2016 European Pay-for-Performance Methodology

Frequently Asked Questions

Effective for Meetings on or after February 1, 2016

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PAY METHODOLOGY

1. How is the total pay figure calculated?

This is described in the white paper which accompanies the launch of the model, but in essence, all figures in the European model are based on realised (i.e., vested) remuneration amounts. This differs from the U.S. and Canadian models which use granted pay.

The model assumes that a single total figure based on the CEO's realised pay for the year under review is available for all companies within the European model. Where such a figure is not available from the current disclosures, ISS has created a single total figure based on its understanding of local market practice. In certain markets where the standard is still to report granted pay values, this involved the local Research team applying consistent handling rules across the market to create a realised pay figure for the year under review.

2. Why did ISS choose to use realised pay for the European model rather than granted pay as in the US and Canada?

During the development of the model, the European research teams reviewed how pay is typically disclosed in each market and the outcome was that a model based on realised pay was felt to fit better with the general direction of pan-European market practice; this conclusion was subsequently verified with a number of large institutional investors during the model development phase.

3. How does ISS account for bonus deferral in the model?

During the year under review, the value of the deferred bonus counted by the model will be taken to be the portion of the annual bonus that has been earned and will be deferred, assuming that the deferred portion is not subject to any further performance conditions other than continued employment. In addition, payments from previous bonus deferrals should be included as payments during the year, if these were subject to performance conditions which have been satisfied.

4. How does ISS account for equity vesting periods in the model?

Share-based payments should reflect the value of share awards vesting over the prior year (i.e., "realised" or take-home equity-based pay). The value of time-vested restricted stock without performance conditions attached should be captured at the time of grant at full value.

5. How are options valued under the European P4P model?

Options will be valued using intrinsic value (exercise price minus market price). As the model uses realised pay, this differs from the approach in the US and Canadian models which are based on granted pay.

6. How does ISS translate granted pay disclosures into a realised equivalent for Swiss companies?

Some Swiss companies disclose CEO remuneration on a granted pay basis. Therefore, in order to ensure that the CEO pay data for these companies is consistent with other Swiss companies as well as with other markets, ISS creates a single figure for these Swiss companies that reflects realised pay. Pay data for these Swiss companies will be collected using the following principles.

All fixed compensation (including base salary, perquisites, pension, and other forms of compensation), as well as the annual cash bonus, any deferred/share bonuses, and any service-based share grants (e.g. time-vesting restricted stock) are captured from the emoluments table for the year of grant. These types of compensation are in essence considered to be realised at the time of grant.

For performance share grants, as well as for stock options (both service-based and performance-based), if the company does not provide sufficient disclosure on the value of such awards paid to the CEO on a realised basis, ISS will typically calculate the value of such awards using a combination of data disclosed for the year in which the awards were originally granted and for the year in which the awards were vested.

- For **service-based stock options**, if the value of vested options or the number of vested options are not disclosed, ISS will calculate the value of vested options based on the number of options originally granted to the CEO, multiplied by the difference between the option strike price and the market price at vesting. In such cases, it will be assumed that all options originally granted to the CEO vested in full on the originally scheduled vesting date(s). ISS will capture the number of granted options from the company's pay disclosure for the year of grant. The strike price will be captured where available, typically in the pay disclosure from the year of grant. If the specific date of vesting is known, or the company discloses the market price at vesting, ISS will use this when calculating the market price at vesting; if neither are disclosed by the company, the market price and the end of the vesting year will be used. If information on the number of originally granted options to the CEO or the option strike price are not available, the company will be excluded from the P4P universe due to lack of available information.
- For **performance-vesting stock options**, data will be collected using the same principles as for service-based options, except that it will not be assumed that all originally granted options vested. Therefore, if the value of vested options or the number of vested performance options are not disclosed, ISS will calculate the value of vested performance options by multiplying the number of originally granted options by the percentage of options that vested, then multiplying this figure by the difference between the option strike price and the market price at vesting. Data on the percentage of vested options will be captured from the pay disclosure from the year of vesting. If the company does not disclose the percentage of performance options that vested, the company will be excluded from the P4P universe due to lack of available information.
- For **performance share awards**, if the value of vested awards is not disclosed, ISS will calculate the value of vested performance share awards based on the number of vested awards multiplied by the market share price at vesting. If the specific date of vesting is known, or the company discloses the market price at vesting, ISS will use this when calculating the market

price at vesting; if neither are disclosed by the company, the market price and the end of the vesting year will be used. If the number of vested performance share awards is not known, ISS will capture the number of granted performance share awards from the pay disclosure from the year of grant, and will multiply this by the percentage of performance share awards that vested based on the company disclosure from the year of vesting. If either the original number of performance share awards granted to the CEO or the percentage of vested awards are not disclosed, the company will be excluded from the P4P universe due to lack of available information.

