



# Canada

## Executive Compensation

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### Frequently Asked Questions

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## PAY FOR PERFORMANCE METHODOLOGY

The Pay for Performance methodology is a tool to help evaluate the alignment of executive pay and company performance. The methodology is designed to focus on companies with a long term trend of over-compensation relative to performance. It comprises an initial quantitative screen and routine qualitative assessment, and, where a potential pay for performance misalignment is identified, a more in-depth and detailed qualitative assessment to determine if there is significant long-term pay for performance misalignment. The in-depth qualitative analysis is completed for all subject companies identified by the quantitative screen as having a potential pay for performance misalignment, and this qualitative assessment drives ISS' ultimate vote recommendation for this policy. The detailed components of the methodology are:

### Quantitative

#### Relative:

- › The **Relative Degree of Alignment (RDA)** is the difference between the company's Total Shareholder Return ("TSR") rank and the CEO's total pay rank within a peer group, measured over a 3-year period;
- › **Multiple of Median (MOM)** is the total compensation in the last reported fiscal year relative to the median compensation of the peer group; and

#### Absolute:

- › The **CEO pay-to-TSR Alignment (PTA)**: the difference between absolute pay changes and absolute TSR changes over the most recent 5-year period (or as long a period as company disclosure permits)

### Qualitative

Companies identified by the above quantitative screen as having potential pay for performance misalignment will receive a qualitative assessment to determine the ultimate recommendation, considering a range of case-by-case factors. These factors may include the ratio of performance to time based equity awards; the overall ratio of performance-based compensation; the completeness of disclosure and rigor of performance goals; actual results of other financial metrics, special circumstances related to a new CEO in the prior FY; and any other factors deemed relevant.

The methodology described above is further explained in the following sections of the FAQ.

## Definition of Compensation

### 1. How does ISS define Total Compensation (Pay) for the pay for performance methodology?

In accordance with the [National Instrument Form 51-102F6 - Statement of Executive Compensation](#), each annual meeting Management Information Circular ("proxy circular") must disclose an array of compensation data, with a three year look-back, for the five highest paid executives, including the CEO and CFO. The centerpiece of these disclosures is the Summary Compensation Table, which enumerates key elements found in a typical top executive's compensation package. These elements include:

- i. Base Salary
- ii. Share-Based Awards
- iii. Option-Based Awards
- iv. Non-Equity Incentive Plan Compensation – Annual Incentive Plans (Annual Bonus)<sup>1</sup>
- v. Non-Equity Incentive Plan Compensation – Long Term Incentive Plans<sup>2</sup>
- vi. Pension Value
- vii. All Other Compensation
- viii. Total Compensation

The proxy circular also includes several other tables which provide more specific information such as grants of equity based awards, outstanding equity based awards, pension values etc. However, the Summary Compensation Table provides the most comprehensive picture of each named executive officer's total planned and earned compensation for the fiscal year - specifically, the pay and pay opportunities that the compensation committee and board determined the executives ought to receive. It is these decisions that investors generally wish to monitor and evaluate, since their aim is to ensure that executives are paid fairly, but not overpaid, for the performance executives ultimately deliver and sustain.

In evaluating pay for performance alignment at a company, ISS focuses on Total Compensation as reflected in the Summary Compensation Table of the proxy circular.

### 2. Why does ISS focus on the CEO's pay to determine pay for performance alignment?

ISS focuses on the CEO's pay because that package sets the "compensation pace" at most companies. In addition, the compensation committee and board are most directly involved in and accountable for the decisions that generate the CEO's pay.

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<sup>1</sup> As per the NI 52-102F6, these columns include the cash awards received by the executive that are either discretionary or dependent upon pre-determined performance goals. Please note that compensation related to Annual Incentive Plan relates only to a single financial year, whereas Long Term Incentive Plans compensation relates to a period longer than a single year.

### 3. Why does ISS use granted values for equity based long term incentive awards instead of using realizable/realized values for such awards?

Some observers suggest that shareholders should evaluate "realized/realizable pay" rather than granted pay in determining whether pay and performance are aligned. This comprises compensation that results (or could result) from the exercise/vesting of an executive's previously granted equity awards at a given point in time. Since equity-based awards are by far the largest component of most top managers' pay, it is true that future shareholder returns will have substantial impact on those realized values – in other words, the pay realized from equity-based awards at underperforming companies is likely to be lower than that realized by executives at better performing companies, all else being equal. Nevertheless, those values are also significantly influenced by the award opportunities themselves, which reflect the compensation level the board has determined top executives deserve and that will appropriately incentivize future performance. Since all equity-based awards are sensitive, to some degree, to market trends beyond the control of individual executives, it is important that pay elements be considered if long-term company performance is misaligned with past pay and award opportunities. In that case, shareholders may expect the board to ensure that future incentive awards are clearly designed to promote performance improvements that will lead to shareholder value creation.

