

ISS Releases Additional Guidance on 2018 Policy Updates

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As discussed in a [November post](#), ISS recently published its 2018 policy updates, effective for meetings held on or after February 1, 2018. Last week, the proxy advisory firm released further guidance in the form of three revised policy supplements.

- **[Pay-for-Performance Mechanics](#)**. ISS' December *Pay-for-Performance Mechanics* whitepaper describes a revised methodology for 2018 pay-for-performance evaluations. Key 2018 updates include: (a) the introduction of the Financial Performance Assessment secondary quantitative screen; (b) changes to the pay-for-performance quantitative screens for S&P 500 companies; and (c) TSR smoothing for quantitative pay-for-performance screens.
 - *Financial Performance Assessment*. The most notable change to ISS' pay-for-performance methodology is the new quantitative Financial Performance Assessment, which compares a company's financial and operational performance against its ISS peer group. This measure of alignment between CEO pay and company financial performance was introduced as part of ISS' qualitative evaluation for 2017, but will now be applied as a secondary quantitative measure after the three existing quantitative screens (Multiple of Median, Relative Degree of Alignment and Pay-TSR Alignment) have been calculated. Depending on the company's industry, three or four financial metrics will be selected and weighted as specified in the whitepaper. Possible metrics include return on invested capital (ROIC), return on assets (ROA), return on equity (ROE), EBITDA growth and operating cash flow growth. The metric selections and weightings, which were developed using a back-tested analysis of historical financial results and shareholder support for say-on-pay proposals, may not necessarily correlate with the company's own performance metrics.
- **[U.S. Compensation Policies FAQs](#)**. ISS also released FAQs, updated as of December 14, providing additional guidance on its U.S. Compensation Policies. New and materially updated questions are highlighted by ISS in yellow. Topics addressed by the revised U.S. Compensation Policies FAQs include: (a) ISS' assessment of board action taken in response to low say-on-pay support; (b) ISS' pay-for-performance evaluation and new Financial Performance Assessment; (c) problematic pay practices most likely to result in an adverse ISS recommendation; (d) ISS' identification of "excessive" levels of non-employee director pay (a pattern of which can result in adverse vote recommendations against board members responsible for approving or setting such pay); and (e) ISS' consideration of information disclosed pursuant to the [CEO pay ratio rule](#), which will not impact ISS' vote recommendations in 2018 (however, the median employee pay figure and CEO pay ratio will be displayed in ISS research reports).
- **[U.S. Equity Compensation Plans FAQs](#)**. Finally, ISS released FAQs, updated as of December 14, providing additional guidance on the assessment of equity compensation plans and ISS' Equity Plan Scorecard. New and materially updated questions are highlighted by ISS in yellow. Topics addressed by the revised U.S. Equity Compensation Plans FAQs include: (a) ISS' burn rate calculation for restricted shares granted as consideration for an acquisition and new 2018 burn rate benchmarks; (b) "liberal change in control" definitions and the impact of plans that include such definitions; (c) ISS' evaluation of equity plan proposals seeking approval of one or more plan amendments; (d) factors considered in ISS' subsequent qualitative review for director equity plans that exceed plan cost or burn rate benchmarks; and (e) changes to ISS' Equity Plan Scorecard policy for 2018, including a higher passing score requirement for S&P 500 companies (55 out of a total 100 possible points, rather than 53).

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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