For other types of long-term performance remuneration, ISS will capture data using the same principles used to capture data for stock options or performance share grants as appropriate.

7. During the recent financial year, a company had multiple CEOs in post. How does the model handle this?

If the company has co-CEOs in post at the same time, the higher total compensation figure will be used. However, the impact of co-CEO compensation costs may be addressed separately as part of ISS' qualitative executive compensation evaluation.

If only one CEO is in post at any point in time, ISS will typically use the pay of the CEO in office at the end of the fiscal year as an input to the model. Exceptions can be made in case there have been multiple recent CEO changes, in which case ISS will include the pay of the longest serving CEO. For CEOs in office for only part of the year, ISS will calculate an annualized basic pay figure.

8. In a company where the CEO is not a Board Member and the lead Executive Director is the Executive Chairman, whose pay is used in the model?

The model takes the CEO pay data as an input, unless he or she is not the highest paid executive, in which case the pay data for the 'lead executive' has been used i.e., the executive chairman.

9. Does ISS take into account the pay of other executive directors or the board as a whole in the European P4P model?

No, not in the current version.

10. What comparator group will ISS use for companies whose annual meeting precedes that for most or all peers?

ISS uses the latest publicly disclosed compensation data available when building peer groups, which, in some instances, may be drawn from the previous year.

MODEL

11. What are the RDA, MOM and PTA models?

At the core of the quantitative methodology in the US, Canadian and European models are three measures of alignment between executive pay and company performance: two *relative* measures where a company's pay-for-performance alignment is evaluated in reference to a group of comparable companies, and one *absolute* measure, where alignment is evaluated independently of other companies' performance.

The three measures are:

- **Relative Degree of Alignment (RDA)**. This relative measure compares the percentile ranks of a company's CEO pay and TSR performance, relative to an industry-and-size derived comparison group, over a three-year period.
- **Multiple of Median (MOM)**. This relative measure expresses the prior year's CEO pay as a multiple of the median pay of its comparison group for the same period.
- **Pay-TSR Alignment (PTA)**. This absolute measure compares the trends of the CEO's annual pay and the value of an investment in the company over the prior five-year period.

Further information on these measures can be found in the white paper which accompanies the European pay-for-performance model.

12. Does the RDA model always require three years of data?

While this is the standard for the model, the model can run with less pay history if, for example, a company has come to the market via an IPO more recently.

The research report will indicate the "scope" the model was run with i.e. how many years' of pay history were considered. Because of recent changes in market practice, certain German companies will not have three years of realised pay data available at the time of the 2016 annual meeting, and for these companies, Research will run the model with a reduced scope as appropriate. Please note that this is anticipated to be an issue for 2016 season only.

13. Why is the PTA chart not present for certain companies?

While the PTA model typically runs on five years of pay data, it can run when there is a minimum of four years of pay data. However, due to recent changes in market practice, in the German market the majority of companies will not have even 4 years of realized pay data available and so the PTA chart will not appear for these companies.

14. Why does the model use TSR as a performance measure?

ISS recognises that there are many ways to measure corporate performance, and that the choice of appropriate metrics, particularly for incentive plans, will vary depending on the industry or company-specific characteristics and situation.

However, when ISS developed the original pay-for-performance model for the US in 2012, it chose TSR as the measure of performance in response to client feedback that it was a key metric for investors in the context of pay-for-performance evaluation over the long-term. Although TSR has attracted some criticism, it remains one of the most transparent and popular measures with the majority of our clients, and it was, and is still, a measure used by the SEC. It was also perceived to be a measure generally well-understood by investors in most markets, which is important for a global approach.

15. How were the thresholds for High, Medium and Low concern selected for the European model?

The thresholds for the European model were set to be in line with those in the other P4P models for the first year to ensure a broadly comparable approach globally. The model output was then reviewed by our Research teams, and the level of concern verified as appropriate for the company. The thresholds will be reviewed annually.

16. Can the model handle subject companies and peers from European countries which use different currencies?

Yes, a currency conversion function has been implemented within the model which supports this exact scenario e.g. there is a subject company from France which uses the Euro (EUR), and it has a peer company from the United Kingdom which reports its pay figures in sterling (GBP) and one from Norway which reports its pay in Krone (NOK.)

The rates used by the currency conversion function are supplied by S&P and are the WM/Reuters closing mid-exchange rates compiled at approximately 16:00h (London time.) These will be updated every six months on 31 December and 30 June. The same FX rate is applied to the remuneration data for all FYs to minimize volatility. The current rates are as shown in the table below – the model requires all inputs to be in Euros.

