Executive Compensation and Employee Benefits Alert: ISS Issues Draft Policy Changes for 2014; Comments Due by October 29, 2014

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On October 15, 2014, Institutional Shareholder Services (ISS) published its draft policy changes for 2015 and opened a public comment period ending October 29, 2014. The proposed revisions for U.S. listed companies are designed to implement more holistic methods for evaluating (i) new equity plan proposals and (ii) independent chair proposals. The final policies are expected to be released the week of November 7, 2014. If adopted, the policies will take effect for meetings of public companies on or after February 1, 2015. The key changes are described below and are available on the ISS website http://www.issgovernance.com/policy, under the Policy Gateway.

1. Equity Plan Scorecard

ISS is proposing to use an equity plan "scorecard" evaluation methodology that will provide for a more nuanced consideration of equity plan proposals and will consider a range of positive and negative factors in determining whether to give a negative recommendation rather than relying on the series of "pass/fail" tests applied in the existing policy. While some egregious plan features will continue to result in a negative recommendation regardless of other mitigating factors (e.g., authority to reprice options without shareholder approval), consideration of all of the scorecard factors will generally determine whether a "For" or "Against" recommendation is warranted. ISS does not intend for the scorecard methodology to change the number of negative recommendations issued and has not provided any guidance on the weightings of the various scorecard factors.

The three main categories of scorecard factors are:

- Plan Cost:
  - The total potential cost of the company's plan relative to industry/market cap peers, measured by the company's estimated "shareholder value transfer" in relation to its peers. "Shareholder value transfer" will be calculated for both (i) new shares requested *plus* shares remaining for future grants *plus* outstanding unvested/unexercised grants and for (ii) new shares requested *plus* shares remaining on future grants only.
- Plan Features:
  - Whether the plan provides for automatic single-trigger award vesting upon a change in control;
  - Whether the plan provides for discretionary vesting authority;
  - Whether the plan provides for liberal share recycling on various award types; and
  - Whether there is a minimum vesting period for grants under the plan (the guidelines do not distinguish between performance-based grants and time-based grants).
- Grant Practices:
  - The company's three-year burn rate relative to industry/market-cap peers;
  - The vesting requirements of the most recent CEO equity grants and the proportion of such grants that are subject to performance conditions;
  - The estimated duration of the share pool under the equity plan based on the sum of the shares remaining available and the new shares requested, divided by the average annual shares granted in the three prior years;
  - Whether the company maintains a clawback policy; and
  - Whether the company has established post exercise/vesting share retention requirements.

Separate scoring models would be employed for companies in the S&P 500, Russell 3000 (excluding S&P 500) and Non-Russell 3000 index groups and for companies that have recently completed an IPO or emerged from bankruptcy. Burn rate benchmarks would be calibrated for respective index groups and the relevant GICS industry classification would be used within each index group.

The scorecard methodology would eliminate the potential for burn rate commitments. Additionally, liberal share recycling provisions would be evaluated as a plan feature, instead of a component of "shareholder value transfer" calculations.

2. Independent Chair Proposal
ISS is also proposing to implement a more comprehensive and nuanced policy for evaluating independent chair shareholder proposals. ISS's current policy is to generally recommend "For" independent chair shareholder proposals *unless* the company satisfies each of the following six criteria:

- The company designates a lead director, who is elected by and from the independent board members with clearly delineated and comprehensive duties;
- The board is at least two-thirds independent;
- The key board committees are fully independent;
- The company has disclosed governance guidelines;
- The company has not exhibited sustained poor "total shareholder return" performance; and
- The company does not have any problematic governance issues.

The proposed methodology would add new governance, board leadership and performance factors to the analytic framework, including:

- The absence/presence of an executive chair;
- Recent board and executive leadership transitions at the company;
- The tenure of the directors/CEO; and
- The company's "total shareholder return" performance over a longer (five-year) period.

Under the new methodology, ISS would consider all the factors as a whole and no one factor would be dispositive to their recommendation. ISS expects that the new methodology will result in a higher level of "For" recommendations.

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