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Proxy Advisory Firms Release 2015 Policy Updates

In November, Institutional Shareholder Services ("ISS") and Glass Lewis released their 2015 policy updates, which will apply to annual meetings held on or after January 1, 2015, for Glass Lewis and February 1, 2015, for ISS. Each firm has held webinars on the policy updates, which are available on their websites.[1]

ISS Equity Plan Scorecard

ISS' most significant policy update pertains to the new equity plan scorecard ("EPSC") for evaluating equity plan proposals. The EPSC is a more nuanced multi-factor approach to evaluating equity plan proposals in contrast to the current approach, which consists of a series of stand-alone pass/fail tests (e.g., shareholder value transfer ("SVT") plan cost and burn rate) and the presence of certain "egregious" plan features (e.g., stock option repricing without shareholder approval).

The EPSC comprises three "pillars" representing: (1) plan cost (45% weighting), (2) plan features (20% weighting), and (3) grant practices (35% weighting). Equity plans will be evaluated based on membership in one of three indices plus a category for recent IPOs or bankruptcy emergent companies, which exists as a separate SVT plan cost category under the current policy. The three indices are the S&P 500, the Russell 3000 (excluding S&P 500 companies), and the Non-Russell 3000.

Plan Cost – SVT plan cost will continue to be evaluated based on market cap size versus the relevant GICS industry classification within each index group or IPO category, but will be assessed on two bases rather than one:

- The first SVT calculation is unchanged and takes into account new shares requested plus shares remaining available for future grants plus outstanding unvested and unexercised grants.

- The second SVT calculation is new and will consider only new shares requested plus shares remaining available for future grants (i.e., excludes outstanding unvested and unexercised grants). The current option overhang carve-out policy, which considers the SVT plan cost attributable to long-held deep in-the-money options, will be eliminated.

Also, the current treatment of "liberal share recycling" (i.e., the ability to add back shares withheld to pay the exercise price of a stock option or settle withholding taxes owed at exercise of a stock option or stock appreciation right) will be eliminated from the SVT plan cost

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[1] The webinars can be found at http://www.issgovernance.com/iss-2015-updates-webinar/ for ISS and at http://www.equilar.com/events/webinars for Glass Lewis.

calculation, but will be evaluated as a plan feature. In a negative development, the definition has been expanded to include the add-back of shares withheld to settle withholding taxes on full-value awards.

Plan Features – Four plan features will be considered, which are:

- Automatic "single-trigger" award vesting upon a change in control ("CIC"),
- Discretionary vesting authority,
- Liberal share recycling on various award types, and
- Minimum vesting periods.

Grant Practices – Six grant practices will be considered, which are:

- The company's three-year burn rate relative to its GICS industry peers within its index group (versus a pass/fail test under the current policy);
- Vesting requirements in the most recent CEO equity grants;
- The estimated duration of the plan based on the sum of shares remaining available and new shares requested, divided by the average annual shares granted in the prior three years;
- The proportion of the CEO's most recent equity grants subject to performance conditions;
- Whether the company maintains a claw-back policy; and
- Whether the company has established post-exercise/vesting share-holding requirements.

The potential to make a future burn-rate commitment if a company has granted shares over the prior three years in excess of its industry burn-rate cap will be eliminated under the new scorecard approach because historical burn-rate comparisons will no longer have pass/fail implications for the vote recommendation.

The new EPSC will allow positive plan features and grant practices to mitigate negative plan features and grant practices as well as SVT plan cost in excess of the allowable cap. Conversely, an equity plan with an SVT plan cost below the allowable cap could receive a negative vote recommendation if there are a sufficient number of negative scorecard factors. For the three index groups and IPO category, the threshold passing score will be the same and will be 53. Certain "egregious" plan features will continue to trigger an automatic negative vote recommendation regardless of the plan's score. ISS does not expect the new policy to change the number of plan proposals receiving negative vote recommendations from approximately 30% currently.

Equity plan data verification is available for free for all companies with an equity plan proposal. Companies may register in advance at http://www.issgovernance.com/equity-plan-data-verification-webform/.

ISS Updated Burn Rates

ISS has also released preliminary burn rates for 2015. New for 2015, there will be three burn rate benchmarks rather than two as S&P 500 companies have been carved out of the Russell 3000.

The three preliminary burn rate benchmarks are shown in the table below. As can be seen, this is a negative development for S&P 500 companies, whose burn rates are significantly lower than the Russell 3000 (excluding the S&P 500).