In the interest of protecting their assets, investors may have another reason to monitor granted pay: corporate pay benchmarking. Companies themselves measure their executives' compensation against competitors with respect to pay and pay opportunities, not "realized/realizable" pay.

A review of realizable/realized pay may be included in the qualitative assessment when a potential pay for performance misalignment has been identified.

### 4. How does ISS treat negative pension values in the Summary Compensation Table?

Negative pension values will be included as reported by the company and can serve to lower the Total Compensation. When an in-depth qualitative review of the company's compensation plans is conducted, ISS may consider both total compensation and total direct compensation. In some rare cases when the negative pension value causes a negative total compensation value in the summary compensation table, ISS may use total direct compensation in order to evaluate the pay for performance alignment at a company.

Total compensation is the sum of all pay elements disclosed in the summary compensation table, that is, salary, share-based awards, option-based awards, non-equity incentive compensation-annual incentive plans, non-equity incentive compensation-long term incentive plans, pension value and all other compensation. Total Direct Compensation is Total Compensation less pension value.

### 5. How does ISS account for more than one CEO in a given fiscal year?

When a company transitions from one CEO to another, ISS will use only one CEO's pay. The CEO that was in the position at the end of the fiscal year will generally be the one whose pay will be used. The base salary for a CEO serving less than one year will be annualized.

If the company has co-CEOs, the higher total compensation figure will be used; note, however, that the impact of co-CEO compensation costs may be addressed separately as a part of ISS' qualitative executive compensation evaluation.

## 6. If the company has transitioned to a new CEO in a particular fiscal year, how does ISS compute total compensation for the new CEO?

Total Compensation for the CEO is calculated as the sum of the following pay elements<sup>2</sup>:

- i. Annualized Base Salary
- ii. Share-Based Awards
- iii. Option-Based Awards
- iv. Non-Equity Incentive Plan Compensation – Annual Incentive Plans (Annual Bonus)<sup>3</sup>
- v. Non-Equity Incentive Plan Compensation – Long Term Incentive Plans<sup>3</sup>
- vi. Pension Value
- vii. All Other Compensation

In order to compare the total compensation of executives, the base salary of the new CEO is annualized. ISS does not, however, annualize any other pay component such as equity or non-equity related incentive plan compensation because these awards are likely related to achievement of performance goals.

If the company discloses contractual salary payments in the proxy circular, then such payments would be used as base salary. If this disclosure is not available, ISS will compute the annualized base salary based on the start date of the executive and fiscal year end of the company, using a 365 day year. Start date is the date the executive began employment as the CEO.

## 7. For pay for performance alignment, how will ISS treat CEOs who have not been in the position for three years?

The quantitative methodology will analyze total CEO pay for each year in the analysis without regard to whether all years relate to the same or different CEOs. If that analysis indicates significant pay for performance misalignment, the ensuing in-depth qualitative analysis may take into account any relevant factors related to a change in CEO during the period. Given an apparent misalignment between performance and CEO pay, shareholders would expect the new CEO's pay package to be substantially performance based (with clearly disclosed metrics and goals).

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<sup>2</sup> Items ii. through vii. are as reported in the Summary Compensation Table.

<sup>3</sup> As per the NI 52-102F6, these columns include the cash awards received by the executive that are either discretionary or dependent upon pre-determined performance goals. Please note that compensation related to Annual Incentive Plan relates only to a single financial year, whereas Long Term Incentive Plans compensation relates to a period longer than a single year.

## 8. How does ISS treat restated compensation amounts for prior years? This may include scenarios in which the Board granted incentive awards to the executive, awards that the executive later declined.

ISS will not restate the total compensation amount for the purpose of the pay for performance methodology if the company restates total compensation values unless there are exceptional circumstances. Specifically, ISS will not restate prior year compensation amounts if previously granted performance based equity awards did not vest; these awards will continue to be recorded at their grant date fair value. The rationale behind this decision is that the total compensation prior to the restatement was what the compensation committee intended to award the executive, and therefore the compensation committee should be held accountable for its decisions regarding compensation amounts awarded. Subsequent events that lead to a restatement of grant date values or an executive declining compensation awards may be included in the qualitative assessment when a potential pay for performance misalignment has been identified.

