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## Frequently Asked Questions on U.S. Compensation Policies

March 28, 2014

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## Frequently Asked Questions on U.S. Compensation Policies

Updated March 28, 2014

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## US Executive Pay Overview

### 1. How many named executive officers' total compensation data are shown in the Executive Pay Overview section?

The executive compensation section will generally reflect the same number of named executive officer's total compensation as disclosed in a company's proxy statement. However, if six or more named executive officers' total compensation has been disclosed, only five will be represented in the section. The order will be CEO, second, third, fourth and fifth highest paid executive by total compensation. Current executives will be selected first, followed by terminated executives. Executives who are terminated after the end of the last fiscal year will be included, as they were executives within the past complete fiscal year.

### 2. A company's CEO has resigned and there is a new CEO in place. Which CEO is shown in the report?

Our report generally displays the CEO in office on the last day of the fiscal year; however, the longer tenured CEO may be displayed in some cases where the transition occurs very late in the year.

### 3. How is Total Compensation calculated?

Total Compensation = Base Salary + Bonus + Non-equity Incentive Plan Compensation + Stock Awards\*+ Option Awards\*\* (based on full grant date values, as calculated by ISS) + Change in Pension Value and Nonqualified Deferred Compensation Earnings + All Other Compensation. The calculation will generally match the Summary Compensation Table with the exception of the stock option value and/or stock awards, described further below.

\*Stock Awards - Grant date value, generally as reported in the Grants of Plan-Based Awards Table for stock awards, but ISS may calculate values as deemed appropriate based on assessment of the grant. Note that performance shares (equity incentive plan awards) may be calculated at target value (# of shares X stock price on grant date) if it differs from the value disclosed in the GPBAT. If the stock awards disclosed in the Grants of Plan-Based Awards table reflect the current rather than past fiscal year, ISS will not include the value in our current report; pursuant to SEC disclosure requirements, the Grants of Plan-Based Award values should reflect equity awards made in the past fiscal year. The disclosed stock awards value should generally be the same in both the Summary Compensation Table and Grants of Plan-Based Awards Table.

\*\*Option Awards - Grant date present value of options using Black-Scholes Option Pricing Model, as calculated by ISS (see #5).

### 4. What inputs are used in ISS' Black-Scholes methodology?

Variable	Item	Source	Comments
C	Option Value	Calculated	
S	Stock Price	Proxy	
E	Exercise Price	Proxy	
σ	Volatility	XpressFeed	Historical three-year stock price volatility measured on a daily basis from the date of grant. If a company has not been publicly traded for at least three years, ISS measures volatility from the IPO date through grant date.
Q	Dividend Yield	XpressFeed	Average dividend yield over five years. If a company has not been publicly traded for at least five years, ISS averages dividend yield from the IPO date and the grant date of option. Dividend yield is based on each dividend divided by the closing stock price on the last business day before the dividend date. The calculation excludes the payouts of special dividend
R	Risk Free Rate	Dept of Treasury website	U.S. Government Bond Yield on the date of grant corresponding to the term of the option. For example, if the option has a 10-year term, the risk free rate is the 10-year U.S. Government Bond Yield on the date of grant.
T	Term/Expected Life	Proxy	Full term of the option.



E	Base of Natural Logarithm	N/A	N/A
Ln	Natural Logarithm	N/A	N/A
N(x)	Cumulative Normal Distribution Function	N/A	N/A

**5. How is the present value of all accumulated pensions calculated in the CEO Tally Sheet table?**

This figure represents the amounts disclosed as the present value of the benefits for all pension plans (including qualified and non-qualified), as disclosed in the Pension Benefit table of the proxy statement.

**6. How is the value of Non-Qualified Deferred Compensation calculated in the CEO Tally Sheet table?**

This figure represents the summation of all deferred compensation values, from both qualified and non-qualified plans, as disclosed in the Non-Qualified Deferred Compensation table.

**7. How are Potential Termination Payments calculated in the CEO Tally Sheet table?**

The values for an involuntary termination without cause and a change in control related termination are provided as disclosed under the relevant termination scenario in the Change in Control Table and/or narrative of the proxy statement.

## Financial Data: Total Shareholder Return and Revenue

**8. Where does ISS obtain a company's 1-year fiscal total shareholder return, 3-year fiscal total shareholder return, and revenue?**

ISS obtains all financial data in the Compensation Profile from Standard & Poor's Research Insight.

**9. How does Research Insight calculate 1-Year fiscal Total Shareholder Return (TSR)?**

The one-year total shareholder return is the annualized rate of return reflecting price appreciation plus dividends (based on reinvestment as of the end of the month of the dividend payment) and the compounding effect of dividends paid on reinvested dividends over a one-year period.

**10. How does Research Insight calculate 3-Year fiscal Total Shareholder Return (TSR)?**

The three-year total shareholder return is the annualized rate of return reflecting price appreciation plus reinvestment of dividends (as described above) and the compounding effect of dividends paid on reinvested dividends over a three-year period.

**11. How does Research Insight calculate company revenue?**

Revenue is the gross sales (the amount of actual billings to customers for regular sales completed during the period) reduced by cash discounts, trade discounts, and returned sales and allowances for which credit is given to customers.

**12. How does Research Insight calculate company net income (loss)?**

Net income or loss is reported by a company after expenses and losses have been subtracted from all revenues and gains for the fiscal period including extraordinary items and discontinued operations.

**13. Why is the CEO pay as percent of a company's revenue showing NA (not applicable)?**

If a company's revenue is zero, the CEO pay as percent of a company's revenue will be NA.

#### 14. Why is the CEO pay as percent of company's net income showing NA?

If a company's net income is zero or negative, the CEO pay as percent of a company's net income will be NA.

## Management Say on Pay (MSOP) Evaluation

#### 15. What is ISS' Executive Compensation Evaluation policy?

The Executive Compensation Evaluation policy consists of three sections: Pay for Performance, Problematic Pay Practices, and Board Communication and Responsiveness. Recommendations issued under the Executive Compensation Evaluation policy may apply to any or all of the following ballot items, depending on the pay issue (as detailed in the policy): Election of Directors (primarily compensation committee members), Advisory Votes on Compensation (MSOP), and/or Equity Plan proposals.

#### 16. If a company has an MSOP resolution on the ballot, will ISS also apply compensation-related recommendations to members of the compensation committee who are up for election?

In general, if a company has an MSOP resolution on the ballot, any compensation-related recommendations will be applied to that proposal; however, if egregious practices are identified, or if a company previously received a negative recommendation on an MSOP resolution related to an issue that is still on-going, ISS may also recommend withhold/against votes with respect to compensation committee members.

#### 17. If one or more directors received a negative recommendation in the prior year due to ISS' concerns over compensation practices will it have a bearing on the following year's recommendation?

If one or more directors received less than 50 percent of shareholders' support (regardless whether it is a compensation issue), ISS may recommend that shareholders withhold from the entire board with the exception of new nominees if the company fails to take adequate action to respond or remediate the issues raised in the previous report. If one or more directors received a high level of dissent (30 percent to 49.5 percent), the company should discuss any action or consideration taken to address the concern. A high level of dissent indicates an overall dissatisfaction and the board/committee should be responsive to shareholders' concerns. A lack of discussion or consideration, coupled with existing borderline concerns may have a bearing on the following year's recommendation.

#### 18. What impact might an adverse say-on-pay recommendation have on equity plan proposals?

If a significant portion of an NEO's misaligned pay is attributed to non-performance-based equity awards, and there is an equity plan on the ballot that includes these participants, ISS may recommend a vote against the equity plan.

Considerations in recommending against the equity plan may include, but are not limited to:

- Magnitude of pay misalignment;
- Contribution of equity grants, particularly grants that are not tied to performance conditions, to overall pay; and
- The proportion of equity awards granted in the last three fiscal years concentrated at the named executive officer level.

A concentration ratio for the top 5 that exceeds 50% would warrant additional scrutiny of both the CEO and the top 5 concentration ratios. If the CEO has less than 20% but the top five has more than 50% due to a new hire situation, it is unlikely that we would recommend against the equity plan. We would also look at the past three years of concentration ratio with and without CEO. Is the concentration high due solely to the CEO or is there more/less equal distribution among the key executives? Is the LTI program similar for the CEO and the top 5? Are there performance features for the equity awards and is it the same for all top five? Are the performance goals sufficiently rigorous?

## Pay for Performance Evaluation

Please see ISS' "[Evaluating Pay for Performance Alignment](#)" white paper for an explanation of the types of quantitative methodology used in the first phase of this analysis, and a discussion of the qualitative factors considered.

