U.S. Equity Compensation Plans

Frequently Asked Questions

Updated December 16, 2016

New and materially updated questions are highlighted in yellow

Table of Contents

GENERAL QUESTIONS

1. How does ISS evaluate equity-based compensation programs?

ISS has developed multiple policies for the purpose of evaluating equity-based compensation programs and related proposals that appear on proxy agendas. These evaluations generally take into account one or more of the following aspects, as applicable to the particular proposal:

- The projected cost of the plan, in dollar terms ("shareholder value transfer" or SVT), including in combination with other continuing equity plans and outstanding grants, relative to the company's market and industry peers.
- Various features of the plan.
- The company's historical grant practices, including its average annual burn rate relative to market and industry peers.

As of 2015, employee stock incentive programs are analyzed under the Equity Plan Scorecard (EPSC) policy; stand-alone equity plans for board directors and certain other types of equity-based programs continue to be evaluated under the applicable continuing policies.

2. Which equity compensation proposals are evaluated under the EPSC policy?

Proposals related to the following types of equity-based incentive program proposals will be evaluated under the EPSC policy:

- Approve Stock Option Plan
- Approve Restricted Stock Plan
- Approve Omnibus Stock Plan
- Approve Stock Appreciation Rights Plan (Stock-settled)

In addition, certain plan amendment proposals may be evaluated under the EPSC policy, if the amendment(s) would or could increase the potential expense of the program from shareholders' perspective (e.g., by requesting new shares and/or a plan extension; see FAQ #28 for more details):

- Amend Stock Option Plan
- Amend Restricted Stock Plan
- Amend Omnibus Stock Plan
- Amend Stock Appreciation Rights Plan (Stock-settled)

Other types of equity-based compensation proposals will continue to be evaluated as provided under ISS' policy for Equity-Based and Other Incentive Plans.

Cost of Equity Plans

3. What is Shareholder Value Transfer (SVT)?

SVT refers to an estimate of the value that the company will transfer to its employees and directors via certain equity-based compensation programs, as measured at a given date based on a standard set of inputs. ISS' proprietary compensation model calculates an SVT benchmark for each company -- based on its market cap, industry, and relevant performance metrics relative to peers – which is used in evaluating the company's SVT.

SVT calculations use a combination of third-party data for the option pricing model as well as company-specific data (including outstanding grants and shares remaining for future grants) generally reported in the annual 10-K or proxy filing.

4. What date does ISS use for the data in the equity plan analysis?

In order to perform option valuations and generate company-specific SVT benchmarks, ISS downloads company-specific data points from an outside vendor. These inputs include the 200-day average stock price, stock price volatility, risk-free interest rate, and other market and accounting-based performance factors.

ISS downloads the option pricing model inputs for all companies four times per year. This quarterly data download (QDD) occurs on December 1, March 1, June 1, and September 1. The QDD used for a given analysis 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 28	September 1

5. A company has a May shareholder meeting and did not start trading until January of that year. 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.

6. 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, which would be captured in ISS' SVT calculation. In an efficient market, buybacks should have a positive impact on the company's stock price, resulting in 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 SVT Benchmark for the company.

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 during the year.

7. How is SVT calculated with respect to stock-in-lieu-of-cash plans?

ISS generally 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, if a plan provides for a clear dollar-for-dollar stock exchange of the cash compensation, ISS will generally 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.

8. How does ISS treat evergreen plan funding?

"Evergreen" funding refers to a plan provision for automatic funding additions, typically on an annual basis, over the life of the equity plan. In estimating potential plan cost in these cases, ISS includes a projection of the future share additions based on the disclosed formula – for example, "shares representing 1 percent of outstanding common stock will be added to the plan reserve each year" – since these essentially represent future new share requests that will not require additional shareholder approval when implemented. In most cases, these projections result in a very high plan cost estimate.

9. Does ISS consider 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?

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

10. A company would like to update the numbers of outstanding awards and shares available for future grants 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 must 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, on a per plan basis;
2. The number of full value shares and stock options underlying outstanding grants and awards, disclosed separately and including the weighted average exercise price and remaining term of options; unvested shares issued in lieu of cash compensation should be disclosed separately as well as any awards that will be settled solely in cash;
3. The total number of common shares outstanding as of the same date; and
4. If there are performance-contingent awards, updated values with respect to earned/unearned portions.

11. A company intends to terminate an existing equity compensation plan (canceling any remaining shares reserved for awards under the plan) when shareholders approve a new equity plan at the upcoming annual meeting. What information should be disclosed to ensure that ISS accurately calculates the estimated SVT cost when analyzing the proposed plan?

