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ISS UPDATES ITS U.S. COMPENSATION AND EQUITY COMPENSATION PLAN POLICIES FOR 2020

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In December 2019, Institutional Shareholder Services ("ISS") published updates to its FAQs for its U.S. Compensation Policies and its policies related to U.S. Equity Compensation Plans with respect to annual meetings occurring on or after February 1, 2020. While ISS did not make major changes for 2020, reporting companies should be aware of the following key updates.

- The passing scores for all U.S. Equity Plan Scorecard ("EPSC") models remain the same as in effect for the 2019 proxy season (55 points for S&P 500 reporting companies, 53 for other reporting companies). However, ISS made the following notable changes and clarifications to EPSC's scoring model:
  - An evergreen feature (i.e., automatic share replenishment without the need for additional stockholder approval) in an equity plan submitted for stockholder approval will be considered a negative overriding factor which may result in a negative vote recommendation. Sunset provisions applicable to such evergreen features will not be considered as a mitigating factor.
  - While the passing scores for EPSC models remain unchanged, certain factor scores within the models have been adjusted (but not disclosed since they are proprietary).
  - Limited partnership interests, including operating partnership units issued by REITs, will be included in common shares outstanding (CSO) for purposes of shareholder value transfer (SVT) and burn rate calculations if such interests are equivalent to common stock on a 1:1 basis and can be exchanged into common stock at any time at no cost to the holder.
- ISS confirmed that it will begin issuing adverse vote recommendations for directors responsible for approving or setting excessive non-employee director pay practices. ISS will identify excessive non-employee director pay practices by (1) quantitatively determining non-employee director pay outliers and then (2) qualitatively evaluating the disclosures supporting its pay practices for such outliers to determine if its concerns are adequately mitigated.
  - Examples of mitigating factors include:

- one-time onboarding grants for new directors;
- payments related to corporate transactions or special circumstances (e.g., special committee service, requirements related to extraordinary need or transition payments made to a former executive for a limited period); and
- payments made in consideration of specialized scientific expertise (applicable to certain industries such as biotech and pharma).

- Examples of circumstances that will not be considered mitigating factors include:
  - payments made to reward general performance or service;
  - payments made under separate consulting or service agreements which have an indefinite or prolonged term or provide payments for services that appear to be routine director responsibilities; and
  - performance-conditioned incentive pay, perquisites or retirement benefits.

- Non-employee director pay outliers generally will be individual non-employee directors with pay figures above the top 2% of all comparable directors in the same index grouping (S&P 500, combined S&P 400 and S&P 600, Russell 3000 and Russell 3000-extended) and sector (within the same two digit GICS group).

- In its quantitative pay-for-performance analysis, ISS revised its financial performance assessment (FPA) screen to be based on economic value added (EVA) instead of GAAP metrics. The FPA screen, which compares the percentile ranks of a reporting company's CEO pay and financial performance relative to an ISS-developed comparison group, is one of four pay-for-performance screens along with relative degree of alignment (which compares the percentile ranks of a company's CEO pay and TSR performance relative to the comparison group, multiple of median (which expresses the prior year's CEO pay as a multiple of median CEO pay of its comparison group) and pay-TSR alignment (which compares the trends of the CEO's annual pay and the change in the value of an investment in the company over a five-year period).

We recommend that reporting companies carefully review their compensation arrangements and equity plan proposals in connection with this updated guidance, and, in particular, assess their non-employee director compensation programs and either make modifications to such programs or disclose their rationale for the programs or other mitigating factors in their 2020 proxy statements.

RELATED PRACTICE AREAS

- Employee Benefits & Executive Compensation
- Employee Benefits & Executive Compensation

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