Australia
Pay-for-Performance Model
Frequently Asked Questions

Effective for Meetings on or after October 1, 2017

Updated April 9, 2018
FAQ: Australia Pay for Performance

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PAY-FOR-PERFORMANCE METHODOLOGY

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

The Australian Pay-for-Performance (PFP) model comprises three quantitative tests resulting in an overall level of concern, which will be included in ISS research reports for companies covered by the model. ISS research will have regard for 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 all relevant qualitative and quantitative factors.

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

2. What is the coverage universe for the Australian Pay-for-Performance model?

The Australian PFP coverage universe for meetings from October 1, 2017, will comprise all companies in the ASX 300\(^1\) that are under ISS Australia policy coverage, as set in June 2017. For the first year of the model, the universe of constituents was set in June 2017 and index constituents for PFP coverage will be reviewed and set annually going forward.

\(^1\) [https://us.spindices.com/indices/equity/sp-asx-300](https://us.spindices.com/indices/equity/sp-asx-300)
Definition of Total Pay

3. How is the total pay figure calculated?

All figures in the Australian PFP model are based on a variation of granted pay, combining cash and non-cash benefits received for the fiscal year along with the grant-date value of all equity awards.

Below is a breakdown of the pay components covered by the Australian PFP model along with a description of each component:

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed Pay</strong></td>
<td></td>
</tr>
<tr>
<td>Base salary</td>
<td>The annual base salary received for the fiscal year. This figure is annualised in cases of partial-year CEOs.</td>
</tr>
<tr>
<td>Non-monetary benefits</td>
<td>Any non-cash benefits and miscellaneous amount given to the individual. Examples are life insurance, fringe benefits tax, and commercial interest on employee loans.</td>
</tr>
<tr>
<td>Superannuation</td>
<td>The statutory payment for retirement to the executive by the company (company contribution).</td>
</tr>
<tr>
<td>Retirement Accrual</td>
<td>The non-statutory benefits for retirement paid to the executive by the company.</td>
</tr>
<tr>
<td>Expat benefits</td>
<td>The non-cash benefits or miscellaneous amounts in relation to relocation costs given to the executive.</td>
</tr>
<tr>
<td>Other benefits</td>
<td>All other payments that do not fit into any other category, such as club membership fees, security payments, and housing allowances.</td>
</tr>
<tr>
<td>Sign-on payment</td>
<td>The sign-on benefits amount that an individual received upon joining the company.</td>
</tr>
<tr>
<td><strong>Total Pay</strong></td>
<td></td>
</tr>
<tr>
<td>Cash Bonus</td>
<td>The earned cash component of the short-term incentives (paid out and deferred).</td>
</tr>
<tr>
<td>Deferred Share Bonus</td>
<td>The earned value of the equity component of the short-term incentives that an individual earned in relation to the fiscal year.</td>
</tr>
<tr>
<td>One-Time STI</td>
<td>The value of the one-time STI award that the individual received during the fiscal year. This can either be cash or equity.</td>
</tr>
<tr>
<td><strong>Short-Term Incentives</strong></td>
<td></td>
</tr>
<tr>
<td>Option Awards</td>
<td>The company disclosed option award fair value (company disclosed grant-date fair value) for each LTI option award granted within the fiscal year. Includes time-based, performance-based, and retention awards.</td>
</tr>
<tr>
<td>Stock Awards</td>
<td>The grant date value of LTI stock awards granted within the fiscal year, as calculated by ISS. The stock awards values are calculated by ISS by taking the target number of shares granted and valuing them at the grant date share price. Includes time-based, performance-based, and retention awards.</td>
</tr>
</tbody>
</table>
4. Why did ISS choose to use granted pay for the Australian model?

During the development of the model, the ISS Australian research team reviewed how pay is typically disclosed in the Australian market and discussed alternative pay definitions with many institutional investors, and the outcome was that a model based on granted pay would best align with disclosure standards and practices for Australian companies.