Normally, ISS counts shares remaining available for future awards (as well as other inputs to the SVT calculation) based on company disclosure of them as of the end of the last fiscal year. If the company does not expect to grant all such shares from its prior approved plan(s) before it is terminated, it should disclose ALL of the following in the 10-K report (or other filing):

1. The number of shares remaining available for future awards, including any impact from fungible counting provisions, *that will no longer be available upon approval of the successor plan*;
2. The number of full value shares and stock options underlying outstanding grants and awards, disclosed separately and 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 with respect to earned/unearned portions.

In addition, the company should include a commitment that no further shares will be granted as awards under such plan(s) unless the proposed plan is not approved by shareholders.

Fungible Plans

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

Under a flexible share plan, each full-value award generally counts as more than one share and each option counts as one share deducted from the plan reserve (or, in some cases, each full-value share awarded counts as one share and each stock option counts as less than one share). 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, with appropriate adjustment of the number reserved according to the ratio provided in the plan document. ISS then utilizes the more costly scenario in our evaluation of the program.

Burn Rate

13. How does ISS consider a company's burn rate in its stock plan evaluations?

ISS uses 3-year average burn rate, as a percentage of weighted average shares outstanding, as a measure of the company's typical annual equity-based grant rate, which is then compared to a benchmark for its industry/index (the "burn rate benchmark," formerly burn rate "cap," calculated as one standard deviation above the 3-year mean burn rate for the peer group). A company's 3-year burn rate relative to that benchmark is a factor in the Equity Plan Scorecard.

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

A company's adjusted annual burn rate is calculated as follows:

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

The "Multiplier" is used to provide more equivalent valuation between stock options and full value shares, based on the company's historical volatility.

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}), … ln (P_{t-749} / P_{t-750}))

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

Note that ISS meeting reports also provide a company's unadjusted average burn rate (without the impact of a multiplier on full-value shares).

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

Yes, reload options are included. Many companies have eliminated reload options since FASB maintained under SFAS 123R that they must be counted as separate grants.

16. Which burn rate calculation applies to a company whose GICS classification or Index membership has recently changed?

Presumably, the new classification or index membership will reflect the appropriate operational and market cap size; thus the burn rates that are reasonable for the compensation structure of similar companies under the new classification will apply.

17. If a company assumes an acquired company's equity awards in connection with a merger, will ISS exclude these awards in the three-year average burn rate calculation?

If the company discloses in the 10-K the number of assumed equity awards in connection with the merger, ISS will not include the assumed awards for that year. However, if the company does not separate the number of assumed awards and number of awards granted, the assumed awards 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.

18. If a company reprices stock 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.

19. If a company grants performance-based awards, how will the shares be counted for the purposes of calculating burn rate?

ISS will count both time- and performance-based awards in the year in which they are granted, unless the company provides tabular disclosure detailing performance-based awards granted and earned in each year for the past three years. Only when there is adequate disclosure of earned awards will ISS count performance-based awards when they are earned.

Adequate disclosure consists of separate tabular disclosure of performance awards, with grants and earned amounts per fiscal year covering the past three fiscal years, in either the company's 10-K or proxy statement. Disclosure of aggregate share totals for all equity awards granted from all plans to all plan participants is required. If a company discloses only the shares earned by the NEOs in the CD&A, ISS will not assume that such figures represent the aggregate.

For performance awards that include a time-vesting period following the performance period, the shares will generally be counted at the end of the time-vesting period. If, however, a company only discloses the shares earned as of the completion of the performance period and not at the end of the time-vesting period, the shares will be counted when earned.

The table below is an example of adequate disclosure:

Performance-Based Awards (Shares / Units)	
	# of Shares/Units
Non-vested at Dec. 31, 2013	
Granted	800,000
Vested [or Earned]	0
Forfeited	0
Non-vested at Dec. 31, 2014	800,000
Granted	0
Vested [or Earned]	400,000
Forfeited	400,000
Non-vested at Dec. 31, 2015	0
Granted	1,000,000
Vested [or Earned]	385,000
Forfeited	115,000
Non-vested at Dec. 31, 2016	500,000

Companies should continue to make the additional disclosure each year after initially providing it, even if there is no equity plan on ballot, in order for ISS to capture performance awards in a similar fashion in subsequent years. Even if performance awards were not granted in any given year or no performance awards vested (either because none were scheduled to vest or because goals were not met), tabular disclosure is required in order to provide a clear view of the year to year status of the performance award program. Although this disclosure may not be required under applicable disclosure rules, it is necessary in order for ISS to use earned amounts for the company's equity compensation burn rate. ISS will generally not engage in calculations to determine earned amounts, even if such calculations may be possible based on the company’s narrative disclosure.

20. Since adoption of the Equity Plan Scorecard policy, ISS no longer considers future burn rate commitments, but what are the implications for companies that made burn rate commitments in prior years to address excessive burn rate under ISS' previous policy?

Companies subject to burn rate commitments made prior to 2015 should adhere to those commitments. In the absence of adherence, ISS may hold the compensation committee accountable.

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

Most companies that made a burn rate commitment "locked in" the then-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 that it is determined whether they are fulfilling their burn rate commitment.