## 9. What pay data does ISS use for companies with meetings early in the year whose peer CEO pay information has not yet been released?

ISS uses the most recent compensation data available for the peer companies, which may be from the previous year in some cases. Pay data is updated very quickly as proxies are released, and the peer data is used only as a screening mechanism, so the impact of differing pay years within a pay group may be considered during ISS' qualitative review.

## 10. How are peer medians calculated for the Components of Pay Table?

The median is separately calculated for each component of pay and for the total annual compensation. For this reason, the median total compensation of the peer CEOs will not equal the sum of all the peer median pay components, because the values are calculated separately for each pay component. Rather, the median total compensation reflects the median of the total compensation of the peer group constituents.

## Definition of Performance

## 11. How does ISS measure the performance of a company for the quantitative section of the pay for performance methodology?

Total shareholder return (TSR) is the key measure used for assessing long-term pay for performance alignment – i.e., change in stock price plus reinvested dividends over the specified measurement period.

## 12. Does ISS's pay for performance analysis only use TSR to gauge company performance?

The quantitative analysis (i.e. the screening phase of the pay for performance methodology) only uses TSR to define a company's performance; however ISS understands that there are myriad ways to measure corporate performance, and key metrics may vary considerably from industry to industry and from company to company depending on the company's particular business strategy at any given time. Therefore, the qualitative assessment of the company's pay for performance alignment considers other measures of company performance (see Relative Pay and Financial Performance Assessment for more information)..

Hence, ISS does not advocate that companies use TSR as the metric underlying their incentive programs; on the contrary, shareholders may prefer that incentive awards be tied to the company's short- and long-term business goals. If a company's business strategy is sound and well executed, the expectation is that it will create value for shareholders over time, as reflected in long-term total shareholder returns. For this reason, TSR, which is objective and transparent, is the primary metric ISS utilizes in evaluating pay and performance alignment in the quantitative analysis.



### 13. What is the Relative Pay and Financial Performance Assessment included in research reports?

ISS will introduce the Relative Pay and Financial Performance Assessment for companies in the S&P/TSX Composite Index and non-Composite companies that provide a Say-on-Pay resolution, beginning with meetings on or after Feb. 1, 2017. This will be a standardized comparison of a long-term CEO pay and financial/operational performance rankings relative to the ISS-defined peer group. The financial/operational performance will be assessed across up to six financial metrics and TSR, depending on the subject company's GICS industry group. The potential metrics are:

- › Cash flow (from operations) growth
- › EBITDA growth
- › Return on assets (ROA)
- › Return on equity (ROE)
- › Return on invested capital (ROIC)
- › Revenue growth
- › Total shareholder return (TSR)

The metrics and weightings will vary by GICS industry group and are based on extensive back testing. The data source is S&P Compustat and metrics are generally measured over the trailing 12 quarters (or 16 quarters for growth metrics) as of the applicable Quarterly Data Download for each company. For additional information on this process, please refer to ISS' [Pay-for-Performance Mechanics](#) white paper.

### 14. How will ISS use the Relative Pay & Financial Performance Assessment in its analysis?

For 2017, the Relative Pay & Financial Performance Assessment is not part of the quantitative screen methodology. Rather, it may be used as part of ISS' qualitative review. The assessment provides a broader view of the performance side of a pay-for-performance analysis. The company's relative financial performance may indicate that the initial quantitative screen result is anomalous – i.e., larger incentive awards may be explained by sustained superior financial and operational performance, despite lagging shareholder returns. It may also inform an evaluation of the rigor of incentive programs. For example, if incentives paid out above target levels against lowered performance goals, is this substantiated by superior relative performance in the applicable metric? Alternately, relatively high executive pay against a backdrop of both underperforming TSR and relative financial results would exacerbate pay-for-performance misalignment concerns.

### 15. Where does ISS obtain 1-, 3- and 5-Year TSR data? And how often are these values updated?

ISS obtains all financial data in the compensation profile from Standard & Poor's Research Insight. The TSR values are updated every month to ensure TSR values accurately represent the fiscal year end of the company in question.

### 16. How does Research Insight calculate 1-, 3-, and 5-year TSR?

The one-, three- and five-year TSR is the annualized rate of return reflecting price appreciation plus dividends (based on reinvestment as of the end of the month of the dividend payment) and the compounding effect of dividends paid on reinvested dividends, over the relevant time period.

