U.S. Compensation Policies

Preliminary Frequently Asked Questions

November 2017

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Introduction

Each year, ISS publishes Frequently Asked Question (FAQ) documents and a methodological whitepaper designed to help all stakeholders understand upcoming changes to ISS compensation-related methodologies. As in prior years, those documents will be published in mid-December 2017.

This year, ISS has received several questions regarding upcoming changes to the quantitative pay-for-performance screening methodology and the Equity Plan Scorecard. In advance of more detailed information to be provided in the comprehensive updates to the FAQs and whitepaper, the following Preliminary FAQs address some of the most commonly received questions to date.

U.S. Quantitative Pay-for-Performance Screens

1. Will any of the quantitative pay-for-performance screen thresholds change for 2018?

Yes. Effective for annual meetings on or after February 1, 2018, the threshold for a medium level of concern on the Multiple Of Median (MOM) quantitative screen for S&P 500 constituents covered by ISS U.S. policy will change from 2.33 to 2.00.

ISS does not expect to make any other changes to medium or high thresholds for U.S. companies other than the medium threshold for the MOM test for S&P 500 constituents only. The high level of concern threshold for the S&P 500 will remain at 3.33, the same as other companies covered by the U.S. pay-for-performance quantitative screening methodology. All other quantitative test thresholds are expected to remain constant for 2018.

2. Will there be any changes to the way in which Total Shareholder Return will be calculated for 2018?

Yes. To reduce the impact of point-in-time stock price fluctuations in the calculation of Total Shareholder Return (TSR), ISS will smooth both beginning-of-period and end-of-period stock prices for the purpose of calculating TSR by averaging the beginning and ending stock price for the month closest to the fiscal year end of a company. The impact of dividends and stock splits occurring during the averaging period will be factored into the calculation of TSR.

If a company’s fiscal year end is on/after the 15th of the month, then that monthly average will be used; otherwise, the monthly average for the prior month will be used.

3. How will the new Financial Performance Assessment (FPA) test affect ISS’ quantitative pay-for-performance screen?

The Financial Performance Assessment (FPA) test will be added to the quantitative pay-for-performance screen and applied as a secondary measure after the traditional three screens (Multiple of Median, Relative Degree of Alignment, and Pay-TSR Alignment) have been calculated. The FPA test will be used to identify certain companies that resulted in a “medium” level of concern on the primary screens, but had relatively strong fundamental financial performance, and may reduce the final level of quantitative concern to "low."

Conversely, the secondary FPA test may identify certain companies that otherwise received a "low" level of concern but had relatively weak fundamental financial performance; in those cases, the company's final level of quantitative concern may be increased to "medium."

4. What metrics will be used in the FPA for each industry?

Based on extensive back-testing, the FPA test will select and weigh metrics slightly differently in each industry. Most industries will use four metrics, but for a small number of industries, three will be used.

The following table lists the metrics used in the calculation of FPA for each industry. The weighting or prioritization of any metric should not be interpreted as ISS' suggestion that a particular metric – or combination of metrics – should be used to form the foundation of any individual company's compensation program.

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

4530	Semiconductors & Semiconductor Equipment	ROIC	ROA	ROE	Operating Cash Flow Growth
5010	Telecommunication Services	ROA	ROE	ROIC	EBITDA Growth
5510	Utilities	ROIC	ROA	ROE	EBITDA Growth
6010	Real Estate	ROIC	ROA	ROE	Operating Cash Flow Growth

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

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

U.S. Equity Plan Scorecard (EPSC)

The below is not an exhaustive list of updates to the Equity Plan Scorecard methodology for 2018. Rather, the answers to these questions may be useful in understanding some of the more significant changes to Equity Plan Scorecard for annual meetings on or after February 1, 2018. Refer to the full FAQ documents, to be released in mid-December, for more information.

5. Will the passing score for U.S. Equity Plan Scorecard (EPSC) change?

Yes, but only for companies subject to the S&P 500 scoring model. For the 2018 policy year, the passing score for the S&P 500 Equity Plan Scorecard (EPSC) model will increase to 55 points. For all other EPSC models, the passing score will remain 53 points.

6. Are there any changes to the Change in Control Vesting factor within EPSC?

Yes. This factor will be simplified for the 2018 policy year, with opportunities for companies to earn either full or no credit. Full credit will be earned in situations where the company's equity plan contains both of the following provisions:

- For performance-based awards, acceleration is limited to actual performance achieved, pro-rata of target based on the elapsed proportion of the performance period, a combination of both actual & pro-rata, or the performance awards are forfeited or terminated upon a change in control. In cases where there are no performance-based awards, points for this factor will be based solely on the treatment of time-based awards.
- For time-based awards, acceleration upon a change in control cannot be automatic single-trigger or discretionary.

In all other cases, companies will not receive credit on this factor.

7. Are there any changes to the Holding Requirement factor within EPSC?

Yes. This factor will be simplified for the 2018 policy year, with opportunities for companies to earn either full or no credit. The threshold for receiving full credit on this factor will change from a 36 month holding period to a 12 month holding period (or, as before, holding through the end of employment). A holding period of less than 12 months will result in no credit. Companies with holding periods that apply only until ownership guidelines are met will not receive credit on this factor.

8. Are there any changes to the CEO Vesting Requirement factors within EPSC?

Yes. The EPSC contains three CEO vesting-related factors, one each for time-based options, time-based restricted stock, and performance-based equity compensation. These factors will be simplified for the 2018 policy year, with opportunities for companies to earn either full or no credit. The threshold for receiving full credit on all three of these factors will decrease from greater than four years to having a vesting requirement of at least three years from the date of grant until all shares from the award vest.

9. Are there any changes to the Broad Discretion to Accelerate Vesting factor within EPSC?

Yes. Full credit on this factor will only be given for discretion being limited to accelerate awards in the cases of death and disability only. Notably, authority to accelerate awards in the case of a change in control will not receive credit under this factor.

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