Liberal Share Recycling

22. How does ISS define liberal share recycling?

For purposes of ISS' Equity Plan Scorecard policy, recycled shares may include, but are not limited to, the following:

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

23. Are stock appreciation rights (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 plan will be deemed to allow liberal share recycling.

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

ISS' Equity Plan Scorecard policy includes separate factors related to liberal share recycling – one for full value awards and one for stock options. If the plan permits shares tendered to pay option exercise prices to be re-granted, or counts only the net shares issued under stock option and/or SAR awards, the Liberal Share Recycling-Options factor will be triggered. If the plan additionally, or alternatively, permits shares tendered or withheld to pay taxes upon the vesting or exercise of an award, the Liberal Share Recycling-Full Value Awards factor will be triggered. Also see the Equity Plan Scorecard section below.

Accelerated Vesting

25. How does ISS view accelerated vesting of awards upon a change in control?

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. Potentially lucrative payouts could provide a perverse incentive for the executive to pursue certain transactions without due consideration of shareholders' best interests. The acceleration of performance-based awards is even more problematic, since it effectively waives both time and performance requirements, further divorcing pay from actual performance.

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, if applicable, 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, an equivalent cash conversion can be made.

Treatment of awards upon a change in control is a factor in ISS' Equity Plan Scorecard policy, as in effect for shareholder meetings as Feb. 1, 2016. As further explained in the Equity Plan Scorecard section below, different potential outcomes related to a change in control provided in the equity program lead to specific scores, with provisions only for accelerated vesting of all awards OR for maximum payout of performance-based awards treated most negatively. Further, if the plan provides for potential accelerated vesting of any awards upon a transaction that ISS defines as a "liberal change in control," the plan may receive a negative recommendation regardless of the EPSC score.

Liberal Definition of Change in Control

26. How does ISS define a "liberal change in control" and what is the impact of a plan that contains such a definition?

A liberal change in control definition typically constitutes vesting triggers linked to: shareholder approval of a transaction, rather than its consummation; and/or an unapproved change in less than a majority of the board; and/or acquisition of a low percentage of outstanding common stock, such as less than 20 percent; and/or announcement or commencement of a tender or exchange offer; or any other trigger that could result in windfall compensation without the occurrence of an actual change in control of the company. ISS generally will recommend a vote against an equity plan if it could permit accelerated vesting of equity awards based upon a liberal change in control definition.

27. 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

Plan Amendment Proposals; 162(m) Proposals

28. How does ISS evaluate an equity plan proposal seeking approval of one or more plan amendments?

Equity plan amendment proposals are evaluated on a case-by-case basis.

Plans being amended without a request for additional shares (or other modification deemed to potentially increase cost) will receive a recommendation based on an analysis of the overall impact of the amendments – i.e., whether they are deemed to be overall beneficial or contrary to shareholders' interests. In these cases, the EPSC score will not determine ISS' recommendation, although the EPSC summary and scoring will be displayed for informational purposes.

If (i) the proposed amendments are bundled with a material new share request (or are deemed to potentially increase cost) or (ii) this is the first time shareholders have had an opportunity to opine on the plan, then ISS' recommendation will consider both the EPSC score as well as an analysis of the overall impact of the amendments. However, in these cases, the EPSC score is the more heavily weighted consideration. If the EPSC evaluation results in a passing score, ISS will generally support the proposal, unless the proposed amendments represent a substantial diminishment to shareholders' interests. Conversely, if the EPSC evaluation results in a non-passing score, ISS will generally not support the proposal, unless the proposed amendments represent a substantial enhancement to shareholders' interests.

Proposals seeking only approval to ensure tax deductibility of awards pursuant to Section 162(m) will generally receive a favorable recommendation, subject to certain other requirements. This will not apply, however, if the 162(m)-related proposal is bundled with plan amendments in the same proposal (see FAQs #29 and #30).

29. How are plan proposals that are only seeking approval in order to qualify grants as "performance-based" for purposes of IRC Section 162(m) treated?

Under the US tax code, companies are required to get shareholder approval at least once every five years to qualify incentive awards as "performance-based compensation" that is deductible by the company under Section 162(m). As such, proposals that only seek approval to ensure tax deductibility of awards pursuant to Section 162(m), and that do not seek additional shares for grants or approval of any plan amendments, will generally receive a favorable recommendation regardless of EPSC factors ("positive override"), provided that the board's Compensation Committee or other administrating committee is 100 percent independent according to ISS standards. However, proposals for Section 162(m) approval that represent the first time public shareholders have an opportunity to weigh in on a plan following a company's IPO or spinoff will not be eligible for this positive override.