## QUANTITATIVE PAY FOR PERFORMANCE EVALUATION

### Relative Degree of Alignment (RDA) and Multiple of Median (MOM)

#### 17. What does RDA measure?

RDA addresses the question: Is the pay opportunity delivered to the CEO commensurate with the performance achieved by shareholders, relative to a comparable group of companies? This measure compares the percentile rank of a company's CEO pay and TSR performance, relative to a comparator or peer group, that is selected by ISS on the basis on size, industry, and market capitalization, over a three-year period. For more information on peer groups please see the Constructing Comparison Groups section below.

The Relative Degree of Alignment is equal to the difference between percentile ranks: the performance percentile rank minus the pay percentile rank, over a three year period.

	Performance	Pay	Difference*
3-Year	26	64	-38

\*Performance Percentile Rank – Pay Percentile Rank

#### 18. What TSR time period will ISS use for the subject company and the peers in the relative pay for performance analysis?

TSR for the subject company and all its peers is measured from the last day of the month closest to the subject company's fiscal year end. For example, if the subject company's fiscal year end is December 31, then the three-year TSR for the subject company and its peers will be based on December 31. The ISS report will show these closest month-end fiscal year end TSRs for the company and its peer groups, which thus may differ from the reported fiscal year returns of the company and its peers. To illustrate: if a company's fiscal year ends on November 29, 2016, then three year TSR will be measured over the periods December 1, 2013 – November 30, 2016.

#### 19. What compensation time period will ISS use for the subject company and the peers in the relative pay for performance analysis?

Compensation figures for all companies are as of the latest available public disclosure filing.

#### 20. What is the range of values for RDA?

Values for the Relative Degree of Alignment (RDA) measure range between -100 and +100, with -100 representing high pay for low performance (i.e., 100th percentile pay combined with 0th percentile performance), zero representing a high degree of alignment (the pay rank is equal to the performance rank), and positive values representing high performance for low pay.

#### 21. What is Multiple of Median (MOM)?

Multiple of Median (MOM) is the company's one-year CEO pay divided by the median one-year CEO pay of the ISS selected comparator group. This measure aims to address the question: Is overall CEO pay significantly higher than amounts typical for the comparison group. This measure can range from zero (if the subject company paid its CEO nothing) to infinity and is designed to highlight cases where shareholders may be overpaying executives regardless of performance.

## Constructing Comparison Groups

### 22. How are peer companies determined?

ISS constructs a comparison group of between 11 and 24 Canadian peer companies for each subject company covered by the Pay-For-Performance methodology. Peer groups for all S&P/TSX Composite Index companies analyzed under this methodology are constructed twice a year, based on data provided by an independent source (Research Insight Quarterly Data Download [QDD]). The following criteria are used to determine peer companies:

- › the GICS industry classification of the subject company
- › the GICS industry classifications of the company's disclosed pay benchmarking peers
- › Size constraints for both revenue (or assets for certain financial companies) and market value, utilizing four market cap "buckets" (micro, small, mid, and large)

Subject to the size constraints, and while choosing companies that push the subject company's size closer to the median of the peer group, peers are selected from a potential peer universe in the following order:

1. from the subject's own 8-digit GICS group
2. from the subject's peers' 8-digit GICS groups
3. from the subject's 6-digit GICS group
4. from the subject's peers' 6-digit GICS groups
5. from the subject's 4-digit GICS group
6. from the subject's 2-digit GICS group
7. from the subject's "Super GICS" group (described further below)

If 11 comparator group members are not selected from the companies in the universe that share the subject company's eight-digit GICS category, the process is repeated with companies in the comparison universe that share the company's peers' eight-digit GICS category, maintaining the company at the median position where possible, until 11 or more comparison companies are selected; if 11 comparison companies cannot be selected using the peers' eight-digit GICS category, then the process is repeated using the next universe set listed above (i.e., the subject's six-digit GICS group), until 11 or more companies are selected; and so on.

### 23. What are ISS' size parameters for qualifying a potential peer?

ISS applies two size constraints to qualify potential peers:

1. Revenue (or assets for certain financial companies, as noted below)  
In general companies should fall in the range 0.25 to 4.0 times the subject company's revenue (or assets). These ranges are expanded when the subject company's revenue is larger than \$10 billion or smaller than \$200 million in revenue (assets). Companies smaller than \$100 million in revenue or assets are treated as if they have \$100 million in revenue/assets.
2. Market capitalization (defined as 200 day average price multiplied by shares issued and outstanding) .
  - › Companies are classified into market capitalization buckets as follows (in millions):

Bucket	Low end	High end
Micro	0	200
Small	200	1,000
Mid	1,000	10,000
Large	10,000	No cap

- › A potential peer must have a market cap that falls between 0.25 times the low end and 4 times the high end of the subject's market capitalization bucket.

