European Pay-for-Performance Methodology

Frequently Asked Questions

Effective for Meetings on or after February 1, 2019

Latest Update: February 6, 2019

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PAY METHODOLOGY

1. How is the total pay figure calculated?

This is described in the white paper which accompanies the European pay-for-performance 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 at the time of vesting 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 does 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 are three measures: two *relative* measures where a company's CEO pay magnitude and the degree of pay-for-performance alignment are evaluated in reference to a group of comparable companies, and one *absolute* measure, where alignment between executive pay and company performance is evaluated independently of other companies' performance.

The three measures are:

› **Relative Degree of Alignment**. 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**. 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**. This absolute measure compares the trends of the CEO's annual pay and the value of an investment in the company over (typically) 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. For companies with a trading history of three years or more, a minimum of three years of pay data is required for the company to be included in the model.

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 are the thresholds for High, Medium and Low concern selected for the European model?

Thresholds for each test (RDA, MOM, and PTA) are determined for each market, ultimately deriving different sets of thresholds for STOXX600 vs. non-STOXX600 companies, and segmenting those by country pay band. Each model output is reviewed by our Research teams, and the level of concern verified as appropriate for the company. The thresholds are reviewed annually to determine if any updates are warranted.

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 are 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 in the same currency. The below applies from December 31, 2018 until June 30, 2019:

Currency	Rate
DKK to EUR	1 to 0.1340
NOK to EUR	1 to 0.1008
SEK to EUR	1 to 0.0983
CHF to EUR	1 to 0.8876
GBP to EUR	1 to 1.1132
USD to EUR	1 to 0.8734

17. How is the overall level of concern calculated?

The research report displays 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 results in a High concern level for the overall scenario
- A single Medium concern level for any of the three tests results in a Medium concern level for the scenario; however, two Medium concern levels 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 is the model 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. After having implemented the pay for performance model for Europe in 2016, the 2016 ISS policy survey confirmed that 92 percent of investors support the model outcomes as a contributing factor within the current holistic approach.

The European Pay for Performance model comprises three quantitative tests resulting in an overall level of concern, which is included in the ISS research reports for companies covered by the model. Model outcomes constitute a material factor among others that analysts use where relevant within a qualitative review of a company's remuneration practices and consider when arriving at a vote recommendation. Put another way, any remuneration-related vote recommendations are 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.

In the 2017 policy year, pay-for-performance factors were added to the Remuneration Pillar in ISS QualityScore, referencing the pay-for-performance results from the Relative Degree of Alignment (RDA), Multiple of Median (MOM), and Pay-TSR Alignment (PTA) tests that can be viewed on each company's research report. In 2017, these factors were included in ISS QualityScore for reference only. Since the 2018 policy year, these factors are weighted/scored within the QualityScore model. For details on the QualityScore methodology, please refer to https://www.issgovernance.com/esg/rankings/.

For newly covered companies, the pay-for-performance questions in QualityScore only apply after the next research report is published for these companies and where a pay-for-performance analysis is included.

PEERS

19. How are 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 P4P white paper.

ISS' methodology for selecting peers maintains a focus on identifying companies that are reasonably similar to the subject company in terms of industry profile, size, and market capitalization, taking into account a company's self-selected peers to guide industry selections. This peer group is used with respect to two of the three quantitative pay-for-performance screens that may trigger and in-depth review and analysis of a company's pay program in connection with say on pay evaluations.

ISS' selected peer group generally contains a minimum of 14 (and always at least 12) and maximum of 24 companies, based on the following factors:

1) The GICS industry classification of the target company
2) The GICS industry classifications of the company's disclosed CEO pay benchmarking peers
3) Size constraints for both revenue (or assets for certain financial companies) and market value
4) The band inclusion of the target company.

Subject to the size constraints and pay band prioritisation, 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 own 2-digit GICS group

In case multiple seed peers qualify for the same group, priority in the selection process is given to the seed peers the subject has chosen in its own peer group and the distance in size (by the appropriate revenue, market capitalisation, or asset size comparison) between the subject and seed peer. Because the disclosure of company selected peers remains limited in Europe (i.e. the level of disclosure is approximately 11% of the 2018 coverage universe) and is concentrated in a few markets, the selection process does not look at counter references (i.e. whether the seed peer has chosen the subject company as a peer or the number of peer selections among the seed peer and the subject company's peers and the companies that have chosen the subject as a peer) in order to avoid significant bias.

