

ISS Releases New and Updated FAQs on U.S. Equity Compensation Plans

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Last Friday, ISS released new and updated FAQs on U.S. Equity Compensation Plans, as summarized below. These FAQs provide new and updated guidance on ISS's evaluation of equity compensation plan proposals, including treatment of performance-based awards in burn rate calculations, bundling of plan amendment proposals, updates to ISS's Equity Plan Scorecard (EPSC) policies, and the EPSC as it applies to newly public companies.

Since 2015, ISS has evaluated proposals for equity compensation plans and certain amendments to these plans using the EPSC. The EPSC analysis is based on three pillars:

- Plan cost ("shareholder value transfer" or SVT), relative to the company's market and industry peers,
- Plan features, and
- The company's historical grant practices, including its 3-year average burn rate relative to market and industry peers.

ISS scores proposals according to factors under each of these three pillars, using its proprietary model. Proposals may receive a maximum of 100 total points, with a threshold of 53 points required to receive a favorable recommendation (absent egregious factors).

Summary of New and Updated FAQs

19. If a company grants performance-based awards, how will the shares be accounted for the purposes of calculating burn rate? Both time- and performance-based awards will be counted in the year in which they are granted for the burn rate calculation, but performance-based awards will be counted in the year in which they are earned if the company provides a table of awards granted and earned each year for the past three years, either in the 10-K or proxy statement. There's a sample table in the FAQ. The aggregate of performance-based awards from all plans to all participants must

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be disclosed, and not just awards for NEOs. For performance awards that are subject to additional time vesting, the shares generally will be counted at the end of the time-vesting period if the number is disclosed. ISS advises companies to continue to make the additional disclosure, so that ISS may capture performance awards going forward and to provide a clear view of the year-to-year status of the performance award program.

28. How does ISS evaluate an equity plan proposal seeking approval of one or more plan amendments? If the proposed amendments do not request additional shares (or other modifications deemed to potentially increase cost), ISS will make a recommendation based on an analysis of whether the amendments are deemed to be “overall beneficial or contrary to shareholders’ interests.” If the proposed amendment is bundled with a material new share request (or are deemed to potentially increase cost), or this is the first time shareholders may vote on the plan, then ISS generally will support the amendments if there is a passing EPSC score, unless the amendments represent a “substantial diminishment to shareholders’ interests.” ISS will generally support proposals seeking approval of performance measures for Section 162(m) tax deductibility purposes, unless they are bundled with other plan amendments. For ISS’s treatment of bundled amendments, see FAQ #30.

30. How are proposals that include 162(m) reapproval along with plan amendments evaluated? ISS encourages companies to unbundle plan amendments from proposals seeking 162(m) reapproval, since the latter are generally supported by ISS (see FAQ #28). ISS will analyze bundled amendments to determine whether they are, on balance, positive or negative with respect to shareholders’ interests. ISS may consider both an EPSC score and/or the balance of positive and negative impacts from the bundled amendments.

32. How does ISS view a plan amendment to increase the tax withholding rate applicable upon award settlement? This type of amendment is generally viewed as an administrative change neutral to shareholders’ interests. However, if the plan contains a liberal share recycling feature (such as recycling of shares tendered as payment for an option exercise, shares withheld to cover taxes, shares added back that have been repurchased using stock option exercise proceeds, and stock-settled awards where only the actual shares delivered are counted against the plan reserve), then a company can mitigate ISS’s concern by providing that only the number of shares withheld at the minimum statutory rate may be recycled, even if the tax withholding is at a higher rate. See also, [Nasdaq Doesn’t Require Shareholder Approval of Equity Compensation Plan Amendments to Increase Tax Withholding](#).

36. What changes were made to the EPSC policy for 2017?

Effective for meetings as of Feb. 1, 2017, the following adjustments will apply to EPSC evaluations:

- *Payment of dividends on unvested awards (new factor):* Full points will be earned if the equity plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award. Accrual of dividends that are only payable upon vesting is allowed. No points will be earned if this prohibition is absent or

incomplete (i.e. not applicable to all award types).

- *Minimum vesting terms (updated factor – see also, FAQ #47):* Full points are awarded only if the equity plan specifies a minimum vesting period of one year for all equity awards. Also, no points will be earned if the plan allows for the administrator to reduce or eliminate the one-year vesting requirement. Companies are permitted to carve out 5% of equity awards granted under the plan, which do not have to be subject to the minimum vesting requirement.
- *Burn rate data:* For companies with between 33 and 36 months of trading history at the applicable quarterly data download date, the EPSC model index will be based on whether the company has disclosed three years of burn rate data. Special Cases models apply for companies with 32 or fewer months of trading history.
- *Factor scoring adjustment (see also, FAQ #42 and 43):* Scoring for certain EPSC factors has been adjusted, though ISS does not provide specifics under its proprietary model.

41. How will equity plan proposals at newly public companies be evaluated?

Newly public companies, including recent IPOs, spinoffs, and bankruptcy-emergent companies, may be evaluated under an EPSC model that includes fewer factors.

In addition to these FAQs, ISS also released new and updated FAQs on U.S. Executive Compensation Policies and updated Pay-for-Performance Mechanics (which details ISS's new Relative Pay and Financial Performance Assessment).