2016 U.S. Equity Plan Scorecard

Frequently Asked Questions

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EQUITY PLAN SCORECARD (EPSC)

General Questions

1. How was ISS' scorecard approach for evaluating equity compensation proposals developed?

The Equity Plan Scorecard (EPSC) policy allows more nuanced consideration of equity incentive programs, which are critical for motivating and aligning the interests of key employees with shareholders, but which also fuel the lion's share of executive pay and may be costly without providing superior benefits to shareholders. While most plan proposals pass, they tend to get broader and deeper opposition than, for example, say-on-pay proposals (e.g., only 57 percent of Russell 3000 equity plan proposals garnered support of 90 percent or more of votes cast in 2015 and as of this publication, compared with 78 percent of say-on-pay proposals that received that support level during the same period). The voting patterns indicate that most investors aren't fully satisfied with many plans.

ISS' EPSC policy is rooted in several years of feedback from clients as well as issuers indicating that, while a proposal's estimated cost to shareholders is important, other factors warrant some consideration in voting decisions on equity proposals. A majority of investor participants in ISS' 2012 policy survey, for example, indicated that factors such as low average burn rates, double triggered change-in-control vesting, reasonable plan duration, and robust vesting requirements should be either somewhat or very much considered in equity proposal evaluations, and a majority of issuer participants also favored consideration of reasonable plan duration and low relative burn rates, as well as long-term TSR performance. In the 2014 ISS policy survey, 75 percent of investor respondents indicated that performance conditions on awards should be "very significant" when weighing factors in a holistic approach to equity plan evaluation. More than 50 percent mentioned other features, such as minimum vesting requirements and repricing authority as "very significant," while a majority also cited plan cost and burn rates as important. Both issuers and investors who submitted comments during ISS' 2014 Policy Consultation period also expressed support for a proposed "scorecard" approach to the evaluation. And participants in ISS' 2014 Compensation Roundtable voiced similar support, citing estimated plan duration as an important factor and also agreeing that separate scoring models for different size companies would be appropriate.

In the course of developing the new model, ISS conducted regression analysis to identify factors with measurable correlation to superior or lagging long-term shareholder return performance; certain factors, including burn rate and repricing authority, showed significant association with performance over time. Finally, ISS conducted extensive back-testing of prototype scorecards for various index groups, which guided development of four models that reflect a combination of all of the above input, feedback, and testing. These models are not designed or intended to change the general mix of ISS recommendations, although the vote recommendation for a particular plan may differ from those under prior policy in some cases.

2. 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, also 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). Additionally, in cases where a proposal will not increase plan cost, and positive aspects or changes being made outweigh any negative amendments, ISS may recommend that shareholders support the plan regardless of the EPSC score. 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.

3. What specific changes were made to the EPSC policy for 2016?

The basic EPSC policy has not changed, but effective for meetings as of Feb. 1, 2016, the following adjustments will apply to EPSC evaluations:

- The "IPO" model is re-named "Special Cases," to analyze companies with less than three years of disclosed equity grant data (generally, IPOs and bankruptcy emergent companies).
- In addition, a new Special Cases model that includes Grant Practice factors other than Burn Rate and Duration will apply to Russell 3000/S&P 500 companies. Maximum pillar scores for this model are as follows:
  - Plan Cost: 50
  - Plan Features: 35
  - Grant Practices: 15
- The Plan Features factor "Automatic Single-Trigger Vesting" is renamed "CIC Vesting," with the following scoring levels:
  - Full points if plan provides for: with respect to outstanding time-based awards, either no accelerated vesting or accelerated vesting only if awards are not assumed/converted; AND with respect to performance-based awards, either forfeiture or termination of outstanding awards or vesting based on actual performance as of the CIC and/or on a pro-rata basis for time elapsed in ongoing performance period(s).
  - No points if plan provides for: automatic accelerated vesting of time-based awards OR payout of performance-based awards above target level.
  - Half points if plan provides for any other vesting terms related to a CIC.
- The period required for full points with respect to the Post-Vesting/Exercise Holding Period Plan Feature is 36 months (versus 12 months previously) or until employment termination; half of full points will accrue for a holding period of 12 months.
- 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. See FAQ #11 for a summary of all scoring.

4. Which types of equity compensation proposals will be 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
- Amend Stock Option Plan
- Approve Restricted Stock Plan
- Amend Restricted Stock Plan
- Approve Omnibus Stock Plan
- Amend Omnibus Stock Plan
- Approve Stock Appreciation Rights Plan (Stock-settled)
- 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.

5. 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 or bankruptcy emergent companies, or any company that does not disclose at least three years of grant data) for each of two groups: Russell 3000/S&P500 and non-Russell companies. Each model uses a combination of Plan Cost, Plan Feature, and Grant Practices factors that are relevant for the coverage group.