#### 24. Why does ISS use 0.25x – 4x revenue/asset range (rounded to nearest tenth)?

There is an extensive literature that demonstrates a strong correlation between company size and CEO pay. Among executive compensation practitioners, a size range of 0.5 times to 2 times size (measured by revenue or assets, as appropriate for the company's industry) has emerged as a standard of practice. Given, however, the size of the Canadian market, ISS has expanded this range to capture peers that may be similar in function but do not fall into a narrow size range.

#### 25. What happens if ISS' peer group methodology does not generate at least 11 peer companies?

ISS' standard peer group construction methodology generally produces all or a majority of peer companies used for the relative comparisons in the quantitative component of the pay for performance analysis. There are, however, companies where the standard methodology does not generate a sufficient number of peers. Hence, additional customization is applied to ensure that each analysis is based on a robust comparison group:

For many large Canadian companies, there are a limited number of similar companies within the size and industry criteria mentioned above. These are handled in the following ways:

- › **Relax the revenue/asset criteria:** Peer groups with an insufficient number of peer companies will be augmented by relaxing the revenue (but not market cap) parameters in the peer group selection process while retaining peers selected under the standard methodology. Additional peer companies that are both larger and smaller will be added in order to maintain the subject company as close to the median size level as possible. The revenue criteria can be relaxed to include a few companies that are closest in terms of size to the subject company within reason. Since company size relates strongly with the top executive pay levels, however, we do not believe that expanding the size criteria significantly would benefit peer company selection.
- › **Super GICS:** In some cases where less than 11 peers have been identified using the standard methodology, the industry group to which the subject company belongs is expanded to include companies that are otherwise comparable to the subject company operationally. A Super GICS group combines closely related two-digit GICS groups to create a larger peer universe for companies that have fewer than 11 peers. The Super GICS groups used by ISS are:

Super GICS Category	Two-Digit GICS Included	Names of Included Sectors
A	10, 15, 20, 55	Materials, Industrials, Energy and Utilities
B	25, 30, 35	Consumer Discretionary, Consumer Staples, and Health Care
C	45, 50	Technology and Telecom

- › **Super Group:** Certain very large companies may have insufficient peers generated by the standard methodology because they are unique in being the largest public companies in their GICS and Super GICS categories, and as such are without a sufficient number of peer companies. Since company size correlates strongly with top executive pay levels, these firms require a special peer group that consists of the 24 largest companies in Canada, as measured by revenues on the semi-annual peer reconstruction date. These companies are similar in size and maturity to the 24 largest companies in Canada. Industry specific performance will also be considered in any resulting qualitative review.
- › **Peers of ISS-Selected Peers:** In very few cases, the above steps will not lead to the generation of a minimum 11-company comparison group. In these cases, ISS will look at the peers of the ISS-selected peer companies. Beginning with the ISS-selected peer company closest in size to the target company, ISS will review the ISS-selected peers of that peer company and select companies from this group to serve as peers of the target company. Comparison companies will be selected from the peer company's peers with the intent of keeping the target company as close to the median of its peer group as possible.

Finally, ISS would like to note that this process is flexible and analysts regularly review company comparator groups to ensure that the comparison companies are appropriate. ISS has and will continue to adjust comparator groups where the comparator companies are deemed inappropriate.

## 26. Which industry groups will use assets for size comparisons? What happens when a company has potential peers in both asset-based and revenue-based industry groups?

ISS will use balance sheet assets (rather than income statement revenue) to measure the size of companies in the following 8-digit GICS groups.

- › 40101010 Commercial Banks
- › 40101015 Regional Banks
- › 40102010 Thrifts and mortgage
- › 40202010 Consumer Finance
- › 40201020 Other Diversified

Both the subject company and potential peers must be in the asset-based GICS groups listed above in order to be compared on the basis of assets. In cases where a subject company is in one of the asset-based GICS groups and a potential peer is not, revenues will be used for size comparisons. This principle applies to the size comparisons made to qualify a company for potential inclusion as a peer; to the size rankings made to maintain the subject company near the median size of the peer group; and to the size prioritization of peers.

In addition, as deemed appropriate by ISS, additional 8-digit GICS categories may be determined to utilize assets and/or market cap to identify peers.