### 19. How does ISS' quantitative pay for performance screen work?

The first step in ISS' evaluation of pay for performance has historically been a quantitative assessment of how well a company's CEO pay has been aligned with its shareholder returns. The current screen (which applies to all Russell 3000 and S&P 500 companies, as well as selected additional companies that are widely held) identifies companies that demonstrate a significant level of misalignment between the CEO's pay and company TSR, either on an absolute basis or relative to a group of peers similar in size and industry (see below for more information about ISS peer groups). Three independent measures assess alignment over multiple time horizons. If any or a combination of these measures indicate a level of misalignment that is considered of significant concern to shareholders, ISS performs an in-depth qualitative review of the company's pay programs and practices to ascertain likely causal factors, or mitigating factors, and a relevant vote recommendation (see Q3 below).

### 20. What are the three quantitative screens?

As of meetings dated Feb. 1, 2014, the quantitative screens work as follows:

- **Relative Degree of Alignment.** This relative measure compares the percentile ranks of a company's CEO pay and TSR performance, relative to an industry-and-size derived comparison group, annualized for the prior three fiscal year periods. Specifically, CEO pay is averaged for the three-year period; annualized TSR is the geometric mean of the three fiscal year TSRs in the period.
- **Multiple of Median.** This relative measure expresses the prior year's CEO pay as a multiple of the median pay of its comparison group for the same period.
- **Pay-TSR Alignment.** This absolute measure compares the trends of the CEO's annual pay and the value of an investment in the company over the prior five-year period.

### 21. How does the initial quantitative pay for performance analysis affect the ultimate vote recommendation for Management Say on Pay proposals or election of compensation committee members (in the absence of management say on pay proposal)?

The quantitative pay for performance analysis serves as an initial screen to identify cases that suggest there has been a significant misalignment of CEO pay and performance. A high or medium concern from the quantitative screen results in an in-depth qualitative review of the company's Compensation Discussion & Analysis to identify the probable causes of the misalignment and/or mitigating factors. As examples, for 2012 proxy season meetings, as a result of the qualitative review of the company's disclosures, only 53% of the high concern companies resulted in negative vote recommendations, while 47% of the high concern companies received a favorable vote recommendation due to mitigating factors identified in the qualitative assessment. For proxy season 2013, the recommendation mix for "high concern" companies was 51% "against" and 49% "for."

### 22. What are the factors that ISS considers in conducting the qualitative review of the pay for performance analysis?

Here are key factors that ISS generally considers in conducting the qualitative review of the pay for performance analysis:

- The ratio of performance- to time-based equity awards;
- The overall ratio of performance-based compensation;
- The completeness of disclosure and rigor of performance goals;
- The company's peer group benchmarking practices;
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior FY or anomalous equity grant practices (e.g., bi-annual awards);
- Realizable pay compared to grant pay; and
- Any other factors deemed relevant.

Relevant factors are discussed in the report.

### 23. If a company received a "low" concern in the quantitative pay for performance model, will ISS still evaluate the company's incentive programs?

Yes, ISS reviews all companies' Compensation Discussion and Analysis and highlights noteworthy issues to investors regardless of the quantitative concern level. This qualitative evaluation, as well as any in-depth qualitative evaluation subsequent to the quantitative screens, is the most important part of the analysis. Problematic incentive designs such as multi-year guaranteed payments, discretionary pay components, inappropriate perquisites compensation (including tax gross-ups) or lack of rigorous goals are generally addressed in the qualitative analysis and may result in a negative recommendation despite of a "low" quantitative concern.

### 24. How does ISS use realizable pay in its analysis?

ISS' standard research report will generally show three-year realizable pay compared to the three-year granted pay for S&P 1500 companies starting with Feb. 1, 2014 meeting dates. See the [next question](#) for ISS' definition of realizable pay and how it will be calculated.

Realizable pay will generally be discussed in cases where the company's initial quantitative screen shows a high or medium concern. For S&P 1500 companies, we may utilize the realizable pay chart to see if realizable pay is higher or lower than granted pay (see Q7 and Q8 below) and further explore the underlying reasons. For example, is realizable pay lower than granted pay due to the lack of goal achievement in performance based awards, or simply due to a decline in stock price? Is realizable pay higher than granted pay due to above target payouts in performance based equity awards and, if so, are the underlying goals sufficiently rigorous, or is the difference due to increasing stock price?

For all companies, ISS' consideration of realized and/or realizable pay is to assist in determining whether the company demonstrates a strong commitment to a pay for performance philosophy. The fact that realizable pay is lower, or higher, than granted pay will not necessarily obviate other strong indications that a company's compensation programs are not sufficiently tied to performance designed to enhance shareholder value over time. However, in the absence of such indications, realizable pay that demonstrates a pay for performance commitment will be a positive consideration. .

### 25. How is Realizable Pay computed?

ISS' goal is to calculate an estimated amount of "realizable pay" for the CEOs of S&P 1500 companies. It includes the cash and benefit values actually paid, and the value of any amounts "realized" (i.e., exercised or earned due to satisfaction of performance goals) from incentive grants made during a specified measurement period\*, based on their value as of the end of the measurement period. Grants made during the measurement period that remain on-going as of the end of the period (i.e., not yet earned or forfeited) will be revalued using the company's stock price, as applicable, at the end of the period. For periods that include multiple CEOs, the departed CEO's pay (excluding any grants forfeited) will be valued as of his/her termination date.

In short, realizable pay includes all non-incentive compensation amounts delivered during the measurement period, plus the value of equity or long-term cash incentive awards made during the period and either earned or, if the award remains on-going, revalued at target level as of the end of the measurement period. The total realizable value for these grants and payments will thus be the sum of the following:

- Base salary reported for all years in the measurement period;
- Bonus reported for all years;
- Short-term (typically annual) awards reported as Non-equity Incentive Plan Compensation for all years;
- For all prospective long-term cash awards made during the measurement period, the earned value of the award (if earned during the same measurement period) or its target value in the case of on-going award cycles;
- For all share-based awards made during the measurement period, the value (based on stock price as of the end of the measurement period) of awards made during the period (less any shares/units forfeited due to failure to meet performance criteria); or, if awards remain on-going, the target level of such awards;
- For stock options granted during the measurement period, the net value realized with respect to such granted options which were also exercised during the period; for options granted but not exercised during the

measurement period, ISS will re-calculate the option value, using the Black-Scholes option pricing model, as of the end of the measurement period;

- Change in Pension Value and Nonqualified Deferred Compensation Earnings reported for all years; and
- All Other Compensation reported for all years.

\*Generally three fiscal years, based on the company's fiscal year. For realizable pay calculated as part of ISS' 2014 analyses, this will generally consist of fiscal years 2011 through 2013.

**Note that ISS' realizable pay amount will be based on a consistent approach, using information from company proxy disclosures. Since current SEC disclosure rules are designed to enumerate "grant-date" pay rather than realizable pay, these estimates will be based on ISS' best efforts to determine necessary inputs to the calculation. In cases where, for example, it is not sufficiently clear whether an applicable award has been earned or forfeited during a measurement period, ISS will use the target award level granted.**

**26. How does ISS calculate the "Granted Pay" that is compared to a CEO's "Realizable Pay"?**

The CEO's "Granted Pay" presented in the "3-Year Granted vs. Realizable CEO pay" chart in ISS' reports for meetings beginning approximately Feb. 1, 2014 will be calculated as the sum of the following for the 3-year measurement period:

- Base salary reported for all years in the measurement period;
- Bonus reported for all years;
- Target short-term (typically annual) awards reported as Non-equity Incentive Plan Awards in the Grants of Plan-Based Awards table, for all years;
- Target long-term cash awards made during the measurement period (as reported in the Grants of Plan-Based Awards table, or elsewhere in the CD&A);
- The grant-date value of all share-based awards made during the measurement period;
- For stock options granted during the measurement period, grant-date value is calculated by ISS using the Black-Scholes option pricing model, per ISS' standard stock option valuation methodology.
- Change in Pension Value and Nonqualified Deferred Compensation Earnings reported for all years; and
- All Other Compensation reported for all years.

**27. Why doesn't ISS use the intrinsic value (exercise price minus current market price) of stock options when calculating realizable pay?**

Top executives' stock options typically expire after seven to 10 years, meaning that even if an option is underwater in the first few years after its grant, there is a substantial likelihood it will ultimately deliver some value to the holder prior to expiration. Shareholders recognize that in considering "realizable" pay as a pay for performance factor, it is important to include the economic value of underwater options (which will also reflect the impact of a lower stock price, if applicable).

**28. A company would like to disclose ongoing and/or completed performance-based equity awards for awards made in the past three years. What type of disclosure format would ISS suggest?**

Disclosure of ongoing or completed performance-based equity awards in a consistent manner would facilitate ISS' calculation of realizable pay (which is based on a best efforts extraction of necessary information from proxy statements). If a company has awarded performance-based equity awards in the past three years, disclosure of the awards in the following table would be helpful:

Grant Date	Threshold Payout (#)	Target Payout	Maximum Payout	Performance Period*	Target/Actual Earned Date	Actual Payout
3/1/2009	100,000	150,000	200,000	1 year	6/1/2010	180,000
3/1/2010	150,000	200,000	250,000	3 years	6/1/2012	Not determined yet

\*Performance period does not include time-vesting requirement.

