

COMPENSATION, GOVERNANCE AND ERISA | January 27, 2016

## ISS Publishes Updates to Its 2016 Executive Compensation Policies

On January 22<sup>nd</sup>, Institutional Shareholder Services Inc. (“ISS”) updated its Frequently Asked Questions for US Executive Compensation Policies and US Equity Compensation Plans.<sup>1</sup> The original FAQs were published on December 18, 2015, and apply to all shareholder meetings held after February 1, 2016. This publication summarizes the Updated FAQs.

### The Updated FAQs

- Impact of Pay for Performance Misalignment on Equity Plan Proposals. If ISS recommends, as a result of a pay-for-performance misalignment, either a negative say-on-pay vote or a vote against compensation committee members, ISS may also recommend a vote against an equity plan proposal that is also on the ballot. In making its recommendation, ISS will weigh: (1) the severity of pay for performance misalignment, (2) whether equity plan practices are driving the misalignment and (3) whether equity plan awards are broad-based or heavily concentrated to the chief executive officer and/or other named executive officers (“NEOs”). ISS does not consider the plan broad-based if the three-year average concentration ratio for equity awards made to the CEO exceeds 30%, or, for all named executive officers (including the CEO), 60%.
- Compensation Disclosure for Externally Managed Issuers (“EMIs”).<sup>2</sup> As our readers know, EMIs are issuers who retain an outside management company to provide services that would otherwise be provided by employees of the issuer. As we previously noted, ISS wants information about the pay practices of the EMI’s external manager. Beginning in 2016, failure to provide adequate information will be a problematic pay practice that will generally result in an adverse recommendation on say-on-pay. In the Updated FAQs, ISS states that the minimum amount of disclosure necessary to avoid an adverse recommendation must include: (1) the portion of the EMI’s

<sup>1</sup> The Updated FAQs covering US Executive Compensation Policies are available at: <http://www.issgovernance.com/file/policy/us-executive-compensation-policies-faq-21-jan-2016.pdf>. The Updated FAQs covering US Equity Compensation Plans are available at: <http://www.issgovernance.com/file/policy/us-equity-compensation-plans-faq-21-jan-2016.pdf>. For a summary of the changes made to ISS’s compensation-related proxy voting guidelines for 2016 (including changes made to ISS’s US Equity Plan Scorecard), please see our client memo, “A Summary of Compensation-Related Updates to the Proxy Voting Guidelines of ISS and Glass Lewis,” available at: <http://www.shearman.com/-/media/Files/NewsInsights/Publications/2015/12/A-Summary-of-CompensationRelated-Updates-to-the-Proxy-Voting-Guidelines-of-ISS-and-Glass-Lewis-CG-and-E-120715.pdf>.

<sup>2</sup> ISS stated that it identified approximately 60 EMIs (most of which are REITs). Executives of an EMI are typically employees of, and compensated by, the external manager. The external manager is then reimbursed by the EMI through a management fee. Although EMIs that are public companies must still hold periodic, advisory say-on-pay votes, they often do not disclose any details about their executives’ compensation arrangements.

management fee that is allocated to the NEO compensation paid by the external manager (aggregated values are acceptable), (2) the breakdown of fixed vs. variable/incentive pay and (3) the metrics utilized to measure performance to determine the NEOs' variable/incentive pay.

- Problematic Pay Practices In the Current Fiscal Year. ISS generally will issue an adverse recommendation on problematic pay practices disclosed by a company (typically in its Compensation Discussion and Analysis) that were adopted after the end of the previous fiscal year. If, however, ISS believes its analysis can be better informed by the additional information required to be disclosed in the following year's proxy statement, it may postpone its recommendation until that year. For example, a problematic equity grant to a CEO hired after the fiscal year end may be better evaluated after the new CEO's total pay is disclosed.

## Conclusion

Compensation committees should be aware of these and other ISS policy recommendations, and weight them appropriately in exercising their business judgment on pay decisions affecting the CEO and other NEOs.

## CONTACTS

**John J. Cannon III**  
New York  
+1.212.848.8159  
[jcannon@shearman.com](mailto:jcannon@shearman.com)

**Kenneth J. Laverriere**  
New York  
+1.212.848.8172  
[klaverriere@shearman.com](mailto:klaverriere@shearman.com)

**Doreen E. Lilienfeld**  
New York  
+1.212.848.7171  
[dlilienfeld@shearman.com](mailto:dlilienfeld@shearman.com)

**Linda E. Rappaport**  
New York  
+1.212.848.7004  
[lrappaport@shearman.com](mailto:lrappaport@shearman.com)

**George T. Spera, Jr.**  
New York  
+1.212.848.7636  
[gspera@shearman.com](mailto:gspera@shearman.com)

ABU DHABI | BEIJING | BRUSSELS | DUBAI | FRANKFURT | HONG KONG | LONDON | MENLO PARK | MILAN | NEW YORK  
PARIS | ROME | SAN FRANCISCO | SÃO PAULO | SAUDI ARABIA\* | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2016 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.

\*Abdulaziz Alassaf & Partners in association with Shearman & Sterling LLP