## 27. Why does ISS select 11-24 companies?

The Relative Degree of Alignment calculation measures percentile ranks of pay and performance for the subject company. The larger the comparison group, the finer the resolution of the percentile ranks (for instance: in a comparison group of 24, percentile ranks move in approximately 4-point increments, whereas they move in 10-point increments for a group of less than ten). We believe that using 11 or more companies in the comparison groups provides sufficient resolution for the percentile measure, while also allowing us to generate comparison groups for the vast majority of companies within the methodology's size and industry constraints.

## 28. Do you include the subject company in the derivation of the peer group median? When you say 11 companies minimum for peers, does the 11 include the subject company?

No, neither the CEO pay nor the TSR for the subject company is included in the median calculation. The subject company is also not included in the number of peer companies.

## 29. Will a company always be at the median of its peer group in terms of size?

The aim of the methodology is to produce a mix of peers larger and smaller than the subject company (ideally putting it at the median); however as long as a company's GICS group peers meet the market cap and revenue/asset range criteria they may be selected. The premise is that any company within the size range may be expected to provide compensation opportunities at around the same level as any other company within its size range.

### 30. When will the company's peer group have more than 11 companies?

If more than 11 companies within the subject company's eight- and six-digit GICS group meet the applicable size criteria (market cap and revenue/assets), up to 24 of those companies may be selected for the peer group. If less than 11 companies in the subject company's six-digit GICS group meet the size criteria, peers that do not meet the criteria will be selected from the broader GICS groups until 11 or more are identified.

### 31. Will ISS use companies from countries other than Canada to create the comparison group?

No. For the purpose of selecting peer companies, ISS shall only select Canadian incorporated companies with proxy materials filed on SEDAR. Please note that ISS will not consider Canadian incorporated companies that file DEF-14A in the US for the purpose of peer selection because these companies are deemed U.S. domestic reporting issuers under the SEC and are thus covered by ISS U.S. Research using U.S. policy.

### 32. Does ISS use the same list of peer companies for pay for performance as used for a company's allowable cap on an equity plan proposal?

Although there may be an overlap of peers selected under each methodology, the peer companies used to determine allowable cap on an equity plan proposal are not necessarily the same peers used for assessing pay for performance. The peer group used for assessing pay for performance alignment is based on a combination of industry and size (revenue/assets and market cap); whereas the peer group used to create the allowable cap to assess a stock based compensation plan is based on industry, with adjustments for market capitalization.

### 33. Who can I contact if I disagree with the GICS classification?

ISS does not classify companies into the GICS codes. Please contact Standard and Poor's at 1-800-523-4534 if you believe that a company has been misclassified.

### 34. When and how often will ISS reconstruct peer groups?

Company peer groups will be reconstructed twice a year during July and December. The expectation is that revised peer groups, which are not anticipated to be significant, will be in place for meeting dates taking place on or after-September 1 and February 1, respectively.

## Pay-TSR Alignment (PTA)

### 35. What does Pay-TSR Alignment (PTA) measure?

Pay-TSR Alignment (PTA) is a measure of long term absolute alignment and is designed to indicate whether shareholders of a subject company and its executives have experienced the same long term trend. It is important to note that PTA is not designed to measure the sensitivity of CEO pay to performance; i.e., whether pay and performance go up and down together on a year-over-year basis. Rather, PTA is a long-term measure of directional alignment.

### 36. How is PTA calculated?

At a high level, the measure is calculated as the difference between the slopes of weighted linear regressions for pay and for shareholder returns over a five-year period. This difference indicates the degree to which CEO pay has changed more or less rapidly than shareholder returns over that period.

By using regressions to estimate the long-term trends for pay and TSR, the method avoids the pitfalls of evaluating pay and performance over time:

- › Performance over a fiscal year and pay granted over that period are measured in a consistent fashion, on the same scale, and are matched in time.
- › Lumpiness of pay and volatility of performance are smoothed but not eliminated – addressing in a consistent fashion both the “lumpy pay” problem as well as the sensitivity of TSR to choice of endpoints.

The trend lines calculated by these regressions are analogous to a 5-year “trend rate” for pay and performance, weighted to reflect recent history. The final Pay-TSR Alignment measure is simply equal to the difference: performance slope minus the pay slope.

### 37. Can you provide more details about the regressions?

Full details are available in Appendix II of [Evaluating Pay for Performance: ISS’ Quantitative and Qualitative Approach](#).