**29. With respect to pay for performance alignment and realizable pay calculations, how will ISS treat CEOs who have not been in the position for three years?**

The quantitative methodology will analyze total CEO pay for each year in the analysis without regard to whether all years are the same or different CEOs. If that analysis indicates significant pay for performance misalignment, the ensuing qualitative analysis may take into account any relevant factors related to a change in CEO during the period. However, given an apparent disconnect between performance and CEO pay, shareholders would expect the new CEO's pay package to be substantially performance-based.

For years when a company has more than one CEO, only one CEO's pay will be included to calculate granted pay (generally the CEO who was in the position at or near the end of the fiscal year) for purposes of the pay-for-performance quantitative screen. The base salary for the CEO will be annualized as appropriate. (Also see Question 39.)

With respect to realizable pay, ISS will include both pay packages and calculate the realizable amount, as of the end of the measurement period, of the Summary Compensation Table pay reported for the CEO in office on the last day of each fiscal year in the measurement period. Pay for a terminated CEO (including the value of unforfeited awards as if they were paid out on the last day of service or the end of the fiscal year, based on information in disclosures) will also be included in realizable pay.

**30. How is three-year total shareholder return (TSR) calculated? How are "peaks and valleys" accounted for in the five-year analysis?**

Beginning with meeting dates as of Feb. 1, 2014, ISS replaced the weighted average one- and three-year TSR measure in the Relative Degree of Alignment (RDA) measure with annualized three-year TSR – i.e., the annualized rate of the three 12-month periods in the three-year measurement period (calculated as the geometric mean of the three TSRs). TSR reflects stock price appreciation plus the impact of reinvestment of dividends (and the compounding effect of dividends paid on reinvested dividends) for the period.

Under the absolute assessment, indexed TSR represents the value of a hypothetical \$100 investment in the company, assuming reinvestment of dividends. The investment starts on the day five years prior to the month-end closest to the company's most recent fiscal year end, and is measured on the subsequent five anniversaries of that date. The Pay-TSR Alignment (PTA) measure (as outlined in the ISS "Evaluating Pay for Performance Alignment" white paper) is designed to account for the possibility of "bumps" in the overall trend.

The following table illustrates how indexed TSR would be calculated for a company with a fiscal year end of October 2, 2011, and how indexed TSR relates to annual total shareholder returns:

Date	Annual TSR	Indexed TSR
9/30/2006	-	100
9/30/2007	9.0%	109
9/30/2008	8.3%	118
9/30/2009	-22.9%	91
9/30/2010	8.8%	99
9/30/2011	5.1%	104

**31. What TSR time period will ISS use for the subject company and the peers in the Pay for Performance analysis? What about the compensation period?**

TSRs for the subject company and all its peers are measured from the last day of the month closest to the subject company's fiscal year end. For example, if the subject company's fiscal year end is September 30, then the one-year and three-year TSRs for the subject company and its peers will be based on September 30. Compensation figures for all companies are as of the most recent available date.

**32. For companies with meetings early in the year, whose latest year peer CEO pay has not yet been released, what pay data does ISS use?**

ISS uses the latest compensation data available for the peer companies, which may be from the previous year. This circumstance is considered in any related qualitative review, as it deemed relevant.

**33. Do you include the subject company in the derivation of the peer group median? When you say 14 companies minimum for peers, does the 14 include the subject company?**

No, neither the CEO pay nor the TSR of the subject company is included in the median calculation. The subject company is also not included in the number of peer companies, which will generally be a minimum of 14 (also see [Determining Peer Companies](#), below).

**34. If a company has not been publicly traded for five fiscal years, does the quantitative pay for performance evaluation still apply? What if the company has not been publicly traded for three fiscal years? Would such a company be used as a peer company for other companies?**

If the company has not been publicly traded for five fiscal years, the relative assessment, specifically the relative one-year and three-year TSR pay and performance rank and the multiple of pay against the peer median, will still apply, based on either one or two years of annualized TSR and CEO pay data, as available and applicable. .

The company's limited life as a publicly traded company will also be considered as part of any qualitative evaluation.

Generally, only companies with three full years of data will be peer companies. In limited circumstances, a company with less than 3 years of data may be used when the quantitative evaluation focuses on only one year.

**35. Will "pay" continue to be defined as summary compensation table pay or consider the current value of LTIs (potential realizable pay)?**

Total compensation calculated by ISS will continue to be defined as granted pay and pay opportunities, for a number of reasons but including that: 1) it is the best reflection of the compensation committee's oversight and decision-making, and 2) pay opportunities should be reflective of the company's past performance to some degree – in particular, if the opportunity appears to be misaligned with that performance (in a negative way), shareholders expect those grant opportunities to be strongly performance-based. Realized or potentially realizable pay will be considered as part of ISS' qualitative evaluation of pay for performance alignment.

**36. How does ISS take the year-over-year change in pension benefits value into account in assessing CEO pay?**

ISS includes changes in pension value in our pay assessments, because otherwise companies that do not offer supplemental defined benefit pensions to their top executives may provide for post-retirement compensation through larger grants of equity-based awards and could be disadvantaged in company-to-company pay comparisons as a result. Because ISS' quantitative analysis has a long-term orientation, pay anomalies caused by issues such as a single large increase in year-over-year pension accumulations, should not have a significant impact on the results. However, such anomalies may be considered in the qualitative evaluation conducted before a negative recommendation would be issued.

**37. ISS has recommended withholds on a company's compensation committee or recommended against a company's management say on pay or equity plan proposal on the basis of a CEO pay for performance disconnect. What actions can the company take to address the concerns?**

The pay for performance evaluation is a case-by-case analysis, and actions should be tailored according to the underlying issues identified in the pay for performance disconnect. Prospective commitments to increase the proportion of performance-based pay in the future will not adequately address concerns; adjustment to recent awards to strengthen their performance linkage may be considered, however. As an example, if the primary source of a pay increase is due to time-vested equity awards, a remedy could be for the company to make a substantial portion of such equity awards to named executive officers performance-based. A substantial portion of performance-based awards would be at least 50 percent of the shares awarded to each of the named executive officers. Performance-based equity awards are earned or paid out based on the achievement of pre-established, measurable performance targets.

The company should disclose the details of the performance criteria (e.g., return on equity) and the hurdle rates (e.g., 15 percent) associated with the performance awards at the time they are made. From this disclosure, shareholders will know the minimum level of performance required for any equity grants to be earned. In this context, strongly performance-based equity awards do not include standard time-based stock options or performance-accelerated grants. Instead, performance-based equity awards are performance-contingent grants, where the individual will not receive the equity grant if target performance is not achieved. Premium-priced options with an exercise price at least 25 percent higher than the fair market stock price on the date of grant may be considered strongly performance-based (the 25 percent premium serves as a

guideline rather than a bright line test; a 25 percent premium may not be rigorous for a company trading at \$1.00). If option vesting is contingent on the stock reaching a specified price, the price condition should be maintained for at least 30 consecutive trading days before vesting in order for the grant to be considered strongly performance-based.

In order for shareholders to assess the rigor of performance-based bonus and equity programs, the company needs to disclose the performance measures and goals. To ensure complete and transparent disclosure, the company should disclose the following:

1. the measures(s) used (and rationale for the selections);
2. the goal(s) that were set for each metric and the target (and, if relevant, threshold and maximum) payout level(s) set for each NEO;
3. the reason that each goal was determined to be appropriate for incentive pay purposes (including the expected difficulty of attaining each goal);
4. the actual results achieved with respect to each goal; and
5. the resulting award (or award portion) paid (or payable) to the NEO with respect to each goal.

Any pay for performance action(s) should be disclosed in a public filing, such as a Form 8-K or DEFA 14A. Based on the additional disclosure, ISS may recommend a vote for the compensation committee members up for annual election and/or vote for the management say on pay or equity plan proposal, if there is one on the ballot. However, ISS is not likely to recommend a vote for the compensation committee members and/or vote for the management say on pay or equity plan proposal unless the company has provided compelling and sufficient evidence of action to strengthen the performance-linkage to its executives' compensation and comprehensive additional disclosure.

