

November 28, 2017

# ISS RELEASES PRELIMINARY FAQs FOR 2018 PROXY SEASON

On November 21, ISS published U.S. compensation policy *preliminary* frequently asked questions (FAQs), which provide insight to the updated ISS quantitative pay-for-performance screening methodology and its U.S. Equity Plan Scorecard (EPSC) evaluation related to stock plan proposals.

ISS recently released its policy updates for the 2018 proxy season.<sup>1</sup> As an immediate follow-up, ISS published U.S. compensation policy *preliminary* FAQs to “address some of the most commonly received questions to date.” The FAQs, which can be found [here](#), provide insight to the updated ISS quantitative pay-for-performance screening methodology and its U.S. EPSC evaluation related to stock plan proposals, each as applicable to public companies with annual shareholder meetings on or after February 1, 2018.

## U.S. Quantitative Pay-for-Performance Screens

ISS Policy Item	2018 Policy Update
<b>Quantitative Pay-for-Performance Test Thresholds</b>	<ul style="list-style-type: none"> <li>Multiple of Median (MOM) threshold for medium concern <u>for S&amp;P 500 companies</u> will be reduced from 2.33 times to 2.00 times. This means pay-for-performance alignment concern will be elevated if CEO pay is 2.00 times the ISS peer group median in 2018 versus 2.33 times the median in 2017. High concern threshold will remain unchanged at 3.33.</li> <li>No change to MOM thresholds for non-S&amp;P 500 companies.</li> <li>No changes to Relative Degree of Alignment (RDA) or Pay-TSR Alignment (PTA) thresholds for any company subject to ISS’ quantitative pay-for-performance tests.</li> </ul>
<b>Total Shareholder Return (TSR) Calculation Methodology</b>	<ul style="list-style-type: none"> <li>Starting and ending stock prices used for purposes of calculating TSR will equal the average of the beginning and ending stock price for the month closest to a company’s fiscal year end (“monthly average”). ISS currently calculates TSR using only the ending stock price as of a company’s fiscal year end. The change in methodology is intended to reduce the impact of point-to-point stock price volatility.</li> </ul>

<sup>1</sup> See [FW Cook Alert dated November 20, 2017](#).

ISS Policy Item	2018 Policy Update
	<ul style="list-style-type: none"> <li>If a company's fiscal year ends on or after the 15<sup>th</sup> of the month, then the monthly average for that month will apply. If the fiscal year ends prior to the 15<sup>th</sup> of the month, then the monthly average for the prior month will apply.</li> </ul>
<b>New Financial Performance Assessment (FPA) Test</b>	<ul style="list-style-type: none"> <li>ISS adopted the FPA as a third relative assessment under the quantitative component of its pay-for-performance analysis. FPA will compare three-year CEO pay rank to three-year financial performance rank using ISS' peer group.</li> <li>FPA will be applied as a <u>secondary</u> measure after the three established primary tests (i.e., RDA, MOM, and PTA). For example, FPA may move a medium concern on the primary tests to low concern if relative fundamental financial performance is strong and vice versa.</li> </ul>
<b>FPA Metrics</b>	<ul style="list-style-type: none"> <li>Financial performance under the FPA will be evaluated using three or four metrics with the metrics and weighting varying by industry.</li> <li>The metrics for 19 of the 24 industries covered are return on invested capital (ROIC), return on equity (ROE), return on assets (ROA), and EBITDA growth.</li> <li>EBITDA growth is replaced by growth in operating cash flow for Insurance, Semiconductors &amp; Semiconductor Equipment, and Real Estate companies. Only the three return metrics are used for Banks and Diversified Financials.</li> <li>See the <u>Appendix</u> for a table of the metrics and weighting rank by industry using four-digit Global Industry Classification System (GICS) codes.</li> </ul>

## U.S. Equity Plan Scorecard

EPSC Factor	2018 Policy Update
<b>Passing EPSC Score</b>	<ul style="list-style-type: none"> <li>Total points required to receive ISS support on an equity plan proposal subject to the EPSC will increase from 53 to 55 for <u>S&amp;P 500 companies</u>.</li> <li>The total point requirement for non-S&amp;P 500 companies will remain unchanged at 53.</li> </ul>
<b>Change in Control (CIC) Vesting</b>	<ul style="list-style-type: none"> <li>Partial credit for CIC vesting provisions in an equity plan has been eliminated under the EPSC. Only full points or no points will be credited to this factor.</li> <li>Full points will be credited if the equity plan includes the following provisions: <ul style="list-style-type: none"> <li>➤ For performance-based awards, acceleration is limited to actual performance achieved, pro-rata of target based on the elapsed proportion of the performance period, a combination of both actual and pro-rata, or the performance awards are forfeited or terminated upon a CIC. In cases</li> </ul> </li> </ul>