20. Do a company's self-selected peers always appear in the ISS peer group, if they meet ISS' size constraints?

Not necessarily. While the methodology does place a priority on the company's own peer selections, there are a number of reasons why a company-selected peer may not appear in the final ISS list, even if it meets the relevant size (revenue or assets and market capitalization) parameters. As noted above, the methodology also places priority on other factors as it builds the peer group:

› The company's own 8-digit GICS category
› Maintaining the subject company size at or near the median of its peer group

› Maintaining the approximate distribution of GICS industry codes as reflected in the company's self-selected peer group

At times, including a company's self-selected peer may push the subject company away from the median, or lead to an overrepresentation of that industry within the final peer group. In these cases the company's self-selected peer may not be included. In addition, if a company's self-selected peer is the only peer company in its 6- and 8-digit GICS category, that industry grouping will not be utilized in the peer selection process (since the company may have selected that peer solely due to geographic proximity, for example).

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

The model requires a minimum of 12 peers to run.

22. 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 or MSCIif you believe that a company has been misclassified.

23. 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.

24. What opportunities do companies have to communicate changes made to their benchmarking peer groups following their more recent disclosures?

In November, ISS provides companies a "peer update" opportunity to allow issuers to communicate changes made to their pay benchmarking peer groups following their most recent disclosures. During the update process, companies can inform ISS of updates to the peer groups they used to benchmark lead executive compensation that will be reported in their upcoming proxy materials (not to benchmark the upcoming year's pay).

Companies that do not participate in the ISS peer update process will continue to have their most recently disclosed compensation peers used in the ISS peer group construction process.

25. What companies can be used as peer companies? Does ISS use companies that an issuer considers as peers (specified in the proxy) to develop the ISS comparator group?

If a company discloses the names of public companies that it uses as its peers, ISS collects the data on those companies even if they are not in the index of companies that are screened through ISS' quantitative pay-for-performance model (STOXX600 and local main indices). If these companies fit ISS' criteria for peers, then they may be used as ISS peers as of the next update of ISS peer groups for the following year's analysis. Note: if a company participates in ISS' peer submission process, its yet-to-be disclosed peers would be considered in the relevant fiscal year's analysis.

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

Institutional investors were asked for their input when the model was being developed, and the consensus was that only European peers should be included in the model. This methodology was carried forward into the latest year, and is consistent with the region-specific approach of the US, Canada, and Australia P4P models.

COVERAGE

27. What is the coverage universe for the European P4P model?

The coverage universe for the model in 2016 was the STOXX Europe 600, which was expanded in 2017 to STOXX Europe 600 and local main indices outlined below.

Country	Index
European	STOXX-600
United Kingdom	FTSE All-Share (ex-investment trusts)
Ireland	ISEQ 20
France	Widely held companies within the CAC All tradable
Belgium	BEL 20
Netherlands	AEX25/AMX25
Luxembourg	LuxX
Denmark	OMX Copenhagen 20
Norway	OBX

Sweden	OMX Stockholm 30
Finland	OMX Helsinki 25
Italy	FTSE MIB / FTSE Italia Midcap
Spain	IBEX 35
Portugal	PSI 20
Greece	FTSE ATHEX Large Cap Index 25
Germany	DAX30/MDAX50/SDAX 50/TecDAX
Switzerland	SMI 20/SMIM 30
Austria	ATX 20

A company can be excluded from the P4P model for poor or limited disclosure. However, the pay disclosures are 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.

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

The coverage universe will be updated in December 2018, and the peers in the model will be finalized by January, 2019. The coverage universe will be updated on a yearly basis.

29. 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 European P4P white paper. In essence, it is 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.

30. 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 is reviewed annuallyto reflect changes in market practice over time.

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

The country bands were originally 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. After the 2018 season, CEO pay trends were reviewed for each country, and it was determined to move Denmark from Band D to Band C based on pay level developments.