6. 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

Pillar	Model	Maximum Pillar Score	Comments
Plan Cost	S&P 500, Russell 3000, Non-Russell 3000	45	All models include the same Plan Cost factors
	Special Cases-Russell 3000/S&P500*	50	
	Special Cases-non-Russell	60	
Plan Features	S&P 500, Russell 3000	20	All models include the same Plan Features factors
	Non-Russell 3000,	30	

Pillar	Model	Maximum Pillar Score	Comments
	Special Cases-Russell 3000/S&P500*	35	
	Special Cases-non-Russell*	40	
Grant Practices	S&P 500, Russell 3000	35	The Non-Russell 3000 model includes only Burn Rate and Duration factors. The Special Cases model for Russell 3000/S&P500 firms includes all Grant Practices factors except Burn Rate and Duration. The Special Cases-non-Russell model does not include any Grant Practices factors.
	Non-Russell 3000	25	
	Special Cases-Russell 3000/S&P500*	15	
	Special Cases-non-Russell*	0	

*generally covers companies recently IPO'd or emerged from bankruptcy that do not disclose 3 years of grant data

7. 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).

8. 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). In these cases, positive or negative features of the stand-alone non-employee director plan will only impact that plan, which continues ISS' historical case-by-case approach to these plan evaluations.

When a proposal enumerated in FAQ #4 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.

9. How will equity plan proposals at recent IPO companies be evaluated?

Companies that have IPO'd or emerged from bankruptcy within the prior three fiscal years may be evaluated under an EPSC model that includes fewer factors. As under our prior policy, neither the burn rate nor duration factors apply for companies that have less than three years of disclosed grant data. See also FAQs #13 and #22.

Factor-Related Questions

10. 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:

(1) new shares requested plus shares remaining for future grants (from all active plans), plus outstanding unvested/unexercised grants, and

(2) 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; and
- *Absence of a minimum required vesting period (at least one year)* for grants made under the plan, which may result in awards with no retention or performance incentives.

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.

11. 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: forfeited, terminated, paid pro-rata and/or based on actual performance No points for: automatic acceleration of time-based equity or above-target vesting of performance awards Half of full points for: other

Factor	Definition	Scoring Basis
		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 at least one award type	No or vesting period < 1 year – no points Vesting period =/> 1 year – full points
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
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 </= 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	Vesting Period > 4 years – full points; Vesting Period =/> 3 years </= 4 (or no award in prior 3 years) – ½ of full points; Vesting Period < 3 years – no points
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; 12 months or until share ownership guidelines met – ½ of full points; No holding period/silent – no points

12. 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 disconnect; 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.

13. Are there additional factors that could result in a recommendation on an equity plan proposal that differs from the EPSC "score" driven recommendation, including proposals with "bundled" amendments?

Yes. Plans that seek approval solely to qualify awards as tax deductible compensation under Internal Revenue Code Section 162(m), for example, will generally receive a positive recommendation as long as all members of the plan's administrating committee are determined to be independent directors, per ISS' standards (but see FAQ #22 also). In addition, plans being amended without a request for additional shares or another modification deemed to increase potential cost (e.g., extension of the plan term) may receive a recommendation based on the overall impact of the amendments regardless of the EPSC score – i.e., whether they are deemed, on balance, to be beneficial or detrimental to shareholders' interests.

14. 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.

15. 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.

Methodology-Related Questions

16. 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.

17. Will there still be a 2% de minimis burn rate?

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

18. Will ISS continue to accept burn rate commitments under the new policy?

No. The new policy considers the company's 3-year average burn rate as a factor in the EPSC evaluation, where it is scored based on a range relative to industry benchmarks (as discussed in previous questions). This eliminates the potential for companies to commit to specific future burn rate levels.

19. How is the CEO equity award proportion that is considered "performance based” determined?

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.

20. 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.

21. 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.

22. 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 <u>only</u> seek approval to ensure tax deductibility of awards pursuant to Section 162(m), and that do not seek additional shares for grants or a plan extension, will generally receive a favorable recommendation regardless of EPSC factors ("positive override"), provided the board's Compensation Committee or other administrating committee is 100 percent independent according to ISS standards. However, note that 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 will not be eligible for this positive override.

In the case of 162(m) focused proposals that include plan amendments (other than requesting new shares or a plan extension), such amendments 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.

23. 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.

24. 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. 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.

25. 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 which should apply to no less than 95 percent of the shares authorized for grant.

26. How does the treatment of performance-based awards affect determination of their accelerated vesting upon a change in control?

ISS will deem performance-based awards as being subject to accelerated vesting upon a CIC, unless (1) the amount considered payable/vested is linked to the degree of performance attainment as of the CIC date, and/or (2) the amount to be paid/vested is pro rated based on the time elapsed in the performance period as of the CIC date.

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