30. How are proposals that include 162(m) reapproval along with plan amendments evaluated?

All "bundled" plan amendments (i.e., multiple amendments voted under one agenda item) will be analyzed to determine whether they are, on balance, positive or negative with respect to shareholders' interests, and ISS will determine the appropriate evaluative framework and recommendation accordingly. This may result in a recommendation based on consideration of both an EPSC evaluation and/or the balance of positive and negative impacts from the bundled amendments (see FAQ #28). If a company is considering proposing plan amendments in addition to seeking Section 162(m) reapproval, ISS encourages companies to unbundle the plan amendments and present them in a separate proposal. The Section 162(m) positive override will not apply if other plan amendments are bundled into the same proposal.

31. How does ISS evaluate amendments by companies listed in France that are made in response to that market's adoption of the *Loi Macron* (Macron Law)?

The Macron Law adopted in August 2015 introduced changes to the legal requirements and tax treatment for French-qualified restricted stock units (RSUs). Equity plans that are approved by shareholders under this legal framework benefit from a tax advantage and lower employer contribution rates compared to plans under the previous framework. The law also reduces the requirements for minimum vesting and holding periods for RSUs. With respect to U.S. Domestic Issuers (covered by ISS' U.S. policy guidelines) that have stock plans covering French employees affected by the Macron Law, ISS will evaluate proposals seeking qualification under the Macron Law from a U.S. policy perspective on a case-by-case basis, taking into consideration the benefits of the favorable tax treatment as well as the impact of any proposed amendments (i.e. to minimum vesting requirements) on shareholders' interests.

32. How does ISS view a plan amendment to increase the tax withholding rate applicable upon award settlement?

ISS generally views a plan amendment to increase the tax withholding rate as an administrative change neutral to shareholders' interests. However, if the plan in question contains a liberal share recycling feature (see FAQ #22), then the amendment would be viewed negatively since it would exacerbate concerns regarding diminished transparency of share usage inherent to liberal share recycling. However, this concern would be mitigated if the plan stipulates that only the number of shares withheld at the minimum statutory rate may be recycled, even if the tax withholding is at a higher rate.

33. A post-IPO company submits an equity plan 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. How will ISS review the plan?

ISS generally recommends support for all proposals that only seek 162(m) approval, do not increase the share reserve or include bundled amendments, and where the Compensation Committee (or other administrating committee) is fully independent per ISS' definitions. However, if it is the first time the equity plan is put up for shareholder approval, for any reason, for the first time (including following a company's IPO), then the proposal will receive a standard EPSC evaluation, including Plan Cost, Plan Features, and Grant Practices under the Equity Plan Scorecard policy. This is to ensure that public shareholders voting on the plan for the first time are not disadvantaged due to adverse provisions that could have a more detrimental impact than a potential loss of tax deductions related to named executive officer grants.

Non-employee Director Equity Compensation Plans

34. How does ISS' evaluation of stand-alone non-employee director equity compensation plans differ from evaluation of employee plans?

Stand-alone director equity plans are not evaluated under the Equity Plan Scorecard model. Further, the 3-year average burn rate policy does not apply to a non-employee director equity plan, unless the number of equity awards to non-employee directors surpasses the number granted to employees. Therefore, a high three-year average burn rate generally will not result in a vote AGAINST a non-employee director equity plan.

ISS will generally recommend against a non-employee director equity plan that does not expressly prohibit repricing if the company has repriced stock options without shareholder approval in the past and non-employee directors participated in the repricing transaction.

On occasion, non-employee director equity plans that set aside a relatively small number of shares exceed ISS' SVT benchmark when combined with employee or executive equity compensation plans. In such cases, ISS supplements the analysis with a qualitative review of board compensation to determine whether the plan, in combination with total compensation for outside directors, is beneficial to shareholders' interests.

EQUITY PLAN SCORECARD (EPSC)

General Questions

35. How does ISS' Equity Plan Scorecard work?

The EPSC considers a range of positive and negative factors, rather than a series of "pass/fail" tests, to evaluate equity incentive plan proposals. Factors are grouped under three "pillars": Plan Cost, Plan Features, and Grant Practices. Each factor has a maximum potential score (i.e., weighting), with 53 out of a maximum 100 total potential points required to "pass" the EPSC model.

The policy in effect for shareholder meetings as of Feb. 1, 2016 will continue to result in negative recommendations for plan proposals that feature certain egregious characteristics (such as authority to reprice stock options without shareholder approval). In general, however, a company's total EPSC score -- considering the proposed plan and certain grant practices relative to applicable factors -- will determine whether a "For" or "Against" recommendation is warranted.