**38. A company makes equity grants near the beginning of each year based on an evaluation of the company and/or the executive's performance in the immediately preceding year. Such grant information will appear in the following year's proxy statement. Will ISS take into account the timing of these early equity grants made in the current fiscal year and make adjustments to the top executives' total compensation when conducting its pay for performance evaluation?**

Such timing issue can be problematic for investors evaluating the relationship between performance and pay. The value of equity grants generally represents a significant proportion of top executives' pay; if the grants are made subsequent to the "performance" year, disclosures in the Grants of Plan-Based Awards Table may distort the pay for performance link. Some investors believe that equity awards can incentivize and retain executives for past and future performance; therefore, adjustments for such timing issues may not be relevant. In addition, ISS' pay for performance analysis has a long-term orientation, where these types of timing issues are less relevant than an evaluation of one year's pay. Nevertheless, ISS may consider the timing of equity awards made early in a fiscal year in its qualitative assessment if complete disclosure and discussion is made in the proxy statement. In order to ensure that pay for performance alignment is perceived, the company should discuss the specific pre-established performance measures and goals that resulted in equity awards made early in the next fiscal year. A general reference to last year's performance is not considered sufficient and meaningful to shareholders. If the company makes equity grants early in each year, based on the prior year's specific performance achievement, shareholders should not be required to search for the information in Form 4s and compute the adjusted total compensation for the top executives in order to make a year-over-year comparison. Instead, companies should provide information about grants made in relation to the most recently completed fiscal year in the proxy statement for the shareholder meeting that follows that fiscal year (aligned with other compensation reported for that year). Many companies provide an alternate summary compensation table that takes into account the recent equity awards made in the current fiscal year. The number of options or stock awards with the relevant exercise price or grant price should be disclosed in the proxy statement. The term of the options should be provided as well. In order for ISS to compute the adjusted total compensation and include it for purposes of our narrative discussion and analysis, companies need to make transparent and complete disclosure in the proxy statement; ISS will not search for the companies' Form 4 filings to make such adjustments but will rely on the specific grant disclosures found in the proxy statement.



**39. With respect to pay for performance alignment, how does ISS treat CEOs who have not been in the position for three years?**

ISS' quantitative methodology analyzes total CEO pay for each year in the analysis without regard to whether all years represent the same or different CEOs. If that analysis indicates significant pay for performance misalignment, the ensuing qualitative analysis may take into account any relevant factors related to a change in CEO during the period. However, given an apparent disconnect between performance and CEO pay, shareholders would expect the new CEO's pay package to be substantially performance-based.

For years when a company has more than one CEO, we will use only one CEO's pay: the CEO who was in the position at the end of the fiscal year will generally be the one whose pay will be used. The base salary for a recruited CEO will be annualized.

**40. A company awards time-based stock awards after meeting specific performance criteria. Does ISS consider such awards to be performance contingent compensation?**

Performance measures and goals should be pre-established and disclosed in the proxy statement for ISS to consider such awards as performance contingent compensation.

**41. How does ISS capture transition period compensation?**

Disclosure of transition period compensation varies across companies. Therefore, ISS does not apply a standardized methodology in all cases. Transition periods generally represent an extension of a recently completed fiscal year (until the start of a new fiscal year period). ISS will generally include transition period pay as part of the most recently completed fiscal year pay. Cash pay components such as base salary and bonus will be annualized and equity pay components will be added, subject to a company-specific case by case review.

## Determining Peer Companies

**42. How does ISS select constituents for the peer groups used in its pay for performance analysis?**

As of 2013, ISS' methodology for selecting peers maintains a focus on identifying companies that are reasonably similar to the subject company in terms of industry profile, size, and market capitalization, taking into account a company's self-selected peers to guide industry selections.

ISS' selected peer group generally contains a minimum of 14 (and always at least 12) and maximum of 24 companies based on the following factors:

- 1) the GICS industry classification of the target company
- 2) the GICS industry classifications of the company's disclosed benchmarking peers
- 3) size constraints for both revenue (or assets for certain financial companies) and market value.

Subject to the size constraints, and while choosing companies that push the subject company's size closer to the median of the peer group, peers are selected from a potential peer universe in the following order:

1. from the subject's own 8-digit GICS group
2. from the subject's peers' 8-digit GICS groups
3. from the subject's 6-digit GICS group
4. from the subject's peers' 6-digit GICS groups
5. from the subject's 4-digit GICS group

When choosing peers, priority is given to potential peers within the subject's "first-degree" peer group (the companies that are either in the subject's own peer group, or that have chosen the subject as a peer), and companies with numerous connections (by choosing as peer or being chosen as a peer) to these first-degree peers. All other considerations being equal, peers closer in size are preferred.

**43. Will a company's self-selected peers always appear in the ISS peer group, if they meet ISS' size constraints?**

Not necessarily. While the new methodology does place a priority on the company's own peer selections, there are a number of reasons why a company selected peer may not appear in the final ISS list, even if it meets the relevant size (revenue or assets and market capitalization) constraints. As noted above, the new methodology also places priority on other factors as it builds the peer group:

- The company's own 8-digit GICS category
- Maintaining the subject company size at or near the median of its peer group
- Maintaining the approximate distribution of GICS industry codes as reflected in the company's self-selected peer group

As a result, at times including a company's self-selected peer may push the subject company away from the median, or lead to an overrepresentation of that industry within the final peer group. In these cases the company's self-selected peer may not be included. In addition, if a company's self-selected peer is the only peer company in its 6- and 8-digit GICS category, it will receive a lower priority in the peer selection process.

**44. What are ISS' size parameters for qualifying a potential peer?**

ISS applies two size constraints to qualify potential peers:

1. Revenue (or assets for certain financial companies, as noted below)  
In general companies should fall in the range 0.4 to 2.5 times the company's revenue (or assets). These ranges are expanded when the subject company's revenue is larger than \$5 billion or smaller than \$200 million in revenue (assets). Companies smaller than \$100 million in assets are treated as if they have \$100 million in assets.
2. Market capitalization (in millions)  
Companies are classified into market capitalization buckets as follows:

Bucket	Low end	High end
Micro	0	200
Small	200	1,000
Mid	1,000	10,000
Large	10,000	No cap

While ISS may choose peers that fall outside a subject company's market cap bucket if necessary to reach a minimum peer group size, none may have a market cap of less than 0.25 times the low end or more than 4 times the high end of the subject's market capitalization bucket.

**45. Which industry groups will use assets for size comparisons? What happens when a company has potential peers in both asset-based and revenue-based industry groups?**

ISS will use balance sheet assets (rather than revenue) to measure the size of companies in the following 8-digit GICS groups

- 40101010 Commercial Banks
- 40101015 Regional Banks
- 40102010 Thrifts + mortgage
- 40202010 Consumer Finance
- 40201020 Other diversified

Both subject and potential peer must be in the asset-based GICS groups listed above in order to be compared on the basis of assets. In cases where a subject company is in one of the asset-based GICS groups and a potential peer is not, revenues will be used for size comparisons. This principle applies to the size comparisons made to qualify a peer for potential inclusion as a peer, to the size rankings made to maintain the subject company near the median size of the peer group, and to the size prioritization of peers.

In addition, as deemed appropriate by ISS, additional 8-digit GICS categories may be determined to utilize assets and/or market cap to identify peers.

**46. When will a company's peer group have more than 14 members?**

In general, the closer the industry match, the larger the subject size of the peer group: for direct matches to the company's own 8-digit GICS, as many as 24 peers may be chosen. For matches of the company's peers' 8-digit GICS, as many as 18 peers may be chosen, falling to a maximum of 14 peers when choosing from the company's 4-digit GICS. More peers, however, may be selected in order to bring the target company's size closer to the median of its peers.

**47. If the standard methodology fails to yield the minimum number of acceptable peers, what peer group will be used? How will ISS create peer groups for very large "super-mega" companies or very small companies?**

In general, ISS will supplement the peer group generated by the standard methodology in such cases. In cases where the standard methodology does not provide a sufficient number of peers, ISS will supplement those peer groups according to the principles above, generally by relaxing size parameters while maintaining the subject company at or near the median size.

In exceptional cases, the ISS peer group may contain a minimum of 12 constituents.

**48. How does ISS treat foreign-domiciled or privately-held company peers?**

ISS uses these peers for the purpose of identifying relevant GICS industry groups, if relevant industry data is readily available. Foreign-domiciled companies that file Def14A, 10-Qs, and 10-Ks may be included as ISS selected peers. Privately-held or other foreign-domiciled companies that do not make such filings are not included as ISS selected peers.

**49. If a company used multiple peer benchmarking groups, which group will ISS use as an input to the process? What does ISS do if a company does not employ a peer group for benchmarking?**

ISS uses the company peer group that is used for CEO pay benchmarking purposes. If there is no peer group employed, the peer methodology will draw peers from the company's own 8-, 6- and 4-digit GICS groups, subject to ISS' size constraints.

**50. Does ISS apply additional judgment in the process of building peer groups?**

ISS may adjust any peer groups that appear to have inappropriate constituents at the time of our analysis. The basic principles of the methodology will still apply: peers should come from similar industries and be of similar size, and company peers will be prioritized where possible.

**51. When will ISS reconstruct peer groups?**

Company peer groups will be reconstructed during December and early January, effective for meetings as of the following February 1. A subsequent peer group construction will occur in July and August, after the Russell 3000 index is updated in July, expected to be in place for research in process as of September 15 (generally affecting companies that have filed DEF14As after mid-August).

