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To:	Global Policy Board, Institutional Shareholder Services
From:	Hugessen Consulting
Date:	November 9, 2015
Subject:	Comments on ISS' Draft 2016 Proxy Voting Policies (Canada)

Hugessen Consulting is a leading provider of independent executive compensation consulting advice to the boards and compensation committees in Canada and the United States. We appreciate the opportunity to comment on the proposed update (published October 26, 2015) introducing the Equity Plan Scorecard ("EPSC") for the ISS' 2016 Canadian Benchmark Policy.

We commend ISS' efforts to develop a more holistic analytic framework and support the move to a balanced scorecard approach. We believe the inclusion of plan features and granting practices in addition to plan cost in determining the vote recommendation is a significant positive development for issuers and investors.

At the same time, we observe that there is very limited information in the published policy update in regards to the weighting of each category, how specific factors will be measured etc. While we presume the final Canadian policy and supplemental documents will provide similar transparency as the existing U.S. policy materials, we do have concerns that the EPSC will effectively make the 'black box' nature of ISS' vote recommendations into a bigger 'black box'.

Below we address the two questions that ISS specifically requested feedback on, and raise another issue with respect to cash-settled long-term incentive awards.

<u>Weighting of factors within proposed scorecard</u>

In our opinion, it is reasonable to weight the Plan Cost and Grant Practices categories heavier than plan features. We note that by including share dilution under the Plan Feature category, the size of the share reserve directly (Plan Cost and Plan Features) and indirectly (Granting Practices) becomes a factor in all three categories.

<u>Policy Change Consequences</u>

One consequence of moving to a scorecard approach, where plan cost is weighed less than 100%, is that larger, more costly plans could generate favourable vote recommendations.

A second consequence is the possible move towards more restrictive plans. Companies typically draft plans to allow for maximum flexibility in their plan provisions, in order to address company specific circumstances and evolving market practices.

<u>Inclusion of Cash-settled Long Term Incentive Awards</u>

From an accounting and CD&A disclosure perspective, both cash-settled and treasury-settled full-value awards are considered equity compensation. Under the current plan cost methodology and the proposed EPSC, ISS does not factor in the cost of cash-settled long-term incentive ("LTI") awards. We believe that this oversight rewards companies who have a large portion of their LTI in the form of cash-settled RSUs and PSUs, leaving them with relatively small pools of shares reserved for stock option grants and penalizes companies who have chosen to settle full-value awards in treasury shares.

This inequity is more pronounced in Canada where the vast majority of full-value awards are cash-settled than in the U.S., where treasury-settled awards are most prevalent. We believe that this issue will become more problematic as more issuers look to reduce their reliance on stock options and design longer-term incentive awards (beyond the typical 3 year term) in response to shareholder feedback.

Some of the key business and design reasons why a Canadian company would chose to settle full-value awards in either cash or treasury shares are outlined below:

- Cash-settled
    - Shareholder approval not needed
    - Access to the corporate tax deduction
- Treasury-settled
    - Fix accounting cost up front
    - Allow for longer term settlement (e.g. go beyond 3 years)
    - Corporate tax deductibility is less important for some companies
    - Cash flow constraints, especially for smaller companies

We acknowledge that there are challenges to resolving the current "apples-to-oranges" comparison of equity plans at companies with different full-value award settlement treatment. ISS may wish to consider incorporating cash-settled full value share awards into the EPSC by way of a "modifier" on the plan cost, where the weighting is dependent on the proportion of LTI that is cash versus treasury settled.

Consideration (under Grant Practices) could also be given to full-value awards with longer award terms. For example an issuer would earn positive points for granting RSUs with terms longer (e.g., 7 years) than the typical 3-year term. Such consideration would address the fact that all full-value awards are assessed a cost equal to 100% of fair market value under Plan Cost and are treated equally under Plan Dilution, regardless of the length of the award terms. This despite the fact that longer term full-value awards would be expected to have a higher shareholder value transfer cost than the typical 3-year award, and over time are less dilutive (given the higher churn rate of shorter term awards).

We appreciate the opportunity to comment on the proposed guidelines and would very much welcome the opportunity to discuss further.

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