36. What changes were made to the EPSC policy for 2017?

The basic EPSC policy has not changed, but effective for meetings as of Feb. 1, 2017, the following adjustments will apply to EPSC evaluations:

- A new factor was added to the Plan Features pillar. The factor evaluates the payment of dividends on unvested awards. Full points will be earned if the equity plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award (however, accrual of dividends payable upon vesting is acceptable). No points will be earned if this prohibition is absent or incomplete (i.e. not applicable to all award types). A company's general practice (not enumerated in the plan document) of not paying dividends until vesting will not suffice.
- The minimum vesting factor is updated so that full points are awarded only if the equity plan specifies a minimum vesting period of one year for *all* equity awards. Also, no points will be earned if the plan allows for the administrator, through individual award agreements or other mechanisms, to reduce or eliminate the one-year vesting requirement beyond the allowable carve-out. As in previous years, the minimum vesting restriction must apply to at least 95% of all equity awards granted under the plan to receive credit (allowing a 5% “carve-out”).
- For companies with between 33 and 36 months of trading history at the applicable QDD date, the EPSC model index will be based on whether the company has disclosed three years of burn rate data. Companies with 32 or fewer months of trading history at the applicable QDD date will continue to be evaluated under the Special Cases models. See FAQs #37, 38 and 41 for further details about the EPSC models.
- Additionally, certain factor scores have been adjusted, per ISS' proprietary scoring model. The maximum of 100 total points and threshold of 53 points to receive a favorable recommendation (absent egregious factors) are unchanged.

37. Are all covered plans subject to the same EPSC factors and weightings?

No. For meetings as of Feb. 1, 2016, EPSC factors and weightings are keyed to five models related to company size and status: S&P 500; Russell 3000 index (excluding S&P 500 companies); Non–Russell 3000; and Special Cases (recent IPOs, spinoffs, and bankruptcy emergent companies that do not disclose at least three years of grant data) for each of two groups: Russell 3000 / S&P 500, and non–Russell 3000 companies. Each model uses a combination of Plan Cost, Plan Features, and Grant Practices factors that are relevant for the coverage group.

38. How do the EPSC models differ?

Effective for shareholder meetings as of Feb. 1, 2016, there are five EPSC models, based on the type and status of the company being evaluated. The chart below summarizes the pillar (and applicable scores) for each model.

Maximum Scores by EPSC Model and Pillars

<table>
<tr><th>Pillar</th><th>Model</th><th>Maximum Pillar Score</th><th>Comments</th></tr>
<tr><td rowspan="3">Plan Cost</td><td>S&P 500, Russell 3000, Non–Russell 3000</td><td>45</td><td rowspan="3">All models include the same Plan Cost factors</td></tr>
<tr><td>Special Cases – Russell 3000 / S&P 500*</td><td>50</td></tr>
<tr><td>Special Cases – non–Russell 3000*</td><td>60</td></tr>
<tr><td rowspan="4">Plan Features</td><td>S&P 500, Russell 3000</td><td>20</td><td rowspan="4">All models include the same Plan Features factors</td></tr>
<tr><td>Non-Russell 3000</td><td>30</td></tr>
<tr><td>Special Cases – non–Russell 3000*</td><td>35</td></tr>
<tr><td>Special Cases – non–Russell 3000*</td><td>40</td></tr>
<tr><td rowspan="4">Grant Practices</td><td>S&P 500, Russell 3000</td><td>35</td><td rowspan="4">The Non–Russell 3000 model includes only Burn Rate and Duration factors. The Special Cases model for Russell 3000 / S&P 500 firms includes all Grant Practices factors except Burn Rate and Duration. The Special Cases model for non–Russell 3000 companies does not include any Grant Practices factors.</td></tr>
<tr><td>Non-Russell 3000</td><td>25</td></tr>
<tr><td>Special Cases – non–Russell 3000*</td><td>15</td></tr>
<tr><td>Special Cases – non–Russell 3000*</td><td>0</td></tr>
</table>

*Generally covers companies that recently had their IPO, were spun off, or emerged from bankruptcy that do not disclose 3 years of grant data.

39. How many EPSC points are required to receive a positive recommendation?

A score of 53 or higher (out of a total 100 possible points) generally results in a positive recommendation for the proposal (absent any overriding factors).

40. How are non-employee director plans treated when another equity plan is on ballot?

The EPSC model is not used for stand-alone non-employee director plans that are on the ballot (although they will receive a standard cost evaluation for Shareholder Value Transfer (SVT) and burn rate). In these cases, positive or negative features of the stand-alone non-employee director plan will only impact that plan's evaluation, which continues ISS' historical case-by-case approach to stand-alone non-employee director plan evaluations. However, when a proposal enumerated in FAQ #2 is on the ballot, the shares available for grant under a non-employee director plan will be incorporated into the Plan Cost evaluation of the EPSC policy.

41. How will equity plan proposals at newly public companies be evaluated?

Recent IPOs, spinoffs, and bankruptcy-emergent companies may be evaluated under an EPSC model that includes fewer factors. As under prior policy, neither the burn rate nor duration factors apply for companies that have less than three years of disclosed grant data. Generally, the Special Cases models will be used in the following two cases: 1) the subject company has less than or equal to 32 months of trading history as of the applicable QDD date; or 2) the subject company has between 33 and 36 months of trading history and there is less than three years of burn rate data.