**52. In December, ISS provides companies an opportunity to communicate any changes made to their benchmarking peer groups following their most recent proxy disclosures. Will companies with later fiscal year-ends that did not know at that time what changes they were making to peer groups used with respect to latest fiscal year compensation decisions also have an opportunity to communicate changes?**

Yes, ISS provides a similar "peer update" opportunity after proxy season, prior to reconstruction of its peer groups per above, for companies with meetings from approximately September 15 through the following January.

**53. Can only Russell 3000 companies be used as peer companies? Will ISS use companies that an issuer considers as peers (specified in the proxy) to develop the ISS comparator group?**

If a Russell company discloses the names of the companies that it uses as its peers, and these companies are public, ISS will collect the data on them even if they are not in the Russell 3000. If these companies fit ISS' criteria for peers, then they may be used as ISS peers as of the next update of ISS peer groups.

**54. What are GICS codes? Who can I contact if I disagree with the GICS classification?**

The Global Industry Classification Standard (GICS) was developed by Standard & Poor's and MSCI in response to the financial community's need for a reliable, complete (global) standard industry classification system. GICS codes correspond to various business or industrial activities, such as Oil & Gas Drilling or Wireless Telecommunication Services. GICS is based upon a classification of economic sectors, which is further subdivided into a hierarchy of industry groups, industries and sub-industries. The GICS methodology is widely accepted as the industry analysis framework for investment research, portfolio management, and asset allocation.

ISS does not classify companies into the GICS codes. Please contact Standard & Poor's at 1-800-523-4534 if you believe that a company has been misclassified.

**55. Are the same peer companies used for a company's allowable cap on an equity plan proposal that are used under the pay for performance analysis?**

No, the list of companies shown in the executive compensation section is not the same peer group used in calculating a company's allowable cap on an equity plan proposal. The peer group used for benchmarking executive pay is based on a combination of industry and size (revenue/assets and market cap); the peer group used for creating the allowable cap calculations for stock-based compensation is based on industry, with adjustments for market cap size.

**56. How are peer medians calculated for the Components of Pay table?**

The median is separately calculated for each component of pay and for the total annual compensation (TC). For this reason, the median total compensation of the peer CEOs will not equal the sum of all the peer median pay components, because the values are calculated separately for each pay component; the median TC reflects the median of TC of the peer group constituents.

## Problematic Pay Practices/Commitments on Problematic Pay Practices

**57. What is ISS' Problematic Pay Practices evaluation?**

Pay elements that are not directly based on performance are generally evaluated on a CASE-BY-CASE basis considering the context of a company's overall pay program and demonstrated pay for performance philosophy. The list below highlights the problematic practices that carry significant weight in this overall consideration and will likely result in adverse vote recommendations:

- Repricing or replacing of underwater stock options/SARS without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- Excessive perquisites or tax gross-ups, potentially including any gross-up related to a secular trust or restricted stock vesting, and home loss buyouts;
- New or extended executive agreements that provide for:
  - CIC payments exceeding 3 times base salary and average/target/most recent bonus;
  - CIC severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers);
  - CIC payments with excise tax gross-ups (including "modified" gross-ups).

**58. Would an agreement that is automatically extended (e.g., an evergreen feature) but is not modified warrant a negative vote recommendation if it contains a problematic pay practice?**

Automatically renewing/extending agreements (including agreements that do not specify any term) are not considered a best practice, and existence of a problematic practice in such a contract is a concern. However, if an "evergreen" agreement is not materially amended in manner contrary to shareholder interests, it will be evaluated on a holistic basis, considering a company's other compensation practices along with features in the existing agreement.

**59. How does ISS view the modification or extension of an executive's employment agreement when severance and CIC benefits are provided under a separate plan or agreement that runs indefinitely?**

The policy relevant for "new or extended executive agreements" applies to any and all agreements or plans under which the executive whose contract is being modified is covered. In other words, in this case, ISS may view the modification as also being a modification or extension of the executive's severance and/or CIC arrangement.

**60. The policy lists the most problematic practices. What is the full list of pay practices that are considered problematic and may result in a withhold or against recommendation, on a case-by-case basis?**

Based on input from client surveys and roundtables, ISS has identified certain practices that are contrary to a performance-based pay philosophy, which are highlighted in the list below. ISS evaluates these practices on a case-by-case basis, considering the facts and circumstances disclosed, in determining whether any extraordinary perks or benefits are a poor use of company assets which could also have other detrimental effects (e.g., creating or contributing to an "imperial CEO" culture).

- Egregious employment contracts:
  - Contracts containing multi-year guarantees for salary increases, non-performance based bonuses, or equity compensation.
- New CEO with overly generous new-hire package:
  - Excessive "make whole" provisions without sufficient rationale;
  - Any of the problematic pay practices listed in this policy.
- Abnormally large bonus payouts without justifiable performance linkage or proper disclosure:
  - Includes performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance
- Egregious pension/SERP (supplemental executive retirement plan) payouts:
  - Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements
  - Inclusion of performance-based equity or other long-term awards in the pension calculation
- Excessive Perquisites:
  - Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements
  - Extraordinary relocation benefits (including any home loss buyouts)
  - Excessive amounts of perquisites compensation
- Excessive severance and/or change in control provisions:
  - Change in control cash payments exceeding 3 times base salary plus target/average/last paid bonus;
  - New or materially amended arrangements that provide for change-in-control payments without loss of job or substantial diminution of job duties (single-triggered or modified single-triggered, where an executive may voluntarily leave for any reason and still receive the change-in-control severance package);
  - New or materially amended employment or severance agreements that provide for an excise tax gross-up. Modified gross-ups would be treated in the same manner as full gross-ups;
  - Excessive payments upon an executive's termination in connection with performance failure;
  - Liberal change in control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring
- Tax Reimbursements: Excessive reimbursement of income taxes on executive perquisites or other payments (e.g., related to personal use of corporate aircraft, executive life insurance, bonus, restricted stock vesting, secular trusts, etc; see also excise tax gross-ups above)
- Dividends or dividend equivalents paid on unvested performance shares or units.
- Internal pay disparity: Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO)

- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts, option exchanges, and certain voluntary surrender of underwater options where shares surrendered may subsequently be re-granted).
- Other pay practices that may be deemed problematic in a given circumstance but are not covered in the above categories.

**61. How does ISS view hedging or significant pledging of company stock by an executive or director?**

Hedging is a strategy to offset or reduce the risk of price fluctuations for an asset or equity. Stock-based compensation or open market purchases of company stock should serve to align executives' or directors' interests with shareholders. Therefore, hedging of company stock through covered call, collar or other derivative transactions sever the ultimate alignment with shareholders' interests. Any amount of hedging will be considered a problematic practice warranting a negative vote recommendation against appropriate board members. Significant levels of pledging of company stock – regardless of whether the shares were obtained through compensation programs or whether the pledged shares exclude the number of shares required to be held under a company's stock ownership guidelines – also may raise risks for the company's stock price or for violation of insider trading restrictions. Please see the Frequently Asked Questions: Policies & Procedures – Board Accountability for more insight on ISS policy in this regard.

**62. After its most recently completed annual and/or long-term performance cycle ended with no payout (due to failure to achieve goals), a company granted retention awards of cash or equity to executives. How would ISS view such awards?**

Investors do not expect boards to reward executives when performance goals are not achieved, whether by "moving the goalposts" (i.e., lowering goals) or granting other awards to compensate for the absent incentive payouts. They recognize, however, that retention of key talent may be critical to performance improvements and future shareholder value. Companies that grant special retention awards of cash or equity to executives when regular incentive plan goals are not met should provide clear and compelling rationale in their proxy disclosure. Awards of cash should be conservative and reflect the fact that performance is lagging (i.e., should generally be significantly less than unearned target award levels). Optimally, "extra" awards designed to encourage retention should also include performance conditions that will ensure strong alignment of pay and performance going forward and avoid "pay for failure" scenarios if the executive is not retained.

**63. Does the presence of single trigger vesting acceleration in an equity plan result in an automatic against recommendation for the plan, the say on pay vote, the entire compensation committee, or the full board?**

There are no "automatic" negative recommendations under ISS policy. We will consider all relevant aspects included with the company's ultimate disclosure. With regard to equity-based compensation, ISS policy encourages "double trigger" vesting of awards after a CIC (considered best practice).

In the absence of double-triggered vesting, the current preferred practice is for the board to have flexibility to determine the best outcome for shareholders (e.g., to arrange for outstanding grants to be assumed, converted, or substituted), rather than the plan providing for *automatic* accelerated vesting upon a CIC.

Equity plans or arrangements that include a liberal CIC definition (such as a very low buyout threshold or a CIC occurring upon shareholder approval of a transaction, rather than its consummation), coupled with a provision for automatic full vesting upon a CIC, are likely to receive a negative recommendation.

