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Summary of Key Results and Expectations from the ISS 2021 Annual Policy Survey

ISS's recent Policy Survey previews potential changes to its proxy voting policies.

Each year, Institutional Shareholder Services (ISS) surveys institutional investors, public companies and the consulting and legal communities on emerging corporate governance and executive compensation issues as part of its annual policy formulation process (the "Survey"). Public companies and their advisors are collectively referred to as "non-investors" in this Client Update. Possibly reflecting concerns about the influence of ISS policies, 61% of this year's survey respondents were non-investors, while only 39% of respondents were investors, primarily large institutional shareholders. The mix of responses between investors and non-investors is consistent with prior years.

ISS conducted this year's Survey to obtain feedback on a wide range of questions, including questions related to the ISS quantitative pay-for-performance assessment, inclusion of ESG metrics in executive compensation programs, adjustments to "in-flight" long-term incentive awards and shareholder proposals requesting a company conduct a racial equity audit. Each of these topics is discussed below.

Key Takeaways Based on Investor Responses

Historically, investor responses to Survey questions have helped to inform ISS's modifications to existing proxy voting policies or implementation of new policies. Based on their responses, **investors** would prefer to see ISS undertake the following:

- Adoption of an additional test in its quantitative pay-for-performance assessment that measures a company's CEO's total pay relative to the ISS peer group median CEO total pay over a 3-year period (in addition to, or possibly instead of, the current 1-year period)
- Continuation of its scrutiny of adjustments to in-flight long-term incentive awards in 2022 (however, investor views were split on whether ISS should be more lenient towards such adjustments, if a company falls in certain industries that continue to be significantly affected by the COVID-19 pandemic)
- Adoption of a policy to evaluate shareholder proposals requiring a company to conduct a racial equity audit on a case-by-case basis considering company-specific factors

In addition, the overwhelming majority of investors believe that incorporating non-financial ESG metrics into executive compensation programs is an appropriate way to incentivize executives.

ISS Quantitative Pay-for-Performance Methodology (U.S. and Canada)

The Survey asked respondents to identify whether ISS's quantitative pay-for-performance ("PfP") assessment should include a longer-term perspective (e.g., a 3-year assessment) of CEO pay amounts.

- Fully 85% of investors and 67% of non-investors believe that a longer-term perspective of CEO pay is relevant and would be helpful.
- Only 6% of investors and 25% of non-investors believe the most recent year's CEO pay is the relevant measure for the quantitative model.

***Meridian Comment*. The strong investor preference for the ISS PfP assessment to include a longer-term perspective may increase the likelihood that ISS will modify the PfP assessment to include a 3-year assessment of CEO pay relative to ISS peer group median. This potential change to the ISS PfP assessment would extend, or at least exacerbate, the impact of one-time awards (front-loading mega-grants, inducement awards) on the PfP outcome by affecting ISS's evaluation of relative pay magnitude beyond a single year. If the PfP assessment is modified, such modification could become effective as early as 2022.**

Non-Financial ESG Performance Metrics in Executive Compensation

The Survey asked respondents several questions relating to the inclusion of non-financial ESG metrics in executive compensation programs. Currently, ISS does not have a policy on whether a company should include non-financial ESG metrics in their incentive programs for executive officers.

The Survey asked whether incorporating non-financial ESG metrics into executive compensation programs is an appropriate way to incentivize executives. As shown in the chart below, the vast majority of investors (86%) and non-investors (73%) believe that including non-financial ESG metrics in executive compensation programs is an appropriate way to incentivize executives under certain circumstances.

Do you believe incorporating non-financial ESG-related metrics into executive compensation programs is an appropriate way to incentivize executives?	Investors	Non-Investors
Yes, but ESG-related metrics should only be used in compensation programs if the metrics selected are **specific and measurable**, and their associated targets are **transparently communicated** to the market	52%	27%
Yes, ESG-related metrics that are not financially measurable can be an effective way to incentivize positive outcomes if the metrics are chosen well	34%	46%
No, ESG performance metrics are not usually relevant or effective as compensation program measures. Compensation programs should only use traditional financial performance measures, for transparency and to maintain alignment with shareholders' financial interests.	4%	16%
Other	10%	11%

The Survey also asked respondents to identify the pay components that are most appropriate for inclusion of non-financial ESG metrics if a company decides to use them. 81% of investors and 71% of non-investors indicated that non-financial ESG metrics could be appropriately included in either short- or long-term incentive plans.