Factor-Related Questions

42. What factors are considered in the EPSC, and why?

EPSC factors fall under three categories ("pillars") in each EPSC model:

Plan Cost*:* This pillar considers the potential cost of the transfer of equity from shareholders to employees, which is a key consideration for investors who want equity to be used as efficiently as possible to motivate and reward employees. The EPSC considers the total potential cost of the company’s equity plans relative to industry/market cap peers, measured by Shareholder Value Transfer (SVT).

SVT represents the estimated cost of shares issued under a company's equity incentive plans, differentiating between full value shares and stock options where applicable. ISS' proprietary SVT model determines SVT benchmarks (expressed as a percentage of the company's market capitalization) based on regression equations that take into account a company's market cap, industry, and performance indicators with the strongest correlation to long-term performance. The EPSC measures a company's SVT relative to two benchmark calculations that consider:

- New shares requested plus shares remaining for future grants (from all active plans), plus outstanding unvested/unexercised grants; and
- Only new shares requested plus shares remaining for future grants (from all active plans).

The second measure reduces the impact of grant overhang on the overall cost evaluation, recognizing that high grant overhang is a sunk, expensed cost and also may reflect long-term positive stock performance, long vesting periods for grants, and/or employee confidence in future stock performance.

Plan Features: Based on investor and broader market feedback, the following factors may have a negative impact on EPSC results:

- *Equity award vesting upon a change in control,* depending on whether or not windfall compensation would be automatically provided upon a CIC, or other options (e.g., conversion or assumption of existing grants) are available;
- *Broad discretionary vesting authority* that may result in "pay for failure" or other scenarios contrary to a pay-for-performance philosophy;
- *Liberal share recycling* on various award types, which obscures transparency about share usage and total plan cost;
- *Absence of a minimum required vesting period (at least one year)* for equity award types issuable under the plan, which may result in awards with no retention or performance incentives; and
- *The ability to pay dividends prior to the vesting of the underlying award.*

Grant Practices: Based on market feedback and analysis of long-standing (and some emerging) techniques, the following factors may have a positive impact on EPSC results, depending on the company's size and circumstances:

- *The company's 3-year average burn rate relative to its industry and index peers* – this measure of average grant "flow" provides an additional check on plan cost per SVT (which measures cost at one point in time). The EPSC compares a company's burn rate relative to its index and industry (GICS groupings for S&P 500, Russell 3000 (ex-S&P 500), and non-Russell 3000 companies).
- *Vesting schedule(s) under the CEO's most recent equity grants* during the prior three years – vesting periods that incentivize long-term retention are beneficial.
- *The plan's estimated duration*, based on the sum of shares remaining available and the new shares requested, divided by the 3-year annual average of burn rate shares – given that a company's circumstances may change over time, shareholders may prefer that companies limit share requests to an amount estimated to be needed over no more than five to six years.
- *The proportion of the CEO's most recent equity grants/awards subject to performance conditions* – given that stock prices may be significantly influenced by market trends, making a substantial proportion of top executives' equity awards subject to specific performance conditions is an emerging best practice, particularly for large cap, mature companies.
- *A clawback policy that includes equity grants* – clawback policies are seen as potentially mitigating excessive risk-taking that certain compensation may incentivize, including large equity grants.
- *Post-exercise/post-vesting shareholding requirements* – equity-based incentives are intended to help align the interests of management and shareholders and enhance long-term value, which may be undermined if executives may immediately dispose of all or most of the shares received.

43. Are the factors binary? Are they weighted equally?

EPSC factors are not equally weighted. Each factor is assigned a maximum number of potential points, which may vary by model. Some are binary, but others may generate partial points or, in some cases, negative points. For all models, the total maximum points that may be accrued is 100. The passing score is 53 in all cases, i.e., slightly more than half of the potential maximum factor scores. The chart below summarizes the scoring basis for each factor.

EPSC Factors & Point Allocation System

Factor	Definition	Scoring Basis
SVT – A+B+C Shares	Company's Shareholder Value Transfer (SVT) relative to peers – based on new shares requested + shares remaining available + outstanding grants and awards	Scaled depending on company SVT versus ISS' SVT benchmarks
SVT – A+B Shares	Company's Shareholder Value Transfer (SVT) relative to peers – based on new shares requested + shares remaining available	Scaled as above
CIC Equity Vesting	Vesting/Payout provisions for outstanding awards upon a change in control	Full points for: • Time-based awards: no acceleration or accelerate if not assumed/converted, AND • Performance-based awards: no acceleration, forfeited/terminated, or vesting that is adjusted for actual performance and/or the fractional performance period ("pro rata") No points for: automatic acceleration of time-based equity or above-target vesting of performance awards. Half of full points for: other provisions.
Liberal Share Recycling – FV	Certain shares not issued (or tendered to the company) related to full value share vesting may be re-granted	Yes – no points No – full points
Liberal Share Recycling – Options	Certain shares not issued (or tendered to the company) related to option or SAR exercises or tax withholding obligations may be re-granted; or, only shares ultimately issued pursuant to grants of SARs count against the plan's share reserve, rather than the SARs originally granted	Yes – no points No – full points
Minimum Vesting Requirement	Does the plan stipulate a minimum vesting period of at least one year for all equity award types?	No or vesting period < 1 year – no points Vesting period =/> 1 year – full points No points if the plan allows for individual award agreements or other mechanisms to reduce or eliminate the minimum vesting requirement.