Currency	Rate
DKK to EUR	1 to 0.1344
NOK to EUR	1 to 0.1073
SEK to EUR	1 to 0.1062
CHF to EUR	1 to 0.9240
GBP to EUR	1 to 1.2033
USD to EUR	1 to 0.9001

17. How will the overall level of concern be calculated?

The research report will display the concern levels for each of the three tests (RDA, MOM and PTA), as well as an overall concern level.

- A single High concern level for any of the three tests will result in a High concern level for the overall scenario
- A single Medium concern level for any of the three tests will result in a Medium concern level for the scenario; however, two Medium concern levels will result in an overall High concern level for the scenario
- And for a Low concern level for the overall scenario, all tests must have a Low concern level

18. How will the model be used in ISS benchmark research?

From the 2014 ISS Policy Survey, 83 per cent of investors who responded supported the development of a European pay for performance quantitative methodology, including the use of peer group comparisons.

The European Pay for Performance model comprises three quantitative tests resulting in an overall level of concern, which will be included in the ISS research reports for companies covered by the model. Where relevant, ISS research will take into account the model outcomes within the qualitative review of a company's remuneration practices as part of the ISS benchmark policy application. Any remuneration-related vote recommendations will be based on a holistic review considering relevant qualitative and quantitative factors.

For clients who partner with ISS on their own customised voting policies, the European Pay for Performance model and/or underlying data may also be an input into their final vote decisions.

PEERS

19. How were the ISS-selected peers allocated to a company?

The peer group selection algorithm used in the US and Canadian model was implemented for the European P4P model, as described in the white paper which accompanies the model's launch.

20. What is the minimum number of peers the model requires?

The model requires a minimum of 12 peers to run.

21. What are GICS codes? Who can a company contact if it disagrees with the GICS classification it has been assigned?

The Global Industry Classification Standard (GICS) was developed by Standard & Poor's and MSCI in response to the financial community's need for a reliable, complete (global) standard industry classification system. GICS codes correspond to various business or industrial activities, such as Oil & Gas Drilling or Wireless Telecommunication Services. GICS is based upon a classification of economic sectors, which is further subdivided into a hierarchy of industry groups, industries and sub-industries. The GICS methodology is widely accepted as the industry analysis framework for investment research, portfolio management, and asset allocation.

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

22. If a company does not agree with its assigned peers, what should it do?

The company should contact the ISS Helpdesk via EuropeanP4PSupport@issgovernance.com. ISS does not intend to amend any peers during season, but will review all feedback on the model on an annual basis.

23. Why are there no peers from outside Europe in this model, given ISS already operates US and Canadian P4P models?

Institutional investors were asked for their input when the model was being developed, and the consensus was that for the first year of the model, only European peers should be included in the model.

24. If a company has disclosed a peer group in its annual report or other meeting materials, why have these not been taken into account by the model?

When ISS reviewed the subject and peer companies in the European model, the vast majority did not have company-disclosed peers and so the data was too sparse for these to be built into the current methodology. However, if market practice changes in Europe, then ISS will consider amending the methodology in future years to incorporate company-disclosed peers.

COVERAGE

25. How does a company know whether it will have a pay-for-performance profile?

If a company is in the STOXX 600 index in December 2015, a pay for performance profile will be generated for it, unless it is one of the minority of companies excluded for poor or limited disclosure practices. If the company wishes to confirm whether it will have a profile, and what the overall pay number used will be, the company should email the ISS Helpdesk via EuropeanP4PSupport@issgovernance.com.

If a company has been excluded from the P4P model for poor or limited disclosure, it is excluded for the year. However, the pay disclosures will be reassessed annually, and if greater information is subsequently provided, the company may appear in the P4P model as both a subject and a peer company in future years.

26. How often is the coverage universe updated and when?

For the first year, the coverage universe will be updated in December 2015, and the peers in the model will be finalized by January 22, 2016. At this point, the universe of subject and peer companies will be fixed until the next coverage update planned for December 2016, with the exception of cases such as where a company delists during season and needs to be swapped out.

27. Why does the European P4P model operate a banded approach when this is not present in the US and Canadian models?

This is described in detail in the white paper which accompanies the launch of the model. In essence, it was to handle the spread in average CEO pay levels within the different European countries in such a way as to avoid introducing bias into the model.

28. Which countries sit in which bands, and how was this decided?

The constituents of the country bands are shown below. The membership of each band can be adjusted, although there are no current plans to do so, in order that a country could move between different bands to reflect changes in market practice over time. The placing of countries within bands will be reviewed after 2016 season.

Band	A	B	C	D
Constituents	UK Ireland Jersey	Germany Switzerland	Belgium France Italy Netherlands Sweden Spain	Austria Denmark Finland Greece Luxembourg Norway Portugal

The country bands were constructed based on the testing of the data used by the model to identify country groupings around quantum of total CEO pay, adjusted for average company size. They were also discussed with institutional clients during the model development phase to check that the company placings were in line with expectations.

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