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Re: Compensation at Externally-Managed Issuers

Institutional Shareholder Services, Inc.
702 King Farm Boulevard, Suite 400
Rockville, MD 20850

Ladies and Gentlemen:

As counsel to several externally-managed issuers (“EMIs”), including real estate investment trusts (“REITs”), we are deeply concerned about the proposed policy change (the “Proposed Policy”) of Institutional Shareholder Services, Inc. (“ISS”), under which ISS “would generally recommend ‘Against’ the say-on-pay proposal (or compensation committee members, the compensation committee chair, or the entire board, as appropriate, in the absence of a say-on-pay proposal on [the] ballot)” where an EMI “provides insufficient disclosure about compensation practices and payments made to executives on the part of the external manager.”

As described in further detail below, the Proposed Policy attempts to effectuate more detailed disclosure regarding the compensation of EMIs’ executives when, in fact, EMIs and their directors have no authority to determine how the employees of their external manager are compensated; as a result, disclosure of such information would have no bearing on the pay-for-performance decisions of the EMIs’ investors. Additionally, even assuming this information had any relevance, the external managers cannot approximate with any reasonable degree of accuracy the compensation paid to their employees in connection with their service to any given EMI, because EMIs are generally part of broader platforms in which the compensation of employees is not tied specifically to any particular EMI. Further, any attempted allocation of compensation would necessarily be performed differently among EMIs, resulting in inconsistent disclosure in the industry and confusion among shareholders. Ultimately, it is critical to note that the alignment of interests between EMIs’ investors and the external manager is ensured by virtue of the fact that, on an annual basis, the board evaluates the external manager’s performance and management fee and

makes a determination regarding whether to renew its contractual relationship with the manager.

I. Specific Information Relating to the Compensation of EMIs' Named Executive Officers is Irrelevant to Investors' Pay-for-Performance Decisions

The Proposed Policy does not advance ISS's purported goal of facilitating shareholders' pay-for-performance decisions, as EMIs' boards of directors have no authority to direct – and do not even influence – the compensation paid by their external managers to their employees, nor can they effect any changes to such compensation in response to any shareholder dissatisfaction.

As acknowledged by ISS, EMIs such as REITs have a unique management structure, in which the EMIs' executives are retained and compensated not by the issuer, but by the external manager – a separate legal entity. Under this structure, the EMI provides the external manager with a management fee (often comprised of both a base management fee and an incentive fee), as specified in a management agreement between the parties, and in exchange, the manager not only provides the EMI with executive officers and services of other employees of the manager, but takes responsibility for all aspects of managing the EMI's business affairs and operations. The fee does not vary based on the number of employees of the manager who provide services to the EMI or the amount of time such employees devote to the EMI, or most importantly, how such employees (including the executive officers of the EMI) are compensated by the manager.

While EMIs generally disclose the management fee and how such fee is calculated, the Proposed Policy appears to be aimed at incentivizing more detailed disclosure about “compensation practices and payments made to executives” of EMIs to enable shareholders “to make a comprehensive assessment for pay-for-performance.” This fails to take into account, however, that boards of directors of EMIs have no control or influence over the compensation paid by the manager to the EMI's executive officers or any of its other employees who provide services to the EMI, or that the manager's compensation of the individuals who provide services to the EMI is based on their performance as employees of the manager as a whole, including the performance of their responsibilities related to other parts of the manager's platform and the performance of the platform as a whole. Consequently, the relevant inquiry for shareholders of EMIs is not – and cannot be – whether there is an appropriate correlation between the compensation that the board had no involvement in setting and the EMI's performance. This is further evident in the fact that if an EMI fails to garner majority support for its say-on-pay proposal, its board has no authority to make changes to the compensation structure of the manager or the amounts paid by the manager to the EMI's named executive officers.

Moreover, if shareholders were able to – and did – express their discontent with respect to the portion of the management fee allocated to the salaries of the named executive officers in relation to the EMI's performance (to the extent such salaries are derived from

the management fee), this would not effect a change in the amount of the management fee paid to the manager. The EMI would still be legally obligated to pay the entire management fee to which it contractually agreed. Thus, assuming it was discernible, disclosing the compensation paid by the external manager to the named executive officers would be of no consequence.