Factor	Definition	Scoring Basis
Full Discretion to Accelerate (non-CIC)	May the plan administrator accelerate vesting of an award (unrelated to a CIC, death, or disability)	Yes – no points No – full points
Dividends Paid on Unvested Awards	Does the plan expressly prohibit the payment of dividends on unvested awards for all award types?	Yes—full points No—no points
3-Year Average Burn Rate	Company's 3-year average burn rate (as a percentage of common shares outstanding) relative to industry and index peers	Scaled depending on company's burn rate versus ISS benchmarks
Estimated Plan Duration	Estimated time that the proposed share reserve (new shares plus existing reserve) will last, based on company's 3-year average burn rate activity	Duration <= 5 years – full points Duration >5 and <= 6 years – ½ of full points; Duration > 6 years – no points
CEO's Grant Vesting Period	Period required for full vesting of the most recent equity awards (stock options, restricted shares, performance shares) received by the CEO within the prior 3 years. Performance awards are considered separately from time-vesting awards.	Vesting Period > 4 years – full points; Vesting Period >= 3 years and <= 4 – ½ of full points; Vesting Period < 3 years – no points; No points for: no performance awards granted in the prior 3 years; ½ of full points for: no time-based options and restricted shares granted in the prior 3 years
CEO's Proportion of Performance-Conditioned Awards	Proportion of the CEO's most recent fiscal year equity awards (with a 3-year look-back) that is conditioned on achievement of a disclosed goal	50% or more – full points; 33% < 50% – ½ of full points; < 33% – no points
Clawback Policy	Does the company have a policy that would authorize recovery of gains from all or most equity awards in the event of certain financial restatements?	Yes – full points No – no points
Holding Period	Does the company require shares received from grants under the plan to be held for a specified period following their vesting/exercise?	At least 36 months or until end of employment – full points; Less than 36 months or until share ownership guidelines met – ½ of full points; No holding period/silent – no points

44. Which factors, on a stand-alone basis, will result in a negative recommendation on an equity plan proposal, regardless of the score from all other EPSC factors?

The following egregious features will continue to result in an “Against” recommendation, regardless of other EPSC factors ("Overriding Factors"):

› A liberal change-of-control definition (including, for example, shareholder approval of a merger or other transaction rather than its consummation) that could result in vesting of awards by any trigger other than a full double trigger;

- If the plan would permit repricing or cash buyout of underwater options or SARs without shareholder approval (either by expressly permitting it – for NYSE and Nasdaq listed companies -- or by not prohibiting it when the company has a history of repricing – for non-listed companies);
- If the plan is a vehicle for problematic pay practices or a pay-for-performance misalignment (see below for more information); or
- If any other plan features or company practices are deemed detrimental to shareholder interests; such features may include, on a case-by-case basis, tax gross-ups related to plan awards or provision for reload options (though not the granting of reload options under a plan previously approved by shareholders).

45. When may a pay-for-performance misalignment have an adverse recommendation implication for the equity plan proposal?

ISS may recommend a vote against the equity plan proposal if the plan is determined to be a vehicle for pay-for-performance misalignment. This determination is case-by-case and considerations include, but are not limited to:

- Severity of the pay-for-performance misalignment;
- Whether problematic equity grant practices are driving the misalignment; and
- Whether equity plan awards have been heavily concentrated to the CEO and/or the other NEOs (as opposed to the plan being considered broad-based).

In determining whether the equity plan is broad-based, ISS examines the three-year average concentration ratio for equity awards made to the CEO and other NEOs. If the average concentration ratio exceeds 30% for the CEO (or 60% for all NEOs, including the CEO), this would indicate that the plan is not broad-based.

46. How do the SVT factors work in the EPSC model?

SVT is calculated the same as under prior ISS policies (see Plan Cost for additional information), except that there are now two SVT measures:

1) One includes the new share request ("A shares" in ISS' internal parlance) plus all shares that remain available for issuance ("B shares") plus unexercised/unvested outstanding awards ("C shares").
2) The second includes only A shares and B shares, excluding C shares.

