L&A SPEAKS WITH INSTITUTIONAL SHAREHOLDER SERVICES INC. (ISS)

By Brent Longnecker & Ian Keas

Recently, members of our team at Longnecker & Associates had the chance to ping some topics off of Institutional Shareholder Services Inc.'s (ISS) consulting side of their "Chinese wall." We wanted to share a high-level overview for you to keep in mind this proxy season.

The consultants let us know that ISS released its report earlier in the month on Schlumberger and recommended an "against" vote for Say on Pay. While opinions vary on ISS, Schlumberger is considered a first-class organization, so any insights ISS could disclose on their recommendation are worth sharing.

On a high-level, ISS noted that, though there were a few items within Schlumberger's pay practices that would be considered inappropriate in the current environment, the main obstacle was the compensation committee's use of positive discretion on the LTIP.

We've detailed other topics discussed below.

ANNUAL INCENTIVES:

- While ISS favors formulaic annual incentive plans, the organization is focusing on how rigorous the performance goals are and how extensive the disclosures are around any performance metrics utilized.
- ISS will be skeptical of awards that are aggressive in a down environment, perhaps symbolizing a pay-for-performance disconnect.

LONG-TERM INCENTIVES:

- ISS doesn't appear focused on potential executive windfalls due to elevated equity awards as far as number of shares, rather it grants fair value of such awards. If shareholders are suffering, ISS expects targeted LTI award values to reflect this in some capacity.
- ISS is agnostic to whether long-term incentives are settled in stock or cash, which caught our team by surprise.
- ISS made an interesting note about the decreased burn rate limits year-over-year. They said the volatility of stock prices in the energy industry in particular led to options being considered more valuable.

RETENTION AWARDS:

- A controversial topic in today's environment, retention awards are viewed very skeptically due to ISS' belief that there should be good reason why people need something on top of base, bonus and long-term incentives.
- Any disclosures around retention awards will have to be in-depth to have a chance to pass the qualitative review test.
- If awards are made, ISS will want to see them with longer terms — i.e. more than a year.
- ISS will favorably view attaching performance measures that comply with 162(m). L&A explained that doing so takes away from the retention characteristic of such award. ISS acknowledged this thinking but didn't want to say they were in agreement.
- Lastly, ISS noted that if retention awards become prevalent in the environment, companies will get major brownie points for adjusting the disclosed target percentile for benchmarking purposes downward to account for the inflated values in compensation.
- Plus, right now a significant amount of retention packages are being contemplated by companies, especially those that have burned through their stock.
- L&A finds this thinking to be counterintuitive. While such methodology might make sense in a compensation environment where all companies are providing retention awards, L&A notes that this is currently not the case. That said, a growing number of companies are beginning to explore different alternatives to motivate and retain key talent as equity capital becomes scarce.

As we all know, it can be challenging to get a substantive conversation out of ISS. We appreciated the time they took with us to share back and forth.

Still, at the end of the day, the key is always going to be "leaders to be leaders; and teams to be teams." There is no playbook, but we have some great leaders out there like all of you that can help make a significant difference in this great country of ours.

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