5. 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. The model will include the earned value of the bonuses earned during the year, including if the bonus is deferred in cash or in shares/rights.

6. 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 for the model. 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 annualised. See item 9 below for further details.

If the company has co-CEOs, the pay of only one co-CEO will be used, generally one with the higher total pay figure; note, however, that the impact of co-CEO pay costs may be addressed separately as a part of ISS' qualitative remuneration report evaluation.

7. How are right/shares/stock awards valued under the Australian PFP model?

All full-value awards of rights/shares/stock, whether they are time-based, performance-based, joining or retention awards, are valued as the number of granted units valued at the grant-date share price. If the award is performance-based, ISS will use the target number of performance units for this valuation.

8. How are options valued under the Australian PFP model?

ISS will use the disclosed grant-date fair value of all option awards granted to the CEO in a given fiscal year.

9. If the company has transitioned to a new CEO in a particular fiscal year, how does ISS compute total annualised pay for the new CEO?

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

If the company discloses the new CEO’s contractual salary in the remuneration report, then this will be used as base salary instead of calculating an annualised base salary. If this disclosure is not available, ISS will compute the annualised 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 disclosed date the executive began employment as the CEO.

10. 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.

11. Does ISS take into account the pay of other executives, directors, or the board as a whole in the Australian PFP model?

No, not in the current version.

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

ISS will not restate the pay amounts for the purpose of the Pay-for-Performance methodology unless there are exceptional circumstances. Specifically, ISS will not restate prior year amounts if previously granted performance based equity awards did not vest; these awards will continue to be recorded at their grant date value. The rationale behind this decision is that the total pay prior to the restatement was what the remuneration committee intended to award the executive, and therefore that this is the best measure of the remuneration committee’s decisions regarding pay amounts awarded. Subsequent events that lead to a restatement of grant date values or an executive declining pay-related awards may be included in the ISS qualitative assessment. What pay data does ISS use for companies with meetings early in the season whose peer companies’ CEO pay information has not yet been released for the latest financial year?

ISS uses the most recent pay data available for the peer companies, which may be from the previous year in some cases. Pay data is updated very quickly as annual reports 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.

13. How are peer company medians calculated for the Components of Pay Table?

The median is separately calculated for each component of pay and for the total annual pay. For this reason, the median total pay 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 pay reflects the median of the total pay of the peer group constituents.

Definition of Performance

14. 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 in the model – i.e., change in stock price plus reinvested dividends over the specified measurement period.

15. 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) in the Australia PFP model only uses TSR to define a company’s performance; however ISS understands that there are myriad ways to measure corporate performance, and that 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. Hence, ISS does not advocate that companies should use TSR as the metric underlying their incentive programs; on the contrary, shareholders may often 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 utilises in evaluating pay and performance alignment in the quantitative analysis.

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

ISS obtains all financial data used in the PFP model and remuneration 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.

17. How does Standard & Poor’s Research Insight calculate 1-, 3-, and 5-year TSR?

The one-, three- and five-year TSR is the annualised 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)

18. 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.

<table>
<thead>
<tr>
<th>3-year percentile rank</th>
<th>Performance</th>
<th>Pay</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>32</td>
<td>59</td>
<td>-27</td>
</tr>
</tbody>
</table>

19. 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 June 30, then the three-year TSR for the subject company and its peers will be based on June 30. 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 May 16, 2017, then three year TSR will be measured over the periods May 31, 2014 – May 31, 2017.

20. What remuneration time period will ISS use for the subject company and the peers in the relative Pay-for-Performance analysis?

Remuneration/pay figures for all companies are as of the latest available public disclosure filing.

21. 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.
22. What happens if the subject company does not have three years of TSR or CEO pay data available?

