October 29, 2014

ISS Global Policy Board
Institutional Shareholder Services Inc.
policy@issgovernance.com

Subject: Comments on ISS' Draft 2015 Proxy Voting Policies (U.S.)

Compensation Advisory Partners LLC ("CAP") appreciates the opportunity to comment on ISS' draft 2015 proxy voting policies related to equity compensation.

CAP is a leading independent consulting firm specializing in executive and director compensation program design and related corporate governance matters. Our consultants serve as advisors to Boards and/or senior management at many leading companies and share ISS' interest in advancing sound corporate governance.

Our comments are detailed below.

Equity Plan Scorecard (U.S.)

ISS historically assessed whether to recommend For or Against a proposed share request (equity plan amendment) based primarily on quantitative factors, including a company's Shareholder Value Transfer ("SVT") and three-year burn rate versus benchmark. Plans were also reviewed for "egregious" practices (e.g., ability to reprice stock options without shareholder approval).

Going forward, ISS will utilize an Equity Plan Scorecard ("EPSC") to determine with more flexibility whether to recommend For or Against a new share request. The scorecard will have three categories:

1. Potential **<u>cost</u>** of plan, in line with the historic Shareholder Value Transfer model. ISS will look at SVT in two ways:
    a. Total Potential Cost of Equity Plan = Awards Currently Outstanding + Shares Still Available for Grant + New Shares Requested
    b. Cost of Future Grants = Shares Still Available for Grant + New Shares Requested
2. Proposed plan **<u>features</u>** (e.g., single vs. double trigger, prohibition on repricing without shareholder approval, minimum vesting periods, discretionary vesting provisions, etc.)
3. Historic equity **<u>grant practices</u>**, including:
    a. Three-year average burn rate
    b. Vesting requirements on CEO grants
    c. Proportion of CEO grants that are performance-based
    d. Expected duration of plan
    e. Use of stock ownership and holding requirements
    f. Whether the company maintains a clawback policy

The weighting of each category and the specifics regarding the factors within each category have not been released, though ISS states that they will be driven by company size and status.
The scorecard will be assessed relative to a company's ISS-determined reference index (i.e., S&P 500, Russell 3000, etc.).

ISS Request for Comment – Proposed Equity Plan Scorecard Approach ("EPSC")

"Are there certain factors outlined in our proposed scorecard approach that should be more heavily weighted when evaluating equity plan proposals?"

CAP Perspective

- We support this broader approach to assessing a new share request (proposed equity plan amendment). Compensation-related decision making is generally better when done on a holistic basis and not through a binary decision (e.g., solely above/below an SVT cap)
- Votes on equity plan amendments are binding and equity plan approvals impact individuals deep into an organization. Therefore, we believe the economic cost of the plan should be weighted most heavily. Historic grant policies and practices may not be fully indicative of future practices. By overweighting historic practices, ISS could penalize employees throughout the organization based on past practices. We also believe that ISS ought to provide a means to consider a company's efforts to improve on past practices (e.g., burn rate cap, change in equity compensation design/mix, etc.) when evaluating a new share request
- As noted above, equity plan approvals impact individuals deep into an organization. Certain factors in the proposed EPSC are focused on the most senior executives. Therefore, without knowing how much ISS will weight items specific to senior executives (e.g., holding requirements, CEO vesting requirements, proportion of CEO equity that is considered performance-based, etc.) it is challenging to form a final/comprehensive opinion regarding the proposed EPSC. We encourage ISS to be fully transparent with respect to its policies, including the weightings of EPSC components
- The Say on Pay vote has significantly increased shareholder communication and influence on executive compensation design and decision making. We do not believe it is appropriate to use equity plan approvals as a means to advance prescriptive views of how executive compensation should be structured (e.g., use of relative metrics, holding requirements, performance-orientation of stock options, etc.)
- Proposed policy updates also mention discretionary vesting of equity awards as problematic, and note minimum vesting periods for equity awards and expected duration of an equity plan (new share request) will be a part of the EPSC evaluation/score. Each of these issues should carry limited weighting in the EPSC. It is important for Committees to be able to exercise judgment, and retain flexibility for unusual situations (e.g., hiring, targeted retention, etc.)
- Lastly, we support ISS' change to look at SVT from two perspectives, including and excluding outstanding grants. We believe this puts companies who utilize stock options on a more equal footing with those that do not. When companies use stock options and executives hold them for a long period of time, there are considerably more shares outstanding than similar value granted in other vehicles. In the past, the use of options could therefore lead to a higher SVT value, which impacted the likelihood of getting a favorable ISS vote recommendation

"Do you see any unintended consequences from shifting to a scorecard approach? If yes, please specify."

CAP Perspective

- One potential unintended consequence of the shift to a scorecard approach is furtherance of a defensive, "one size fits all" executive compensation model. With more and more practices quantitatively compared to market, companies may be encouraged to migrate to what everyone else is doing, which may not be in the best interest of shareholders. For example, heavier use of stock options may make a lot of sense for growth/emerging companies, but because they are being compared broadly on a relative basis, the scorecard could "ding" the company for greater use of stock options (which ISS considers non-performance-based pay)
- ISS needs to be very transparent in the weightings of each scorecard component so that companies can readily understand the features of the EPSC and how they will affect their next submission. Too much of a "black box" approach could have the unintended consequence of companies believing these changes were brought about to benefit ISS more than shareholders

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CAP is submitting commentary on its own behalf and not on behalf of any specific clients. Please contact the authors, listed below, if you would like to discuss our comments.

Best Regards,

COMPENSATION ADVISORY PARTNERS LLC

By:

Dan Laddin, Partner
Compensation Advisory Partners LLC
212-921-9359
daniel.laddin@capartners.com

Matt Vnuk, Principal
Compensation Advisory Partners LLC
212-921-9364
matthew.vnuk@capartners.com