**64. While guaranteed multi-year incentive awards remain problematic, is providing a guaranteed opportunity for what ISS considers a performance-based vehicle acceptable?**

While guaranteeing any executive pay elements (outside of salary and standard benefits) is not considered best practice, the fact that the payout of such an award would ultimately depend on performance attainment (i.e., no payout would occur if performance is below a specified standard), assuming the performance hurdles appear reasonably, robust would generally mitigate concerns about the guaranteed award opportunity.

**65. Are material amendments other than extensions of existing contracts a trigger for analysis with respect to problematic existing contract provisions?**

Shareholders are concerned with the perpetuation of problematic practices; thus, agreements that are extended or new will face the highest scrutiny and weight in ISS' analysis. Material amendments will be considered an opportunity for the board to fix problematic issues, but as part of the holistic analysis.

**66. In 2009, in response to an ISS vote recommendation, a company adopted a policy prohibiting payments of tax gross-ups made on life insurance premiums in new or amended agreements. Certain officers were grandfathered at that time, and they continue to receive such payments. Is that policy, which ISS approved, to no longer be honored by ISS?**

All factors are weighed in the holistic analysis; including existing agreements, commitments, and continuing practices of the company. However, unless the existing contracts are extended, they do not rise to the level of the most problematic practices.

**67. Will commitments entered into in 2010 or prior, before ISS announced its policy not to consider forward-looking commitments for the 2011 Proxy Season, be "grandfathered"?**

Commitments not to enact problematic features in future agreements will no longer mitigate the enacting of problematic pay practices in new or amended agreements during the prior fiscal year.

**68. If a company put excise tax gross-ups in new agreements in the last fiscal year, what action can they take to prevent an against recommendation from ISS?**

The company can remove that provision from the new agreements.

## Frequency of Advisory Vote on Executive Compensation

**69. In the event that a company's board decides not to adopt the say on pay vote frequency supported by a plurality of the votes cast, what are the implications in terms of ISS' voting recommendations at subsequent meetings?**

If the board adopts a longer frequency for say-on-pay votes than approved by a plurality of shareholder votes, ISS will make a case-by-case recommendation, considering the following:

- The board's rationale for choosing a frequency that is different from the frequency which received a plurality;
- The company's ownership structure;
- ISS' analysis of the company's executive compensation and whether there are compensation concerns or a history of problematic compensation practices; and
- The previous year's support level on the company's say-on-pay proposal.

## Advisory Vote on Golden Parachutes (SOGP):

**70. An event has technically triggered a change in control according to the company's formal definition; however the company continues to exist and there is minimal impact on board turnover or management structure. How would ISS apply its SOGP policy in this regard?**

In cases where ISS concludes that a bona-fide change in control event has not occurred (e.g., the company's equity remains outstanding and the board is not significantly affected) ISS views that severance payments or automatic acceleration of outstanding equity awards should not occur. If ISS' policy framework is not applicable due to unusual circumstances, recommendations will generally be made on a case-by-case basis, taking into consideration whether the outcome is beneficial to shareholders.

**71. How would ISS determine that the performance measures would not have been achieved in the absence of the decision to accelerate the performance based awards? If a truncated performance period is used, then how would ISS know whether the performance measures would not have been achieved had no CIC transaction occurred?**

Best practice is pro rata vesting based on current achievement. If it is impossible to measure performance under pre-determined performance criteria the board should justify paying an award as if target or highest performance goals were met.

**72. How does ISS determine whether specified golden parachute payouts are "excessive"?**

In evaluating disclosed payouts related to a change in control with respect to the SOGP proposal, ISS may consider a variety of factors, including the value of the payout on an absolute basis (e.g., relative to an executive's annual compensation) or one or total payouts relative to the transaction's equity value. There are no bright line thresholds for these considerations, since they are made in conjunction with other factors in ISS' review.

**73. How will ISS consider existing problematic change-in-control severance features in its SOGP evaluation?**

Beginning in 2013, ISS will consider existing (as opposed to new in the last year) problematic features such as excise tax gross-up provisions and single and modified single payout triggers in determining a vote recommendation on SOGP proposals. In general, legacy excise tax gross-up provisions will be considered in the context of the amount of actual tax gross-ups reported as part of the company's SOGP disclosure. Legacy single/modified single triggers also may be considered in the context of the total change-in-control payout and whether they result in unjustifiable payouts in the absence of an executive's termination without cause in connection with the change in control.

## Equity Related

### Repricing

**74. Does ISS consider the cancellation and regrant of stock options/SARs as repricing? What about the cancellation of stock options/SARs for cash payments?**

Yes, ISS considers the above two scenarios as repricing and will recommend against the equity plan if the company undertakes such arrangements without shareholder approval.

**75. What progressive action may a company take if it fails to meet the repricing provision policy in equity plans?**

Companies may eliminate the provision that allows the board or the administrator discretion to implement any form of repricing without seeking prior shareholder approval. Alternatively, such provisions can also be explicitly superseded by a statement clarifying that any transaction allowing for an economic value exchange by optionees will require further shareholder approval.

**Sample Language:**

*"Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, distribution (whether in the form of cash, Common Shares, other securities or other property), stock split, extraordinary cash dividend, recapitalization, change in control, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Common Shares or other securities, or similar transaction(s)), the company may not, without obtaining stockholder approval: (a) amend the terms of outstanding Options or SARs to reduce the exercise price of such outstanding Options or SARs; (b) cancel outstanding Options or SARs in exchange for Options or SARs with an exercise price that is less than the exercise price of the original Options or SARs; or (c) cancel outstanding Options or SARs with an exercise price above the current stock price in exchange for cash or other securities."*



**76. With the market rebound, fewer companies are seeking shareholder approval for option exchange programs. If a company were to consider such a program, can you provide additional guidance besides the standard shareholder friendly features, such as value-for-value exchange, exclusion of named executive officers and directors, resetting vesting schedules?**

Option exchange creates a gulf between the interests of shareholders and management, since shareholders cannot reprice their stock. Option exchange should be the last resort for management to use as a tool to re-incentivize employees. Only deep underwater options should be eligible for the program rather than somewhat underwater options, especially if the company's stock is volatile. Using a company's 52-week high as the threshold exercise price may be reasonable in a depressed economy, but it may not be rational in a market rebound. A company's 52-week high may be its current stock price which may suggest that these options are marginally underwater. As a rule of thumb, the threshold exercise price for eligible options should be the higher of the 52-week high or 50 percent above the current stock price. That way, only deep underwater options are eligible for the program. However, this rule of thumb should not be considered in isolation, as there are several other factors, such as the timing of the request and whether the company has experienced a sustained stock price decline that is beyond management's control among others. Further, a company's current stock price can be a consideration as well. A premium of 50 percent for a company trading at \$1 may be a low threshold if the company's stock price is particularly volatile.

A company should discuss the various levels of employees (management versus non-management) who will be eligible participants in the program. Some companies have broad-based option programs whereas others tend to grant to management at the Vice President level. Absent such disclosure, institutional investors may assume that equity grants are generally awarded to management.

**Cost of Equity Plans**

**77. What date does ISS use for the data used in equity plan analysis?**

In order to perform option valuations and generate company-specific allowable caps, ISS downloads company specific data points from an outside vendor. These inputs include the average stock price, stock price volatility, risk-free interest rate, and other market and accounting-based performance factors.

ISS will download the option pricing model inputs for all companies four times per year. The quarterly data download (QDD) occurs on December 1, March 1, June 1, and September 1. The QDD used will depend on the shareholder meeting date for the company as shown below:

Shareholder Meeting Date	Data Download Date
March 1 to May 31	December 1
June 1 to August 31	March 1
September 1 to November 30	June 1
December 1 to February 29	September 1

**78. A company has a May 2014 shareholder meeting and did not start trading until January 2014. ISS would normally use a December QDD for this company but there is no data for this company. What would be ISS' approach in determining the company's stock price in evaluating its equity plan proposal?**

Here is the hierarchy of choices that ISS uses to determine stock price with respect to equity plan proposal evaluations:

1. 200-day avg. stock price as of the applicable QDD;
2. 50-day avg. stock price as of the applicable QDD;
3. Closing stock price as of applicable QDD;
4. If applicable QDD is not available, use most recent QDD 200-day avg stock price;
5. If applicable QDD is not available, use most recent QDD 50-day avg stock price;
6. If applicable QDD is not available, use closing price as of the most recent QDD;
7. Last resort, use current stock price.