The Relative Degree of Alignment (RDA) level will only be considered in overall quantitative concern level when the subject company has a minimum of two years of pay and TSR data. Companies with less than two years of data will receive a “not applicable (N/A)” concern for their RDA test, and the Overall Quantitative screen will be based strictly on the Multiple of Median (MOM) test.

Constructing Comparison Groups

23. How are the ISS peer companies determined?

ISS constructs a comparison group of at least 11 Australian peer companies for each subject company covered by the PFP methodology. Peer groups for all subject companies analyzed under this methodology are constructed once per year, based on data provided by an independent source (S&P XpressFeed Quarterly Data Download [QDD]). The following criteria are used to determine peer companies:

- the GICS industry classification of the subject company
- Size constrains for 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 own 6-digit GICS group
3. from the subject's own 4-digit GICS group
4. from the subject’s own 2-digit GICS group
5. 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 six-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’ six-digit GICS category, then the process is repeated using the next universe set listed above (i.e., the subject’s four-digit GICS group), until 11 or more companies are selected; and so on.

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. To do this, ISS creates a “Super GICS” group, which 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:

<table>
<thead>
<tr>
<th>Super GICS Category</th>
<th>Two-Digit GICS Included</th>
<th>Names of Included Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>10, 15, 20, 55</td>
<td>Materials, Industrials, Energy and Utilities</td>
</tr>
<tr>
<td>B</td>
<td>25, 30, 35</td>
<td>Consumer Discretionary, Consumer Staples, and Health Care</td>
</tr>
<tr>
<td>C</td>
<td>45, 50</td>
<td>Technology and Telecom</td>
</tr>
</tbody>
</table>
24. What are ISS' size parameters for qualifying a potential peer?

ISS applies two size constraints to qualify potential peers:

1. Revenue\(^2\) (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 $8 billion (AUD) or smaller than $160 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 AUD millions):

<table>
<thead>
<tr>
<th>Bucket</th>
<th>Low end</th>
<th>High end</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>0</td>
<td>160</td>
</tr>
<tr>
<td>Small</td>
<td>160</td>
<td>800</td>
</tr>
<tr>
<td>Mid</td>
<td>800</td>
<td>8,000</td>
</tr>
<tr>
<td>Large</td>
<td>8,000</td>
<td>No cap</td>
</tr>
</tbody>
</table>

   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.

25. Why does ISS use 0.25x – 4x revenue/asset range?

   There is an extensive literature that demonstrates a strong correlation between company size and CEO pay. Among executive pay practitioners, a size range of 0.5 times to 2 times (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 Australian market, ISS has expanded this range to capture peers that may be similar in function but do not fall into a narrow size range – hence, the range chosen for the market is 0.25 times to 4 times (rounded to the nearest tenth).

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

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\(^2\) Peers for companies within the Oil, Gas & Consumable Fuels GICS Industry (8-digit GICS groups 10102010, 10102020, 10102030, 10102040, and 10102050) are determined solely based on market capitalization.
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 utilise assets and/or market cap to identify peers.

27. Why does ISS select a minimum of 11 peer 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 pay 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 Australia to create the comparison ISS peer group?

No. For the purpose of selecting peer companies, ISS will only select Australian companies covered under ISS’ Australia market policy. Please note that ISS will not consider Australian 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 Securities and Exchange Commission (SEC) and are thus covered by ISS U.S. Research using U.S. policy.

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

ISS does not classify companies into the GICS codes. Please contact Standard & Poor’s if you believe that a company has been misclassified.

33. When and how often will ISS reconstruct peer groups?
Company peer groups will be reconstructed once every year in June.

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

If a company does not agree with the ISS peers which have been allocated by the model, or considers they have been wrongly allocated, it can provide this feedback through the ISS Help Center (https://issgovernance.service-now.com/csp).

**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 two or more Medium concern levels will result in an overall High concern.

