Compensation at Externally-Managed Issuers (U.S.)

Background and Overview

Like most U.S. public companies, externally-managed issuers (EMIs) are required to hold periodic say-on-pay votes. However, unlike most other companies, an EMI typically does not directly compensate its executives. Instead, executives are compensated by the external manager, which is reimbursed by the EMI through a management fee. EMIs typically do not disclose with sufficient detail the compensation arrangements and payments made to executives on behalf of the external manager. When executive compensation information is disclosed, the extent of such disclosure varies by company, but is usually limited to the aggregate management fees paid by the EMI to the manager. Without sufficient disclosure regarding the structure of executive compensation arrangements and payments made to the executives, it is impossible for shareholders to assess pay programs and their linkage to company performance.

In addition, a management structure in which executives are compensated by the external manager rather than the issuer raises questions about potential conflicts of interest underpinning such compensation arrangements. Without disclosure surrounding compensation arrangements, shareholders are unable to judge whether pay programs create incentives in the best interest of shareholders (as opposed to the external manager).

Key Changes Under Consideration

ISS is proposing to update its pay-for-performance analysis policy with respect to EMIs that do not provide sufficient compensation disclosure to make a comprehensive assessment for pay-for-performance and potential conflicts of interest.

Under the proposed policy change, ISS would generally recommend "Against" the say-on-pay proposal (or compensation committee members, the compensation committee chair, or the entire board, as appropriate, in the absence of a say-on-pay proposal on ballot) in cases where a comprehensive pay analysis is impossible because the EMI provides insufficient disclosure about compensation practices and payments made to executives on the part of the external manager.

Intent and Impact

The proposed policy update is intended to address concerns regarding the lack of transparency surrounding executive compensation arrangements with the external manager, when such limited disclosure fails to meet shareholders' informational needs.

ISS is aware of approximately 60 externally-managed issuers in the U.S. (typically but not always REITs), and in most cases these companies provide limited or no disclosure on executive compensation arrangements with the external manager. Under this proposed policy update, these companies would likely have received an "Against" recommendation on their say-on-pay proposals.

Request for Comment

- Does your organization agree that an "Against" vote recommendation for an externally-managed company's say-on-pay proposal is appropriate when the company does not provide sufficient disclosure on executives' compensation arrangements with the external manager? Please explain your answer.
- What factors should ISS consider in gauging potential conflicts of interest underpinning executives' compensation arrangements with the external manager?
- Do you see any unintended consequences that may result from the proposed policy update?