EPSC points allocated for each SVT factor are based on the relationship of the company's SVT measures (ABC and AB) to their respective ISS benchmarks. The ISS benchmark SVT is based on regression analysis for the company's GICS industry group, market cap size, and operational and financial metrics identified as correlated with total shareholder return performance in the industry. Maximum potential EPSC points are accrued for proposals with total costs at or less than approximately 65 percent of the ISS benchmark SVT (which is equivalent to the SVT "Allowable Cap" under prior policy). SVT in excess of the ISS benchmark may result in negative points.

47. How does ISS assess a plan's minimum vesting requirement for EPSC purposes?

In order to receive EPSC points for a minimum vesting requirement, the plan should mandate a vesting period of at least one year for all equity award types issuable under the plan, which applies to no less than 95 percent of the shares authorized for grant. Exceptions beyond this 5 percent will prevent a company from receiving credit on this factor. No points are awarded if the minimum vesting requirement does not apply to all equity award types, or if the plan allows for individual award agreements or other mechanisms to reduce or eliminate the requirement.

48. How does ISS determine the treatment of performance-based awards that may vest upon a change in control?

If a plan would permit accelerated vesting of performance awards upon a change in control (either automatically, at the board's discretion, or only if they are not assumed), ISS will consider whether the amount of the performance award that would be payable/vested is (a) at target level, (b) above target level, (c) based on actual performance as of the CIC date and/or prorated based on the time elapsed in the performance period as of the CIC date, or (d) based on board discretion.

49. How does ISS determine the proportion of CEO equity awards that is considered performance-based?

The proportion of the CEO's equity grants deemed to be "performance conditioned" is based on the ISS valuation of awards reported in the Grants of Plan-Based Awards table (i.e., the target number of shares times the closing price of company stock on the grant date). Time-vesting stock options and SARs are not considered performance conditioned unless the vesting or value received depends on attainment of specified performance goals, or if ISS determines that the exercise price is at a substantial and meaningful premium to the grant date fair market value. Grants in the most recent of the last three completed fiscal years are considered for this purpose.

50. How does the burn rate factor work in the EPSC?

ISS calculates burn rate benchmarks for specific industry groupings in three index categories: S&P500; Russell 3000 (excluding S&P 500); and Non–Russell 3000. For each index, these benchmarks reflect each 4-digit GICS industry group's 3-year mean burn rate plus one standard deviation (with a floor for the benchmark of 2.00 percent). Scoring for the Burn Rate factor is scaled according to the company's 3-year average annual burn rate relative to its applicable index/industry benchmark; maximum EPSC points for this factor are accrued when the company's 3-year average burn rate is at or below 50 percent of the benchmark. Burn rate in excess of the benchmark may result in negative points.

51. Is there still a 2% de minimis burn rate?

The minimum burn rate benchmark for each index/industry group will be 2 percent.

52. How is plan duration calculated under the EPSC?

Duration is calculated as the sum of all new shares requested plus shares remaining available for issuance, divided by the average annual burn rate shares over the prior three years. This calculation yields an estimate of how long the company's requested total reserve is expected to last.

If a company's proposed plan has a fungible share design (where full value awards count against the share reserve at a higher rate than appreciation awards), the proportion of the burn rate shares that are full-value awards will be multiplied by that fungible ratio in order to estimate the plan's duration. Under the EPSC, maximum points are accrued for plan duration of five years or less.

Other Questions

53. Will ISS continue to potentially "carve out" a company's option overhang in certain circumstances?

No. The dual SVT measurement approach in the EPSC (which considers SVT that excludes the impact of grant overhang) eliminates the need for a carve-out of long-term outstanding option overhang.

54. How does the EPSC operate if multiple equity plans are on the ballot?

When approval is sought for multiple equity plans, the Scorecard will evaluate the plans as follows:

- The Plan Cost pillar will consider the cost of all plans on the ballot in aggregate. The Plan Features and Grant Practices pillars will evaluate the factors based on the "worst" scenarios among the plans. If an acceptable score is generated on the aggregate basis, all plans will be considered passed (absent overriding factors).

- If the score on an aggregate basis is lower than the passing threshold, then the following logic will apply, subject to the overriding factors:
  - If each plan's individual EPSC score is below the EPSC threshold, then each plan fails.
  - If only one plan's individual EPSC score is equal to or exceeds the threshold, then that plan will pass and the other plan(s) fail.
  - If all plans' individual EPSC scores are equal to or exceed the threshold, then the plan with the highest SVT cost (on an A/B/C basis) will pass and the other plan(s) fail.

55. What action may a company take if its three-year average burn rate exceeds ISS' burn rate benchmark under the Equity Plan Scorecard policy?

Under the EPSC policy, three-year burn rate is considered along with other factors in evaluating a company's equity plan proposal. If a company's three-year average burn rate exceeds 50 percent of its burn rate benchmark (former burn rate "cap") fewer than the maximum possible points for that factor (including, potentially, negative points) will accrue in the EPSC model; the company may adopt relevant positive plan features and/or other grant practices that may compensate for the burn rate short-fall.

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.

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