<table>
<thead>
<tr>
<th>Measure</th>
<th>Medium Concern</th>
<th>High Concern</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative Degree of Alignment (RDA)</td>
<td>-47.0</td>
<td>-61.2</td>
</tr>
<tr>
<td>Multiple of Median (MoM)</td>
<td>2.8</td>
<td>3.4</td>
</tr>
<tr>
<td>Pay-TSR Alignment (PTA)</td>
<td>-30</td>
<td>-40</td>
</tr>
</tbody>
</table>
QUALITATIVE PAY-FOR-PERFORMANCE EVALUATION

39. What impact might an elevated concern level on the quantitative portion of the Pay-for-Performance methodology have?

The purpose of ISS' pay-for-performance evaluation is to identify companies where there is an apparent misalignment of pay decisions relative to the company's performance track record. ISS' quantitative assessment is designed to detect such apparent misalignments, based on both relative and absolute pay-performance evaluations, as well as to identify apparent good or satisfactory alignment that shareholders may also 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 elevated concern level on the quantitative portion of the Pay-for-Performance methodology will not of itself 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 pay:** This key consideration includes a review of the overall ratio of performance-based pay to total pay, focusing particularly on the remuneration committee's most recent decision-making (which reflects its current direction) as regards to performance metrics and disclosure of performance goals which are required to be achieved.

A company that exhibits significant apparent misalignment of pay and performance over time may be expected to strongly emphasise performance-based pay (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 may 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, such as normalised earnings, adjustments should be clearly disclosed (along with compelling rationale if such adjustments are nonstandard). If the company uses non-financial metrics, then shareholders may also expect sufficient disclosure to justify such metrics and sufficient explanation of achievement being aligned with the company’s strategy and long-term shareholder value creation. ISS will take all relevant factors into consideration in the qualitative assessment.

**The company’s own peer group benchmarking practices:** Several studies have pointed to companies' peer group benchmarking practices as a source of pay escalation that is divorced from company-specific performance considerations. Companies may 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". Peer selection for benchmarking may be influenced by many considerations. If a company exhibits long-term apparent disconnect between pay and performance, ISS closely examines the appropriateness of 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 pay 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 results on metrics such as return measures and growth in revenue, profit, cash flow, etc. – both absolute and relative to peers – may also be 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 sufficiently detailed.

Special circumstances: The qualitative analysis may also consider exceptional situations, such as recruitment of a new CEO in the prior fiscal year or unusual cash or equity grant practices 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 full fiscal years, does the quantitative Pay-for-Performance evaluation still apply? What if a 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 yet been publicly traded for five full fiscal years, the relative assessment (specifically, the relative annualised 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.

If the company has been publicly traded for less than three years, the relative degree of alignment test will apply if at least two years of annualised TSR and CEO pay data are available; otherwise, the relative test will only include the multiple of median, which only requires one year of pay data.

The company’s limited longevity 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 selected as ISS 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. If a company makes equity grants for a fiscal year outside of the fiscal year start and end dates (i.e., right before the start of the year OR right after the end of the year), will the equity granted be counted for the fiscal year in which it was intended?

No. Equity awards are counted for the fiscal year during which they were granted, regardless of the intended fiscal year of the award. For example, if a granted equity award is intended for the fiscal year ended June 30, 2017, but its grant date is Junly 15, 2017, the award will be counted and valued for the fiscal year ending June 30, 2018 because it was granted during that fiscal year.

43. How does ISS account for differences in disclosure currency?

All companies analyzed under the Australian Pay-for-Performance policy are analyzed in the currency of their most recent disclosure. To do so, all figures for the company across all years are converted to match the most recent disclosure currency. And if equity awards are disclosed in a different currency than other remuneration components, all pay data is converted to the currency for the base salary disclosure.
During the Pay-for-Performance analysis, all peer pay data is converted to the subject company’s disclosure currency as well in order to perform accurate comparisons between companies.

To convert data, ISS uses a yearly average exchange rate. The exchange rate used to convert an individual company’s CEO pay to 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 15th 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.
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