## Thresholds for Quantitative Evaluation

The philosophy of the framework is simple: if pay-for-performance measures for a company lie within a range of typical values, then it has demonstrated some evidence of pay-for-performance alignment; if the company’s measure is an outlier beyond that range, however, it begins to raise some degree of concern that a potential misalignment may exist.

### 38. What are the values for each pay for performance measure that may raise some degree of concern?

The evaluative approach begins by identifying companies that are significant outliers in each measure. The approach is based on empirical observation of the distribution of the measures within the back-testing universe. Additionally, the methodology, where possible, avoids arbitrary threshold effects by using a continuous scoring approach. As a result, scores are additive; concerns raised for multiple measures can accumulate to provide evidence for a potential pay for performance misalignment and a deeper dive by the analyst covering the company. Thus the methodology identifies whether:

1. a company’s particular measure is a sufficient outlier to demonstrate a high concern by itself; or
2. a company’s particular measure is a sufficient outlier to demonstrate a high concern in conjunction with one or both of the other measures.

The table below shows the levels for each measure that indicate, based on initial testing analysis, where a company would be considered an outlier (triggering Medium concern) or a significant outlier (which would trigger High concern). High concern for any individual factor will result in an overall High concern level for the quantitative component of the pay-for-performance evaluation, and multiple Medium concern levels may also result in an overall High concern.

Measure	Level that may trigger high concern in conjunction with other measures		Level that triggers high concern by itself	
	Level	Percentile	Level	Percentile
Relative Degree of Alignment (RDA)	-45%	~17 <sup>th</sup> percentile	-65%	~7 <sup>th</sup> percentile
Multiple of Median (MOM)	2.5x	~93 <sup>rd</sup> percentile	3.5x	~96 <sup>th</sup> percentile
Pay-TSR Alignment (PTA)	-25%	~13 <sup>th</sup> percentile	-40%	~3 <sup>rd</sup> percentile

## QUALITATIVE PAY FOR PERFORMANCE EVALUATION

### 39. What impact might an adverse score on the quantitative portion of the pay for performance methodology have?

The purpose of ISS' pay-for-performance evaluation is to identify companies where shareholders may wish to communicate concern about the pay-setting approach, given misalignment of compensation decisions relative to the company's performance track record. ISS' quantitative assessment is designed to detect such misalignment, based on both relative and absolute pay-performance evaluations, as well as to identify apparent good or satisfactory alignment that investors appreciate being aware of.

An important step when pay and performance appears misaligned is to assess how various pay elements may be working to encourage, or to undermine, long-term value creation and alignment with shareholder interests. All cases where the quantitative analysis indicates significant misalignment will continue to receive an in-depth qualitative assessment, to determine either the likely cause or mitigating factors. An adverse score on the quantitative portion of the pay for performance methodology will not lead to an adverse vote recommendation, rather to an in-depth qualitative analysis.

### 40. What qualitative factors are considered by ISS in the qualitative assessment of the company's pay and performance alignment?

The factors considered by ISS during the qualitative assessment of the company's pay for performance alignment include but are not limited to the following:

**Strength of performance based compensation:** This key consideration includes a review of the ratio of performance- to time-based equity awards as well as the overall ratio of performance-based compensation to total compensation, focusing particularly on the compensation committee's most recent decision-making (which reflects its current direction).

A company that exhibits significant misalignment of pay and performance over time would be expected to strongly emphasize performance-based compensation (though not by simply increasing the size of the pay package in order to make it more performance-based). ISS will review both recent cash awards paid and the award opportunities (long-term incentive grants) intended to drive future performance to evaluate their performance conditions. Time-based awards (including time-based stock options) that are not granted due to the attainment of pre-set goals are not considered strongly performance-based in this context. Shareholders would also expect such a company to fully disclose performance metrics and goals, which should be reasonably challenging in the context of its past performance and goals, guidance the company has provided to analysts, etc. Use of a single metric, or similar metrics, in either or both of the short- and long-term incentive programs may suggest inappropriate focus on one aspect of business results at the expense of others. If the company uses non-GAAP metrics, adjustments should be clearly disclosed (along with compelling rationale if such adjustments are nonstandard).

**The company's peer group benchmarking practices:** Several studies have pointed to companies' peer group benchmarking practices as a source of pay escalation that is divorced from performance considerations. Companies undertake benchmarking in order to ensure that their top management pay packages will stay competitive in the interest of attracting and retaining key executives. While this is an important objective, there are no established standards or rules for the practice, one which has been described as "more of an art than a science" by many companies. Peer selection may be influenced by many considerations. If a company exhibits long-term disconnect between pay and performance, ISS closely examines its disclosed benchmarking approach to determine whether that may be a contributing factor. For example, a preponderance of self-selected peers that are larger than the subject company may drive up compensation without regard to performance. Above-median targeting may have the same effect.