EPSC Factor	2018 Policy Update
	<p>where there are no performance-based awards, points for this factor will be based solely on the treatment of time-based awards.</p> <ul style="list-style-type: none"> <li>➤ For time-based awards, acceleration upon a CIC cannot be automatic single-trigger or discretionary.</li> <li>• No points will be credited if the above requirements are not met, including the use of board discretion, which receives partial credit under the current (2017) policy.</li> </ul>
<b>Holding Requirement</b>	<ul style="list-style-type: none"> <li>• Partial credit for post-vesting or exercise holding requirements has been eliminated under the EPSC. Only full points or no points will be credited to this factor.</li> <li>• Full points will be credited for a 12-month holding period on shares received from grants, which is a reduction from the 36-month period required for full credit under the current policy.</li> <li>• No points will be credited for holding periods of less than 12 months or if the holding requirement only applies until an ownership guideline is met. Current policy provides partial credit for holding periods of less than 36 months or until ownership guidelines are met.</li> </ul>
<b>CEO Vesting Requirement</b>	<ul style="list-style-type: none"> <li>• Partial credit for CEO vesting requirements has been eliminated under the EPSC. Only full points or no points will be credited to this factor.</li> <li>• Full points will be credited for a minimum three-year vesting period, which is a change from the greater than four-year period required for full credit under the current policy.</li> <li>• No points will be credited for periods of less than three years, which is unchanged from the current policy. Partial credit is provided for minimum vesting of three to four years under the current policy.</li> </ul>
<b>Board Discretion to Accelerate Vesting</b>	<ul style="list-style-type: none"> <li>• Full points will be credited if board discretion to accelerate unvested awards is limited to cases of death and disability.</li> <li>• This is more limited than the current policy, where a company could get full credit while also maintaining discretion to accelerate in the event of a CIC (in addition to death or disability).</li> </ul>

\* \* \* \* \*

***ISS clarified that the preliminary FAQs are “not an exhaustive list of updates.” ISS is expected to release complete executive compensation policy and equity compensation plan FAQs and an updated pay-for-performance white paper in mid-December.***

General questions about this summary can be addressed to:

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**Appendix**  
**Relative Financial Performance Assessment (FPA)**  
**Metrics and Weighting Rank by Industry**  
*(Source: ISS US Compensation Policies: Preliminary FAQs)*

GICS-4	Industry	Rank 1	Rank 2	Rank 3	Rank 4
1010	Energy	ROIC	ROA	ROE	EBITDA Growth
1510	Materials	ROA	ROE	EBITDA Growth	ROIC
2010	Capital Goods	ROIC	ROA	ROE	EBITDA Growth
2020	Commercial & Professional Services	ROIC	ROE	ROA	EBITDA Growth
2030	Transportation	ROIC	ROA	ROE	EBITDA Growth
2510	Automobiles & Components	ROIC	ROA	ROE	EBITDA Growth
2520	Consumer Durables & Apparel	ROIC	ROA	ROE	EBITDA Growth
2530	Consumer Services	EBITDA Growth	ROIC	ROA	ROE
2540	Media	ROIC	ROA	ROE	EBITDA Growth
2550	Retailing	ROE	ROIC	ROA	EBITDA Growth
3010	Food & Staples Retailing	ROA	ROIC*	ROE*	EBITDA Growth
3020	Food Beverage & Tobacco	ROA	ROIC*	ROE*	EBITDA Growth
3030	Household & Personal Products	ROA	ROIC*	ROE*	EBITDA Growth
3510	Health Care Equipment & Services	EBITDA Growth	ROIC	ROA	ROE
3520	Pharmaceuticals, Biotechnology & Life Sciences	ROIC	EBITDA Growth	ROA	ROE
4010	Banks	ROA	ROIC*	ROE*	
4020	Diversified Financials	ROIC	ROA*	ROE*	
4030	Insurance	ROIC*	ROA*	Operating Cash Flow Growth	ROE
4510	Software & Services	ROIC	ROA	ROE	EBITDA Growth
4520	Technology Hardware & Equipment	ROIC*	ROA*	ROE**	EBITDA Growth**
4530	Semiconductors & Semiconductor Equipment	ROIC	ROA	ROE	Operating Cash Flow Growth
5010	Telecommunication Services	ROA	ROE	ROIC	EBITDA Growth
5510	Utilities	ROIC	ROA	ROE	EBITDA Growth
6010	Real Estate	ROIC	ROA	ROE	Operating Cash Flow Growth

\* Indicates equal weighting for two metrics within an industry. These metrics are listed adjacently in this table.

\*\* For GICS 4520, metrics with rank 1 and 2 are weighted equally, and metrics with rank 3 and 4 are also weighted equally but less than the rank 1 and 2 metrics.