**79. How does ISS look at the practice of buying shares on the open market to fund employees' equity grants?**

The practice of repurchasing shares on the open market in order to avoid dilution from employees' equity grants may be beneficial to shareholders if this represents a good use of the company's cash. However, there is still a cost to the company, and we would still capture that cost by our SVT calculation. In an efficient market, the buyback should have a positive impact on the company's stock price. Therefore, it should have a generally neutral effect on market valuation despite the reduction in outstanding shares. In addition, when a buyback is executed, a company immediately receives higher EPS and other share-denominated accounting performance metrics, which in turn may lead to higher allowable cap. With respect to burn-rate calculations, ISS uses the weighted average number of outstanding common shares for the applicable year(s), which smooths out the impact of both share buybacks and share issuances. Adjustments to reduce the voting power dilution may be made if the share repurchase is implemented to offset dilution from stock-based compensation and if such repurchase is made within the past two years.

**80. What is the policy on stock-in-lieu-of-cash plans?**

ISS includes all stock in lieu of cash plans in evaluating the total costs of equity plans. ISS believes that cash or stock payments are considered as compensation to the employees and therefore should be considered in evaluating equity proposals. The total cost of equity-based compensation to directors is also generally considered under the compensation model. However, some stock-based plans do allow directors to take all or a portion of their cash compensation in the form of stock. If such plan provides for a clear dollar-for-dollar stock exchange of the cash compensation, ISS will view the stock in lieu of cash as value neutral for SVT purposes. Any other non-value neutral form of exchange which may include a premium for deferring cash compensation for stock is considered by ISS to cause transfer of shareholder's equity which should still be measured.

**81. A non-REIT company would like ISS to consider its limited partnership (LP) units as part of the company's common shares outstanding when determining market capitalization in the shareholder value transfer analysis and weighted common shares outstanding in the burn rate analysis. Currently, operating partnership (OP) units are included for REIT companies because each OP unit is generally equivalent to one share of common stock and is convertible into common stock. OP units also receive the same dividend payout as common stock.**

ISS applies a case-by-case analysis to determine if a company's convertible equity or debt should be considered as part of common stock outstanding. If the convertible vehicle carries direct voting and dividend rights and may be converted into common stock, then ISS may include such convertible vehicle as part of common stock outstanding. The total number of outstanding convertible vehicle, vested or unvested should be clearly disclosed in the company's proxy statement or 10-K.

**82. A company would like to update the numbers of shares available and outstanding awards due to significant changes that occurred after the end of its last complete fiscal year (the disclosure that ISS relies on in calculating potential equity plan costs). What specific information does ISS require in order to utilize updated numbers?**

In order for ISS to utilize disclosures other than those that are based on the end of the company's last reported fiscal year, ALL information required for our analysis should be disclosed in the proxy statement (or another public filing cited in the proxy statement), all as of the same new date. This includes information normally provided in the 10-K report, including ALL of the following:

1. The number of shares remaining available for future awards, including any impact from fungible counting provisions;
2. The number of shares and stock options underlying outstanding grants and awards, including the weighted average exercise price and remaining term of options;
3. The total number of common shares outstanding as of the same date; and
4. If there are performance-contingent awards, updated values should show the earned/unearned portions.

## Burn Rate Policy

### 83. How does ISS calculate the burn rate and annual stock price volatility?

The annual burn rate is calculated as follows:

Annual Burn rate = (# of options granted + # of full value shares awarded \* Multiplier) / Weighted Average common shares outstanding)

Stock Volatility is based on the 3-year (750-trading day) historical volatility as of the company's quarterly data download, then annualized:

Stock Volatility = Standard Deviation of  $(\ln(P_t/P_{t-1}), \ln(P_{t-1}/P_{t-2}), \dots, \ln(P_{t-749}/P_{t-750}))$

Annualized stock volatility = Stock Volatility X Square Root of 250.

### 84. A company went public two and a half years ago. However, the 10-K discloses three years of historical grant information. Does the burn rate policy apply?

The burn rate policy applies to companies that have been publicly traded for three complete fiscal years. However, ISS will closely scrutinize cases where there is any unusual outsized equity grant made just before the three-year burn rate policy becomes applicable to such companies. Such scrutiny may result in application of the burn rate policy, if appropriate.

### 85. What action may a company take if it fails to meet the three-year average burn rate policy?

A company may commit to a prospective gross three-year average burn rate, which excludes stock options with a reload feature granted prior to 2005, equal to the higher of two percent of the company's common shares outstanding or the mean plus one standard deviation of its GICS peer group. A company's burn rate may exceed the peer group average in the first year, provided the prospective three-year average burn rate remains below the commitment level. The company would need to publicly notify shareholders of its commitment via, e.g., a form 8-K, DEFA14A, or in the summary plan description of the stock plan proposal in the DEF14A. The company would also be required to disclose in its future proxy statements the status of the commitment during the applicable period.

#### Sample Disclosure:

*"The Company commits that, with respect to the number of shares subject to awards granted over the next three fiscal years [period of time], we will maintain an average annual burn rate over that period that does not exceed [x%] of weighted common shares outstanding. For purposes of calculating the number of shares granted in a particular year, all awards will first be converted into option-share equivalents. In this case, each share that is subject to awards other than options will count as equivalent to [current multiplier] option shares."*

Making a commitment does not guarantee a vote change if ISS believes there are concerning flaws that remain in the company's equity plan design. Also, when the plan potentially propagates an egregious compensation practice that was identified, a recommendation against the plan may persist. Note that when a prior burn-rate commitment was modified or has been violated mid-stream, it may warrant a vote against the plan absent justifiable reasons, or in some cases, may result in a recommendation against the compensation committee members.

### 86. What multiplier is used to evaluate whether the company has fulfilled its burn rate commitment?

Most companies, as part of their burn rate commitment, "lock in" the current year's multiplier to reduce uncertainty. If the multiplier is thus specified in the commitment, ISS will use that multiplier. If a company did not lock in the multiplier as part of their burn rate commitment, then ISS uses the multiplier that applies to the company in the year we are analyzing whether they are fulfilling their burn rate commitment.

### 87. Are reload options included in the numerator of the three-year burn rate calculation?

Yes, reload options are included. ISS anticipates that many companies will eliminate reload options since FASB maintained under SFAS 123R that they must be counted as separate grants. However, reload options are excluded in the prospective three-year average burn rate commitment.

**88. Which burn rate policy applies to a company whose GICS classification or Index Membership has been recently changed?**

Presumably, the new classification or index membership will reflect the appropriate operational and revenue size; thus the burn rates that are reasonable for the compensation structure of similar companies under the new classification will apply. In very limited cases, ISS may consider a modified burn-rate commitment.

**89. Does the burn rate policy apply to a company that has been recently acquired?**

Yes. For companies that have been acquired, we would generally use the three-year average burn rate data for the acquirer. For companies that have merged in a merger of equals, we would generally average the three-year average burn rate for both companies.

**90. If a company assumes an acquired company's stock options in connection with a merger, will ISS exclude these stock options in the three-year average burn rate calculation?**

If the company discloses in the option activity table of the 10-K the number of assumed options in connection with the merger, ISS will not include assumed options for that year. However, if the company does not separate the number of assumed options and number of options granted, the assumed options will be included.

This exclusion does not apply to new (inducement, recruitment, retention) equity awards granted following an acquisition, as these have the effect of depleting the available share reserves for compensation purposes.

**91. How many prospective burn rate commitments may a company maintain at one time?**

Shareholders prefer to see clear demonstration that a company is fulfilling a burn rate commitment before accepting a new commitment; thus, consecutive-year commitments will generally not be accepted. In the case of a company that has made multiple overlapping burn-rate commitments, each average burn-rate commitment level is expected to be maintained for the applicable commitment period (i.e., a second burn-rate commitment does not supersede a prior one that is still in effect).

***Note that, beginning with meetings as of Feb. 1, 2014, ISS will no longer consider an additional burn-rate commitment for a company that is still subject to an existing three-year average burn rate commitment.***

**92. What are the implications for a company that is unable to fulfill its burn rate commitment?**

ISS may recommend that shareholders withhold votes from the compensation committee members and is unlikely to accept another burn rate commitment from the company due to the company's failure to fulfill its burn rate commitment made to shareholders previously.

**93. If a company reprices options, how will the shares be counted to avoid double counting?**

If the company discloses the number of repriced options in the option activity table of the 10-K, and the repricing was approved by public shareholders, ISS will not include repriced options for that year. However, if the company does not separate the number of repriced options from number of options granted, the repriced options will be included.

**94. If a company grants performance-based awards, how will the shares be counted to avoid double counting?**

If the company clearly distinguishes the portion of unearned performance-based awards from the year's grants in its proxy statement or 10-K, ISS will not include these in the burn-rate calculation, provided that the company also clearly discloses the number of performance shares that vest each year based on attainment of performance goals. Actual performance-based shares earned, deferred shares earned, or any performance-based equity awards that deplete the share reserve will be counted as they are earned, provided that all disclosure is adequate. In general, time-based awards are counted in the year in which they are granted, and performance-based awards are counted in the year in which they are earned (subject to adequate disclosure practice).

