

ISS Issues FAQs on Its New Equity Plan Scorecard

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The [FAQs](#) issued by ISS on its new Equity Plan Scorecard (EPSC) model indicate that the revised model will consider, and score, a range of positive and negative factors, rather than use a series of “pass/fail” tests. As we previously [discussed](#), about 1,200 equity plan proposals were subject to shareholder approval in the first half of 2014, with average support at 89%. ISS recommended against at least a quarter of the proposals, although only eight actually failed to pass (including two ISS favored).

The general mix of ISS recommendations for plans is expected to remain largely the same under the EPSC model, although the recommendation for a particular plan may differ. The EPSC model is summarized in the FAQ as follows:

Three pillars. There are three separate pillars examined: plan cost, plan features and grant practices.

Plan costs. The EPSC considers the Shareholder Value Transfer (SVT) of a company’s plan relative to its industry or market cap peers. ISS’ SVT model is proprietary. It determines a company’s SVT relative to two benchmark calculations that considers both: (a) new shares requested plus only shares remaining for future grants, in order to reduce the impact of grant overhang and (b) adding outstanding unvested or unexercised grants to those shares. The relationship of these two SVT measures is weighed against a company’s respective ISS benchmark SVT, which is based on an analysis for the company’s GICS industry group, market cap size, and operational and financial metrics that ISS identified as correlated with TSR performance in the industry. Maximum points are allocated for proposals with costs at or less than about 65% of the benchmark SVT, which is equivalent to the “allowable cap” under the prior policy. However, there is no longer a carve-out of long-term outstanding option overhang.

Plan features. New features examined that may negatively impact the model include: automatic single-trigger vesting upon a change in control; broad discretionary vesting authority; liberal share recycling; and the absence of a minimum vesting period of at least a year. We understand a “modified” single-trigger is viewed the same as an “automatic” single-trigger.

Grant practices. A preference is stated for companies to limit share requests to an amount needed for no more than five or six years, with maximum points provided for five years or less. A plan’s duration is calculated as the sum of all new shares requested plus shares remaining available for issuance, divided by the average annual burn rate shares over the prior three years.

In addition, the following may also have positive impacts on the model: the three-year average burn rate relative to its industry and index peers, using GICS (the minimum burn rate benchmark for each industry group will be 2%, and ISS will no longer accept future burn rate commitments); the CEO’s most recent vesting schedule during the prior three years; the proportion of the CEO’s most recent equity grants/awards subject to performance conditions; a clawback policy that includes equity grants; and post-exercise/post-vesting shareholding requirements (with maximum points awarded for holding periods of over 12 months).

The proportion of the CEO’s equity grants deemed to be performance-based depends on ISS’ valuation of the awards reported in the Grants of Plan Based Awards table. Time-vesting stock options and SARs are not considered performance-based unless the vesting or value received depends on attainment of specified performance goals, or if ISS determines that the exercise price is at a substantial and meaningful premium to the grant date fair market value.

Scoring methodology. For S&P 500 and Russell 3000 companies, the maximum score for each pillar is weighed as follows, for a total of 100 points: plan cost (45), plan features (20) and grant practices (35). 53 points are needed to result in a positive recommendation, absent any overriding egregious factors discussed below. While some of the scoring, such as the SVT, is scaled, many factors are binary. For example, a company without a minimum vesting schedule of at least a year gets zero points for that element. Similarly, “automatic” single-triggers also receive zero points.

Overriding egregious factors. The following will continue to result in negative recommendations regardless of the other features: a liberal change-of-control definition (including, for example, announcement or commencement of a tender offer, provisions for acceleration upon a potential takeover, shareholder approval of a merger or other transactions, or similar language); if the plan would permit repricing or cash buyout of underwater options or SARs without shareholder approval; if the plan is a “vehicle for problematic pay practices or a pay-for-performance disconnect”; or any other plan features or company practices are deemed detrimental to shareholder interests (examples of possibilities include tax gross-ups related to plan awards or provision for reload options).

Multiple plans. If a company is seeking approval for multiple plans, then the Plan Cost pillar will review the cost of all plans on the ballot in aggregate. The Plan Features and Grant Practices pillars will evaluate the factors based on the “worst” scenarios among the plans. If an acceptable score is generated on the aggregate basis, all plans will be considered passed.

Plans considered differently. 162(m) plans that do not add shares for grants will generally receive a favorable recommendation regardless of the EPSC model, but the board’s compensation committee must be fully independent in accordance with ISS (and not just the listing exchanges and/or the company’s) definitions.

Non-employee director plans will not be evaluated under the EPSC model, although if there is also a traditional equity plan on the same ballot, the shares available for grant under the non-employee director plan will be integrated into the Plan Cost evaluation.

IPO companies will be evaluated under a model that contains fewer factors, such as not including burn rate or duration factors. An IPO company’s 162(m) plan, if it is the first time shareholders have been asked to vote on a plan following the IPO, will be subject to a full equity plan evaluation under the EPSC model.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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