Preliminary 2015 Burn Rates

GICS	Industry Description	S&P 500	Russell 3000 (ex. S&P 500)	Non-Russell 3000
1010	Energy	2.00%	4.83%	7.46%
1510	Materials	2.00%	3.05%	7.85%
2010	Capital Goods	2.10%	3.36%	8.16%
2020	Commercial & Prof. Services	2.10%	4.56%	7.33%
2030	Transportation	2.10%	3.63%	3.69%
2510	Automobiles & Components	2.41%	4.25%	5.95%
2520	Consumer Durables & Apparel	2.41%	4.67%	7.61%
2530	Consumer Services	2.41%	4.15%	4.28%
2540	Media	2.41%	4.82%	5.47%
2550	Retailing	2.41%	4.54%	6.60%
3010	Food & Staples Retailing	2.14%	3.01%	4.45%
3020	Food Beverage & Tobacco	2.14%	3.01%	4.45%
3030	Household & Personal Products	2.14%	3.01%	4.45%
3510	Healthcare Equipment & Svs.	2.89%	5.12%	9.08%
3520	Pharm., Biotech. & Life Scs.	2.89%	6.16%	8.98%
4010	Banks	3.17%	3.18%	2.79%
4020	Diversified Financials	3.17%	9.58%	7.56%
4030	Insurance	3.17%	3.48%	2.58%
4040	Real Estate	3.17%	2.52%	2.68%
4510	Software & Services	4.41%	7.56%	9.14%
4020	Tech. Hardware & Equip.	4.41%	5.66%	8.91%
4030	Semiconductors & Semi. Equip.	4.41%	7.05%	9.75%
5010	Telecommunications Svs.	2.00%	4.47%	7.54%
5510	Utilities	2.00%	2.00%	3.66%

Burn rates are defined as average three-year share usage expressed on an option-equivalent basis with full-value shares converted to option equivalents based on a company's stock price volatility. They are calculated on a gross basis excluding shares cancelled or forfeited and represent each industry group's (defined using the 4-digit Global Industry Classification Standard ("GICS") industry groups) average share usage plus one standard deviation, subject to a minimum of 2.00%.

ISS Pay-for-Performance Updates

New in 2015, ISS' quantitative pay-for-performance ("PFP") test will apply to the Russell 3000E Index, which will expand the number of companies covered by the test by approximately 700 microcap companies. In addition, ISS adjusted the concern levels for two of the components of the test: relative degree of alignment ("RDA") and pay-TSR alignment ("PTA"). The new levels of concern are shown in the table on the following page.

PFP Component/Timeframe and Comparison	ISS Concern Levels			
	Before 2/1/2015		On/After 2/1/2015	
	Medium	High	Medium	High
Relative Degree of Alignment - 3 years; relative to ISS peers	-30	-50	-40	-50
Multiple of Median - 1 year; relative to ISS peers	2.33x	3.33x	2.33x	3.33x
Pay-TSR Alignment - 5 years; not relative to ISS peers	-30%	-45%	-20%	-35%

ISS Peer Group Formation

ISS currently uses revenue as the primary scope criteria for identifying potential peer group companies, except for certain financial companies for which total assets is used.[2] In 2015, ISS will use market capitalization for certain energy companies in the Oil, Gas & Consumable Fuels industry (i.e., GICS code 101020).[3] For these companies, peers will be chosen based on market capitalization between 0.4x and 2.5x the subject company. The expanded market capitalization buckets will not be applicable. Furthermore, for companies in two sub-industries (i.e., 10102010 Integrated Oil & Gas and 10102020 Oil & Gas Exploration & Production), peers will only be selected from the company's 8-digit GICS group and/or the 8-digit GICS groups of its selected peers (i.e., peers will not be selected for the 6- or 4-digit GICS groups).

ISS Peer Group Updating

Finally, companies wishing to update their compensation peer groups used for setting 2014 executive pay levels should do so by **December 11, 2014**, on ISS' website at http://www.issgovernance.com/u-s-company-peer-group-feedback/.

Glass Lewis Policy Updates

Glass Lewis made minor changes to its pay-for-performance assessment to:

- Add a new discussion of "one-off" awards, which are not viewed favorably, to look at a description of the awards, disclosed rationale for the awards, explanation of why existing awards are not adequate, whether the award has future service or performance conditions, and if/how regular awards may be affected

- Clarify that if a company receives an "F" (i.e., a failing grade) on Glass Lewis' quantitative pay-for-performance model, Glass Lewis will consider other qualitative factors (e.g., an effective overall incentive structure, the relevance of selected

[2] The GICS codes for the sub-industries for which total assets is used are: 40101010 Commercial Banks, 40101015 Regional Banks, 40102010 Thrifts & Mortgage, 40202010 Consumer Finance, and 40201020 Other Diversified.
[3] The GICS codes for the sub-industries for which market cap will be used are: 10102010 Integrated Oil & Gas, 10102020 Oil & Gas Exploration & Production, 10102030 Oil & Gas Refining & Marketing, 10102040 Oil & Gas Storage & Transportation, and 10102050 Coal & Consumable Fuels.

performance metrics, significant forthcoming program enhancements or reasonable long-term payout levels) and may support the say-on-pay proposal even when a pay-for-performance disconnect has been identified

Equilar Peer Group Updating

Glass Lewis partners with Equilar, a compensation data provider, to incorporate Equilar's market peers for a company in its analysis. Russell 3000 companies wishing to update their compensation peer groups for disclosure to be in their 2015 proxy statements may do so by **December 31, 2014**, on Equilar's peer group update portal at www.equilar.com.

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