**Results of financial/operational metrics:** If a disconnect is driven by cash pay, ISS considers the rigor of performance goals (if any) that generated the payouts. Recent (GAAP) results on metrics such as return measures and growth in revenue, profit, cash flow, etc. -- both absolute and relative to peers – may also be further examined to assess the rigor of goals and whether the quantitative analysis may be anomalous (if other metrics suggest sustained superior performance). As noted above, company disclosure about the metrics, goals, and adjustments to results, should be clear and fulsome.

**Special circumstances:** The qualitative analysis may also consider exceptional situations, such as recruitment of a new CEO in the prior fiscal year or unusual equity grant practices (e.g., bi- or triennial awards) that may distort a quantitative analysis. We note, however, that such circumstances do not automatically invalidate other aspects of the analysis, including the quantitative results, since that methodology's long-term orientation is designed to smooth the impact of timing anomalies. Further, while shareholders may welcome a new CEO in light of lagging performance, they may nevertheless be concerned about a board that has been forced to pay dearly for outside talent but fails to appropriately link the new CEO's pay to performance improvement.

## MISCELLANEOUS QUESTIONS

41. If a company has not been publicly traded for five fiscal years, does the quantitative Pay-for-Performance evaluation still apply? What if the company has not been publicly traded for three fiscal years? Would such a company be used as a peer company for other companies?

If the company has not been publicly traded for five fiscal years, the relative assessment (specifically, the relative annualized three-year TSR pay and performance rank and the multiple of pay against the peer median) will still apply. The absolute assessment (i.e., the pay-TSR alignment test) will not apply as it requires at least 4 years of data to be valid. The company's limited life as a publicly traded company will also be considered as part of any qualitative evaluation.

Generally, only companies with three full years of data will be peer companies. In limited circumstances, a company with less than 3 years of data may be used when the quantitative evaluation focuses on only one year.

42. What impact might an adverse pay-for-performance recommendation have on an equity plan proposal?

If a significant portion of the CEO's misaligned pay is attributed to non-performance-based equity awards, and there is an equity plan on the ballot with the CEO as one of the participants, ISS may recommend a vote against the equity plan.

43. A company makes equity grants near the beginning of each year based on an evaluation of the company and/or the executive's performance in the immediately preceding year. Such grant information will appear in the following year's proxy statement. Will ISS take into account the timing of these early equity grants made in the current fiscal year and make adjustments to the top executives' total compensation when conducting its pay for performance analysis?

Such timing issues can be problematic for investors evaluating the relationship between performance and pay. The value of equity grants generally represents a significant proportion of top executives' pay; if the grants are made subsequent to the "performance" year, disclosures in the Summary Compensation Table or the Awards Outstanding at Year End may distort the pay-for-performance link.

Some investors believe that equity awards can incentivize and retain executives for past and future performance; therefore, adjustments for such timing issues may not be relevant. In addition, ISS' pay-for-performance analysis has a long-term orientation, where these types of timing issues are less relevant than an evaluation of one year's pay. Nevertheless, ISS may

consider the timing of equity awards made early in a fiscal year if complete disclosure and discussion is made in the proxy statement in a qualitative assessment. In order to ensure that pay-for-performance alignment is perceived, the company should discuss the specific pre-established performance measures and goals that resulted in equity awards made early in a fiscal year. A general reference to last year's performance is not considered sufficient and meaningful to shareholders. If the company makes equity grants early in each year, based on the prior year's specific performance achievement, shareholders should not be required to search for the information. Instead, companies should provide information about grants made in relation to the most recently completed fiscal year in the proxy statement for the shareholder meeting that follows that fiscal year (aligned with other compensation reported for that year).

#### 44. How do you account for differences in disclosure currency?

All companies analyzed under the Canadian Pay for Performance policy are analyzed in Canadian dollars (CAD). To do so, all figures disclosed in a currency other than CAD (e.g., USD) are converted to CAD before conducting the analysis.

ISS uses a yearly average exchange rate. The exchange rate used to convert an individual company's CEO pay to CAD is the (yearly average) exchange rate ending in the month closest to the respective company's fiscal year end date. If a company's FYE date is on or after the 15<sup>th</sup> day of a given month, the exchange rate as of that month-end will be used; otherwise, the previous month's yearly average exchange rate is used.