## Liberal Share Recycling

### 95. What is the liberal share recycling policy?

Plans that have liberal share recycling provisions, i.e., where shares granted and exercised can, under certain circumstances, be added back to the plan reserve for future grants, will receive a more costly valuation in that all shares will be evaluated in the ISS model as full-value awards.

### 96. Under what circumstances are shares considered “recycled”?

For purposes of ISS’ liberal share recycling policy, recycled shares may include, but are not limited to, the following:

- Shares tendered as payment for an option exercise;
- Shares withheld from exercised shares for taxes;
- Shares added back that have been repurchased by the company using stock option exercise proceeds;
- Stock-settled SARs where only the actual shares delivered with respect to the award are counted against the plan reserve.

### 97. Are SARs settled in cash considered “recycled”?

In cases where a plan allows SARs to be settled in either cash or stock, ISS will assume all to be stock-settled. If the plan also provides that only the net shares delivered with respect to the award will be counted against the plan reserve, the liberal share recycling policy will be triggered.

### 98. What happens if a company provides a limit on the number of shares that it can recycle?

If there is an articulated limit on full value awards and it is explicit that liberal recycling is only allowed on full value awards, then ISS will apply the limit accordingly as stated. However, if liberal recycling is also permitted on other forms of awards (i.e. options), then ISS will consider that the recycling feature effectively nullifies the stated limit under the plan because of the additional cost attributed to the potential of recycling other types of awards.

## Accelerated Vesting

### 99. What is ISS' view of accelerated vesting of awards upon a change in control?

Absent a liberal definition of a change in control (CIC) – see below -- ISS does not have a specific policy regarding accelerated vesting provisions in an equity plan proposal. However, investors increasingly view full acceleration of equity awards without an accompanying termination of employment to be problematic as it may result in a windfall to the executive, i.e. the executive automatically receives the full economic value of awards that were otherwise intended to be earned over a multi-year period. Such potentially lucrative payouts may serve as a perverse incentive for the executive to pursue certain transactions without consideration of shareholders’ best interests. The acceleration of performance-based awards is more problematic, since it effectively waives both time and performance requirements, further divorcing pay from actual performance.

While executives are not expected for forfeit awards upon a CIC, there are alternatives to single-trigger full acceleration that can retain the original awards’ retentive value and continue to serve pay for performance objectives, including the assumption or conversion to equivalent awards of the acquiror’s equity. Even in an all-cash transaction, an alternative is for unvested time-based equity awards to retain their original vesting schedules, post-conversion to the cash consideration, so that the converted cash awards remain subject to the executive’s continued service (and only accelerate if there is an employment termination in connection with the CIC). Best practice for unvested performance-based equity awards is pro rata vesting, adjusted for actual performance and the fractional performance period, which would appropriately reward for performance actually achieved. The compensation committee can adjust performance goals in good faith to account for the shortened performance period. Once this adjustment is taken into account, the equivalent cash conversion can be made.

## Liberal Definition of Change in Control

### 100. What is the policy on liberal change in control definitions found in equity plans?

ISS may recommend a vote against an equity plan if it could permit accelerated vesting of equity awards based upon a liberal change in control definition (e.g., a trigger linked to shareholder approval of a transaction, rather than its consummation, or an unapproved change in less than a substantial proportion of the board, or acquisition of a low percentage of outstanding common stock, such as 15 percent).

### 101. What progressive action may a company take if its equity plans contain liberal change in control definitions?

A company may qualify the problematic change in control definition to be preconditioned on determinate events that effectively constitute a change in control event, such as "consummation of a transaction" or "constructive loss of employment (double-triggered CIC)."

**Sample language:** *"Change in Control shall be deemed to have occurred...upon the consummation of a merger or consolidation of the Company with any other corporation."*

For an existing plan that is being amended, as opposed to a new plan, it is acceptable to specify that the non-liberal CIC definition is effective for grants made after the plan amendment date.

Examples:

<http://www.sec.gov/Archives/edgar/data/729237/000072923710000012/exhibit1011.htm>

[http://www.sec.gov/Archives/edgar/data/1324948/000114420410046664/v195238\\_ex10-1.htm](http://www.sec.gov/Archives/edgar/data/1324948/000114420410046664/v195238_ex10-1.htm)

## Fungible Plans

### 102. How does ISS evaluate flexible share plans or fungible share pools?

Under a flexible share plan, each full-value award counts more than one share and each option counts as one share of the plan reserve. ISS evaluates the total costs of the plan by analyzing a flexible share plan under two scenarios: (1) all new shares requested as full value awards (2) all new shares requested as stock options. Under the first scenario, ISS adjusts the number reserved according to the ratio provided in the plan document. ISS will support a flexible share plan as long as both scenarios generate total costs below the allowable cap. ISS presents the more costly scenario in our proxy analysis.

## Plan Duration

### 103. How does ISS calculate the probable duration of a proposed equity plan share request?

Probable duration is calculated as:

- New shares requested + Shares remaining available for grant, divided by
- 3-year average unadjusted burn rate, times
- Most recent weighted common shares outstanding.

When the plan has a fungible share counting provision, the duration calculation uses the "all stock option/SARs" scenario. Note that probable duration is not a determining factor in ISS' vote recommendation on equity plans, although a number of ISS' clients consider it in their evaluations under custom policies.

## 162(M) Plans

### **104. A post-IPO company submits an equity plan that has problematic issues (e.g. repricing provisions) for approval by public shareholders for the first time, solely for 162(m) purposes. The company will not be adding shares to the plan or in any way changing any provision in the plan. Will ISS review the plan?**

While ISS generally recommends support for 162(m) plan approvals, all equity plans put up for shareholder approval, for any reason, for the first time following a company's IPO will receive a standard analysis, including SVT calculation and a review of plan features. This is to ensure that any adverse provisions would not have a more detrimental potential impact on shareholders than a potential loss of tax deductions related to named executive officer grants.

## Stock Option Overhang Carve-Out

### **105. When will ISS apply the stock option overhang carve-out policy?**

Companies with sustained positive stock performance and high overhang cost attributable to in-the-money options outstanding in excess of six years may receive a carve-out of these options from overhang as long as the dilution attributable to the new share request is reasonable and the company exhibits sound compensation practices. A company needs to demonstrate that the in-the-money options outstanding in excess of six years have been continuously in-the-money after they were vested. The fact that employees had the opportunity to exercise these options but chose not to exercise them may reflect the confidence they have in the company's future prospects. Presenting in-the-money options in excess of six years is not sufficient information for ISS to determine whether these options were continuously in-the-money after they were vested. Companies are advised to provide the individual tranches of option grants with grant dates, option exercise prices and vesting schedules so that ISS can analyze the portion of in-the-money options to potentially carve out from the overhang.

### **106. In the stock option overhang carve-out policy, what does ISS consider to be sustained positive stock performance?**

ISS generally looks for positive 5-year total shareholder return (TSR) as well as positive year over year performance for the past five fiscal years at the time of the analysis. Exceptions may be made if stock performance was negative for the first two years and then strongly positive for the remaining three years, but vested grants that have been underwater for a substantial time during the 5-year period will not be eligible for the carve-out. These options should be deeply in the money for the periods where the company's stock performance was only high for the latest three years. A comparison of the company's five-year TSR against its four-digit GICS group can be helpful.

### **107. Is ISS making any exceptions to the sustained positive stock performance criteria in light of the financial debacle experienced by almost all companies in 2009?**

ISS recognizes that companies are affected by the global recession and would take that into consideration of the company's stock performance during this tumultuous period. Strong performing companies have experienced significant market rebound and should reflect that the stock price decline is temporary.

### **108. Can ISS provide an example of a company providing such disclosure in order for ISS to carve out continuously in-the-money options outstanding in excess of six years?**

See Myriad Genetics' [DEFA 14A](#) filed Oct. 28, 2009, Air Products and Chemicals' [8K](#) filed Jan. 5, 2010, NVR, Inc.'s [DEF 14A](#) filed March 19, 2010.

### **109. How does ISS define high overhang cost in applying the stock option overhang carve-out policy?**

High overhang cost means that the sum of outstanding options and stock awards and remaining shares available under existing equity plan(s) should exceed or approach the company's specific allowable cap. Outstanding options and stock awards must be a significant driver of the high overhang, and should be in the range of 75 to 100 percent of the total overhang.



**110. What does ISS look for with respect to the distribution of awards to executives vs. other employees (concentration ratio) in the stock option overhang carve-out policy?**

ISS will calculate the concentration ratio in the past fiscal year, defined as total equity grants to the top five executives divided by total equity grants to employees and directors. Concentration ratios greater than 50 percent to named executive officers may be concerning.

***Note: The questions and answers in this FAQ are intended to provide general guidance regarding the way in which ISS' Global Research Department will analyze certain issues in the context of preparing proxy analyses and determining vote recommendations for U.S. companies. However, these responses should not be construed as a guarantee as to how ISS' Global Research Department will apply its benchmark policy in any particular situation.***