What is relevant to investors of EMIs charged with assessing pay-for-performance is the total management fee remitted to the external manager in exchange for its full array of services – information that EMIs currently disclose. That management fee is negotiated by the EMI's board of directors. In addition, the board typically evaluates the management agreement on an annual basis, and the independent directors meet in executive session to discuss the performance of the manager and of the executives placed at the EMI by the manager. Thus, board and/or shareholder dissatisfaction with the services provided by the external manager in exchange for the total fee paid can – and likely would – incentivize the board to negotiate a lower fee and/or sever the relationship with the existing manager.

Because EMIs' boards have no authority with respect to setting or altering the compensation paid by the manager to the EMI's executives, the Proposed Policy does not further ISS's purported objective of enabling shareholders of EMIs to engage in a comprehensive pay-for-performance analysis. For this reason we believe that ISS should not adopt the Proposed Policy.

II. Information Regarding the Compensation of EMIs' Named Executive Officers Cannot Be Reasonably Approximated, Would Result in Reporting Inconsistencies Across EMIs and Shareholder Confusion, And is Not in EMIs' Control

As noted above, disclosure of compensation information is of no relevance to EMI shareholders. In addition, identifying this information with any clarity would be fraught with difficulty or, in many instances, would be impossible, not to mention the fact that the costs and time spent identifying this information would outweigh the benefits of providing this information to shareholders, for the reasons discussed above.

In most cases, it would be extremely difficult if not impossible for external managers to isolate the portion of the executives' compensation that relates to their work for a particular entity within the manager's overall platform. This is because the employees of external managers often serve in various positions at the manager, its affiliates, and/or other EMIs managed by the same external manager, and external managers generally do not compensate their employees specifically for services relating to any particular issuer within their platform. Indeed, among the benefits to EMIs of the external management structure are the collective knowledge, depth of experience and relationships that result from the external manager's platform, which are often substantially deeper and more extensive than those that would be available to the EMI if it were internally managed and not part of a broader platform. At the same time, to the extent any potential conflicts of interest arise

from the EMI's executive officers having responsibility for other entities within the manager's platform, these are disclosed to shareholders. Moreover, it is critical to remember that incentive fees paid to the external manager serve to align the manager's interest with that of the EMI.

Disclosing the total amount of compensation allotted to the named executive officers for the sum of their employment duties, whether or not pertaining to the EMI, would be misleading. Accordingly, the Proposed Policy essentially amounts to an appeal to EMIs and their external managers to somehow approximate the portion of compensation provided to their executives that is specifically tied to the services provided to the EMI. Any attempt to do so, however, will likely be based on little empirical data, will be inherently imprecise, will not be comparable across companies (particularly as external managers are likely to allocate fees differently), and, as a result, will be of little relevance and confusing to investors. Currently, EMIs disclose the management fees they pay their managers, which is not only discernible but is more pertinent and lends itself to comparison by shareholders.

Even if the amount of compensation provided to the manager's employees in connection with their service to a particular EMI were able to be determined, EMIs have no control over this information. As noted above, while boards of directors of EMIs negotiate the overall management fee to be paid to the external manager and generally disclose pertinent information regarding the fee and its calculation to investors, they are not privy to information concerning how this fee is allocated by the manager, which is typically a privately held entity. EMIs, therefore, do not know and do not have ready access to data relating to the compensation of their companies' executive officers, who are employees of the external manager and/or its affiliates. Management agreements between EMIs and external managers do not generally provide for disclosure of compensation information to EMIs, nor do external managers have any legal obligation to provide this information. Accordingly, the Proposed Policy seeks to penalize issuers with an external management structure for not disclosing information over which they have no possession or control. What is more, EMIs' disclosure of compensation information pursuant to the Proposed Policy could potentially expose EMIs to liability for information that EMIs have no ability to control and are entirely reliant upon privately held third-parties to provide to them.

Accordingly, not only does the Proposed Policy seek to compel the disclosure of information that we believe is not relevant to shareholders of EMIs in the context of externally-managed structures as discussed above, but it could result in adverse vote recommendations against EMIs or their directors due to their inability to disclose information that is indiscernible and over which they have no control and could expose EMIs to liability for information provided to them by third-party managers. For these reasons, we urge ISS not to adopt the Proposed Policy.

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Thank you for the opportunity to comment on ISS's proposed policy change. We would be pleased to discuss our comments with you or provide any additional information you would find useful. If you have any questions regarding this letter, please do not hesitate to contact the undersigned at (212) 455-3577 or akeller@stblaw.com, Yafit Cohn at (212) at (212) 455-3815 or yafit.cohn@stblaw.com, or Dov M. Gottlieb at (212) 455-2034 or dgottlieb@stblaw.com.

Very truly yours,


Andrew R. Keller