***Meridian Comment*. While the Survey shows strong investor preference for including ESG metrics in incentive plans for executives, we do not expect ISS to adopt a prescriptive policy in this area at this time. We have seen rapid adoption of E&S metrics by large caps, predominantly in annual incentive plans.**

Adjustments to In-Flight Long-Term Incentive Awards

The Survey asked respondents to identify their view on adjustments to in-flight long-term incentive awards for companies incurring long-term negative impacts of the COVID-19 pandemic.

- 53% of investors and 15% of non-investors believe mid-cycle changes to long-term incentive programs should continue to be viewed as a problematic response to the pandemic.
- 40% of investors and 76% of non-investors believe mid-cycle changes to long-term incentive programs may be reasonable for companies that have incurred long-term negative impacts from the pandemic.

***Meridian comment*. We expect ISS to continue to scrutinize adjustments to in-flight long-term incentive awards in 2022. However, given investor feedback, ISS may be more lenient towards such adjustments, if a company continues to be significantly affected by the COVID-19 pandemic.**

Shareholder Proposals Seeking to Implement Racial Equity Audits

The Survey asked respondents several questions regarding shareholder proposals requesting companies to implement third-party racial equity audits. During the 2021 proxy season, 14 S&P 500 companies included in their proxies shareholder proposals covering racial equity audits; 13 of these proposals failed and one is pending.

Currently, ISS does not have a policy on such shareholder proposals. However, ISS has adopted policies on analogous issues. For example, ISS will evaluate, on a case-by-case basis, shareholder proposals requesting that a company report on: (i) pay data by gender, race or ethnicity, or (ii) policies and goals to reduce any gender, race or ethnical pay gap.

The Survey asked respondents to identify whether, and under what circumstances, a company would benefit from an independent racial equity audit. As shown in the table below, nearly a majority of investors (47%) and a majority of non-investors (54%) believe that a company would benefit from an independent racial equity audit, depending on company-specific factors.

What is your opinion about third-party racial equity audits?	Investors	Non-Investors
Whether a company would benefit from an independent racial equity audit depends on company-specific factors including outcomes and programs	47%	54%
Where permissible, most companies would benefit from an independent racial equity audit, whether or not the company has adequate corporate programs addressing racial equity or company-specific racial equity controversies	44%	18%
Most companies would not benefit from an independent racial equity audit	9%	28%

The Survey also asked the respondent to identify company-specific factors that indicate a company would benefit from an independent racial equity audit. As shown in the chart below, the vast majority of investors (89%) and non-investors (73%) believe that a company's involvement in racial and/or ethnic diversity-related controversies is a relevant factor.

A majority of investors believe that diversity disclosure (72%), workforce initiatives (65%) and internal processes for addressing implicit bias (62%) are also relevant factors.

Which of the following company-specific factors are relevant in indicating that a company would benefit from an independent racial equity audit?	Investors	Non-Investors
The company is involved in significant racial and/or ethnic diversity-related controversies	89%	73%
The company does not provide detailed workforce diversity statistics, such as EEO-1 type data	72%	38%
The company has not undertaken initiatives/efforts aimed at enhancing workforce diversity and inclusion, such as trainings or pay disclosure	65%	57%
The company does not disclose an adequate internal framework/process for addressing implicit or systemic bias throughout the organization	62%	26%
The company has not undertaken initiatives/efforts aimed at offering products/services and/or made charitable donations with a specific focus on helping create opportunity for people and communities of color	18%	17%

***Meridian comment*. We expect ISS will adopt a policy to evaluate racial equity audit proposals on a case-by-case basis considering company-specific factors, including any controversies, workforce diversity and pay outcomes and company initiatives to promote racial equity.**

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The ***Client Update*** is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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