and January 1, 2018 for Glass Lewis. CAP has summarized the compensation-related policy updates and highlighted some of the other key changes to both ISS and Glass Lewis' policies.

# ISS Updates

## CEO Pay-for-Performance Assessment

ISS modified their existing approach to evaluating CEO pay-for-performance for U.S. companies and provided guidance as to how their Financial Performance Assessment ("FPA") will be incorporated as a secondary measure into their quantitative assessment:

**Multiple of Median (MOM) Test (current primary measure)**: For S&P 500 companies, ISS reduced the threshold for a "Medium" concern from 2.33x to 2.00x the median pay of peers. The "High" concern threshold remains unchanged at 3.33x. Current thresholds remain unchanged for non S&P-500 companies.

**Relative Degree of Alignment (RDA) Test (current primary measure):** ISS will now calculate total shareholder return ("TSR") by averaging the daily closing prices for the beginning and end months of the TSR measurement period. Previously, ISS measured TSR using a point-to-point on the beginning and last days of the measurement period. The change in methodology is intended to reduce stock price volatility.

**Pay TSR Alignment (PTA) Test (current primary measure):** No change

**Financial Performance Assessment (new secondary measure for 2018):** After introducing a relative measure of CEO pay and financial performance alignment in 2017 as a qualitative consideration, ISS received positive feedback from investors and will now include in its quantitative CEO pay-for-performance assessment as a secondary measure. The FPA will utilize three or four financial metrics (depending on industry) and compare 3-year performance and 3-year CEO pay. A company's 3-year CEO pay rank compared to peers will be subtracted from 3-year financial performance rank compared to peers and produce a result ranging from -100 to +100.

ISS' CEO pay-for-performance assessment will now be determined as follows:

1. Initial Quantitative Concern Level: Will continue to be determined by the results of the three primary pay-for-performance tests (MOM, RDA, and PTA)

2. Overall Quantitative Concern Level: Will reflect a final concern level which may or may not be impacted by the FPA test as described below

The FPA may impact the Overall Quantitative Concern level only if a company has a Medium concern under the Initial Quantitative screen or a Low concern result under the Initial Quantitative Screen [but which results border the Medium concern threshold under any of the three initial measures (MOM, RDA, PTA)]. See table below:

| Quantitative Concern Thresholds: S&P 500 | | | |
|---|---|---|---|
| **Measure** | **Eligible For FPA Adjustment** | **Medium Concern** | **High Concern** |
| RDA | -28.4 | -40 | -50 |
| MOM | 1.64x | 2.00x | 3.33x |
| PTA | -13% | -20% | -35% |

The FPA could potentially modify a concern level from Medium to Low if relative financial performance is strong, or from a Low to a Medium if relative financial performance is weak. The FPA will have no impact on a Low Initial Quantitative Concern if the company is well below the FPA Adjustment threshold (defined above) and will have no impact on a High Initial Quantitative Concern.

The Overall Quantitative Concern level will be the indicator for any pay-for-performance disconnect resulting in an in-depth qualitative review.

More information on the 2018 CEO pay-for-performance assessment mechanics can be found here: https://www.issgovernance.com/file/policy/2018-pay-for-performance-mechanics.pdf

## Equity Plan Scorecard

ISS made changes to their approach to evaluating equity plan proposals:

**S&P 500 Companies' Passing Score**: The passing score for S&P 500 companies will now be 55 points, up from 53 points. There are no changes to the passing score for all other companies.

**Equity Holding Requirements**: Companies will either receive a full point for having a holding requirement of at least 12 months (a reduction from 36 months) or no points for less than 12 months. No points will be earned if the holding requirement is only applicable until ownership guidelines are met.

**CEO Vesting**: A full point will now be earned if CEO equity award vesting is at least 3 years compared to the previous requirement of 4 years. No points will be earned if vesting is less than 3 years.

**Change in Control Vesting:** Full points will only be awarded for (i) performance-based awards, if acceleration is limited to actual performance achieved, pro-rata of the target award, a combination of both actual and pro-rata, or the performance awards are forfeited or terminated and for (ii) time-based awards, if acceleration cannot be automatic single-trigger or discretionary. Any other provisions will receive no points.

**Broad Discretion to Accelerate Vesting**: Full points will only be earned when discretion is limited to cases of death and disability only. Discretion in any other instance (such as a change in control) will result in no points.

More information on ISS' Equity Plan Scorecard can be found here: https://www.issgovernance.com/file/policy/2018-us-equity-compensation-plans-faq.pdf

## CEO Pay Ratio

ISS will display the median employee pay figure and the CEO pay ratio in its reports; however, it will not impact their voting recommendations for 2018.

## Board Responsiveness

If a company received less than 70% of votes cast, ISS will now also review the timing and frequency of engagements and whether independent directors participated, disclosure of the specific concerns voiced by dissenting shareholders that led to the say-on-pay opposition and disclosure of meaningful actions address the issues that contributed to the low level of support.

## Non-Employee Director Pay

ISS is introducing a policy in which they will recommend voting AGAINST board/committee members responsible for setting director non-employee director compensation if there is a recurring pattern (i.e., two or more years) of excessive pay without compelling rationale or mitigating factors. This policy will not go into effect until the 2019 proxy season and the purpose is to identify a pattern of extreme outliers.

## Gender Pay Gap

ISS is introducing a new policy related to voting recommendations on shareholder proposals relating to gender pay gaps and will evaluate such proposals on a case-by-case basis. In making a vote recommendation ISS will consider (i) current policies and disclosures on diversity and inclusion and the use of equitable compensation practices, (ii) whether the company has been the subject of any recent controversy, litigation or regulatory actions related to gender pay gap issues and (iii) whether the company's reporting relating to gender pay gap policies or initiatives lags its peers.

### Board Diversity

ISS will now highlight boards with no gender diversity, though now there will be no vote recommendations made in 2018 based on this information.

## Glass Lewis

### NEO Pay-for-Performance Assessment

Glass Lewis did not make any changes to their model but clarified their current scoring system and highlighted that a "C" grade is a desirable outcome indicating pay and performance are aligned.

### CEO Pay Ratio

Similar to ISS, Glass Lewis will display the pay ratio as a data point in their reports, but it will not be a determinative factor in their voting recommendations.

### Board Responsiveness

Glass Lewis has lowered the threshold in which they expect the board to respond to shareholder dissent of any management proposal of more than 20% of votes cast (prior threshold was 25%), especially in the case of a compensation or director election proposal. Additionally, for companies with a dual-class share structure, Glass Lewis believes the board should respond when vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal.

### Board Diversity

In 2018, Glass Lewis will not make recommendations based solely on the diversity of the board; however, beginning in 2019 Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members. The vote may extend to other nominating committee members depending on the size of the company, the industry in which the company operates and the governance profile of the company. Glass Lewis will consider mitigating features such as whether the company is outside of the Russell 3000, whether sufficient rationale is provided for not having any female board members or the company discloses plans to address the lack of diversity.

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The summary above highlights some changes to ISS and Glass' Lewis policies for 2018 and are not intended to be all encompassing. For all information related to ISS and Glass Lewis' 2018 voting policies please visit:

ISS: https://www.issgovernance.com/policy-gateway/latest-policies/
Glass Lewis: http://www.glasslewis.com/guidelines/