Davis Polk

ISS Releases Its Compensation-Related Policy FAQs for 2021

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On December 21, 2020, ISS released its updated compensation-related FAQs for 2021. For U.S. companies, this set of guidance consists of ISS' **Compensation Policies FAQ**, **Equity Compensation Plans FAQ**, **Pay-for-Performance Mechanics**and **Peer Group FAQ**. As we previously **discussed**, ISS released its **2021 U.S. Proxy Voting Benchmark Policy Recommendations** in November. The updated policies and FAQs are effective for shareholder meetings occurring on or after February 1, 2021.

ISS' FAQs are intended to provide guidance as to how the proxy advisor will consider certain issues as it prepares its proxy analyses and determines its vote recommendations for U.S. companies in 2021.

COVID-19. This latest set of guidance does not modify ISS' October 2020 guidance, **U.S. Compensation Policies and the COVID-19 Pandemic FAQ**, regarding COVID-19-related pay decisions. ISS will continue to consider the exceptional circumstances of the COVID-19 pandemic and its impact on company operations as part of its qualitative evaluation. Please refer to our **prior post** for additional information on how ISS will evaluate COVID-19-related pay decisions in 2021.

This post summarizes key changes outlined by the updated compensation policies and equity compensation plans FAQs.

U.S. Compensation Policies FAQ

- *Say-on-Pay Pay-for-Performance Evaluation*. ISS applies an initial set of quantitative screens followed by a set of qualitative screens when evaluating say-on-pay proposals. For shareholder meetings on or after February 1, 2021, the Multiple of Median (MOM) measure high concern threshold used in the primary quantitative screen for S&P 500 companies will be lowered from 3.33 times to 3.00 times the peer median. ISS' other three quantitative pay-for-performance screens remain unchanged.
- *Disclosure Relating to Terminations and Severance Payments*. According to ISS, severance is intended for involuntary or constructive job loss and not voluntary resignation or retirement. In this FAQ, ISS clarifies the extent of disclosure that companies should provide to allow shareholders to consider the appropriateness of severance payments and whether there have been any discretionary payments. Disclosure indicating that an executive "stepped down" or that the executive or the board "mutually agreed" on a departure will not clearly indicate an involuntary termination. Companies should disclose both the type of termination (e.g., termination without cause or resignation for good reason), as defined under the applicable agreement, as well as the provision by which severance payments were made under such agreement.

U.S. Equity Compensation Plans FAQ

- *Calculating SVT in the Context of Plan Terminations.* When a company plans to terminate an existing equity plan, it may wish to cancel remaining shares reserved for awards under the existing plan upon shareholder approval of a new equity plan. For shares reserved under the existing plan to be excluded from ISS' analysis of shareholder value transfer (SVT)—i.e., the "plan cost" pillar of ISS' Equity Plan Scorecard, known as its EPSC, model—the FAQ recommends that a company disclose all of the following in its Form 10-K or proxy statement as of the same date (or other filing cited in the proxy):

    - The total number of shares remaining available for future awards that will no longer be available upon approval of the new plan;
    - The total number of full value awards and appreciation awards outstanding, including the weighted average exercise price and remaining term of appreciation awards and additional detail on the earned/unearned portions of performance awards; and
    - A commitment that no more shares will be granted under the existing plan unless the successor plan is not approved by shareholders.

– *Changes to EPSC Framework for 2021*. ISS' EPSC model is the methodology it employs to evaluate management proposals to adopt new equity compensation plans or amend existing plans. As previewed in its October COVID-19 guidance, ISS is revising the threshold passing scores for its EPSC evaluations. Each out of a total 100 possible points, the threshold passing scores will increase from 55 points to 57 points for the S&P 500 model and from 53 points to 55 points for the Russell 3000 model. The threshold passing scores remain unchanged at 53 points for other models. Unlike the case in 2020, there are no new factors or factor score adjustments for the EPSC in 2021.

– *Amendments to Stand-Alone Non-Employee Director Plans*. Stand-alone non-employee director equity plans are not evaluated under ISS' EPSC model. Instead, ISS generally evaluates these plans' costs against a plan cost benchmark and, in rare cases, a burn rate benchmark. The FAQ clarifies that ISS' recommendation on a stand-alone non-employee director equity plan proposal containing only plan amendments (and not a request to extend the plan term or approve additional shares) will be based on a qualitative analysis of the overall impact of the amendments. That is, ISS will determine whether the amendments are overall beneficial or contrary to shareholders' interests. In any event, ISS may recommend against a plan that contains egregious features (e.g., option repricing without shareholder approval).

– *Updated Burn Rate Benchmarks*. ISS updates its burn rate benchmarks annually. It uses these benchmarks, based on the Global Industry Classification Standard, or GICS, codes assigned to each company, primarily as part of its EPSC evaluation. ISS measures "burn rate" using the total number of equity awards granted each year expressed as a percentage of total common shares outstanding.

The latest FAQ also includes ISS' updated 2021 burn rate benchmarks for S&P 500, Russell 3000 and non-Russell 3000 companies. Compared to the 2020 benchmarks, ISS' 2021 burn rate benchmarks remained flat or are lower for S&P 500 companies. Most 2021 burn rate benchmarks are lower for Russell 3000 and non-Russell 3000 companies as well; however, higher benchmarks will apply for some GICS codes—for Russell 3000 companies: Food & Retailing Staples; Food, Beverage & Tobacco; and Household & Personal Goods; and, for non-Russell 3000 companies: Commercial & Professional Services; Consumer Services; Retailing; Health Care Equipment & Services; and Software & Services.

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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