

ISS Updates Burn Rate Tables for 2014 Proxy Season

Earlier this month, Institutional Shareholder Services, the prominent corporate governance advisory services firm, updated its “burn rate” tables, which govern its voting recommendations on equity plan proposals. In recent years, burn rate levels have fluctuated significantly, making this an increasingly important area for technology and life sciences companies to monitor.

Updated Burn Rate Tables

Each year, ISS updates its burn rate tables and allowable limits for Russell 3000 and non-Russell 3000 companies for the upcoming proxy season. ISS measures “burn rate” using the total number of equity awards (stock and options) granted in a given year and expresses the computation as

a percentage of the number of common shares outstanding. These tables set ISS’ acceptable burn rate levels (based on one standard deviation above the industry mean) using global industry classification standard (“GICS”) codes.

ISS’ updated 2014 burn rate tables, which apply to annual meetings of shareholders that are held on or after February 1, 2014, are set forth below.

Burn Rate Policy

Under ISS’ current U.S. proxy voting guidelines, it will recommend a vote “against” an equity plan proposal if the company’s average three-year burn rate exceeds the greater of:

GICS	Description	Russell 3000					Non-Russell 3000				
		Mean	Standard Deviation	2014 Cap	2013 Cap	Change from 2013	Mean	Standard Deviation	2014 Cap	2013 Cap	Change from 2013
1010	Energy	2.14%	2.16%	4.30%	4.57%	-0.27%	2.66%	3.60%	7.46% *	9.46%	-2.00%
1510	Materials	1.55%	1.30%	2.85%	3.08%	-0.23%	3.20%	4.65%	7.85%	8.04%	-0.19%
2010	Capital Goods	1.81%	1.39%	3.20%	3.70%	-0.50%	3.28%	4.88%	8.16%	6.69%	1.47%
2020	Commercial & Professional Services	2.55%	1.82%	4.37%	4.74%	-0.37%	3.68%	3.65%	7.33%	7.28%	0.05%
2030	Transportation	1.53%	1.80%	3.33%	3.21%	0.12%	1.71%	1.98%	3.69%	4.88%	-1.19%
2510	Automobiles & Components	1.78%	2.03%	3.81%	3.28%	0.53%	2.74%	3.21%	5.95%	7.60%	-1.65%
2520	Consumer Durables & Apparel	2.48%	1.80%	4.28%	4.83%	-0.55%	3.37%	4.24%	7.61%	7.01%	0.60%
2530	Consumer Services	2.55%	1.61%	4.16%	3.88%	0.28%	2.16%	2.12%	4.28%	4.99%	-0.71%
2540	Media	2.45%	1.98%	4.43%	5.60%	-1.17%	3.23%	2.24%	5.47%	6.29%	-0.82%
2550	Retailing	2.41%	1.75%	4.16%	3.93%	0.23%	3.39%	3.21%	6.60%	5.61%	0.99%
3010-3030	Consumer Staples	1.59%	1.18%	2.77%	2.82%	-0.05%	2.13%	2.32%	4.45%	5.17%	-0.72%
3510	Health Care Equipment & Services	3.00%	1.82%	4.82%	5.09%	-0.27%	4.81%	4.27%	9.08%	9.92%	-0.84%
3520	Pharmaceuticals & Biotechnology	3.65%	2.26%	5.91%	6.70%	-0.79%	4.87%	4.11%	8.98%	10.58%	-1.60%
4010	Banks	1.48%	1.65%	3.13%	2.75%	0.38%	1.12%	1.67%	2.79%	2.28%	0.51%
4020	Diversified Financials	3.65%	5.09%	8.74%	9.53%	-0.79%	2.74%	4.43%	7.56% *	9.56%	-2.00%
4030	Insurance	1.75%	1.55%	3.30%	3.02%	0.28%	1.05%	1.53%	2.58%	2.38%	0.20%
4040	Real Estate	1.36%	1.50%	2.86%	3.25%	-0.39%	1.12%	1.56%	2.68%	3.09%	-0.41%
4510	Software & Services	4.56%	2.69%	7.25%	7.26%	-0.01%	5.26%	3.88%	9.14%	9.58%	-0.44%
4520	Technology Hardware & Equipment	3.50%	1.99%	5.49%	5.77%	-0.28%	3.96%	4.95%	8.91%	8.53%	0.38%
4530	Semiconductor & Semi Equipment	4.34%	2.38%	6.72%	6.58%	0.14%	4.67%	5.08%	9.75%	10.55%	-0.80%
5010	Telecommunication Services	2.59%	1.63%	4.22%	4.85%	-0.63%	3.57%	3.97%	7.54%	8.75%	-1.21%
5510	Utilities	0.82%	0.47%	2.00%	2.00%	0.00%	1.76%	1.90%	3.66%	4.99%	-1.33%

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- the mean plus one standard deviation of the company’s GICS peer group segmented on the basis of whether or not it is in the Russell 3000; or
- two percent of the company’s weighted common shares outstanding.

As part of its annual proxy analysis, ISS will also penalize a company that fails the burn rate test (by deducting points from its compensation score) when conducting its QuickScore review of the company’s governance-related practices.

If a company grants both full value awards and stock options, ISS applies a premium or “multiplier” to the full value awards for the past three fiscal years to equate them economically with stock options. For 2014, this premium or “multiplier,” is unchanged from 2013 as follows:

Stock Price Volatility	Multiplier
54.6% or higher	1 full-value award will count as 1.5 option shares
36.1% or higher and less than 54.6%	1 full-value award will count as 2.0 option shares
24.9% or higher and less than 36.1%	1 full-value award will count as 2.5 option shares
16.5% or higher and less than 24.9%	1 full-value award will count as 3.0 option shares
7.9% or higher and less than 16.5%	1 full-value award will count as 3.5 option shares
Less than 7.9%	1 full-value award will count as 4.0 option shares

Exception for Burn Rate Commitments

Where a company does not meet ISS’ applicable burn rate cap, it can avoid an “against” vote recommendation if it commits to a prospective gross three-year average burn rate equal to the higher of 2% of the company’s weighted common shares outstanding or the mean plus one standard deviation of its GICS peer group. The company’s burn rate may exceed the GICS peer group average in the first two years, as long as the prospective three-year average burn rate remains below the commitment level.

This commitment must be publicly disclosed, either in a current report on Form 8-K or in the company’s definitive proxy statement.

Observations

While ISS’ burn rate methodology remains the same as in 2013, on average the burn rate limits for companies in the Russell 3000 decreased by approximately 3%, while limits for non-Russell 3000 companies are down approximately 6%.

For technology and life sciences companies in the Russell 3000, the limits changed as follows:

- for Software and Services, from 7.26% to 7.25%
- for Semiconductor Equipment, from 6.58% to 6.72%
- for Technology Hardware & Equipment, from 5.77% to 5.49%
- for Health Care Equipment & Services, from 5.09% to 4.82%
- for Pharmaceuticals & Biotechnology, from 6.70% to 5.91%

For non-Russell 3000 technology and life sciences companies, the limits changed as follows:

- for Software and Services, from 9.58% to 9.14%
- for Semiconductor Equipment, from 10.55% to 9.75%
- for Technology Hardware & Equipment, from 8.53% to 8.91%
- for Health Care Equipment & Services, from 9.92% to 9.08%
- for Pharmaceuticals & Biotechnology, from 10.58% to 8.98%

As part of its long-standing practice (which is intended to limit extreme fluctuations from year to year), ISS provides that annual limits cannot increase or decrease by more than 2% each year.

Companies should consider these updated limits as one factor in their annual equity strategy review. Companies that developed equity budgets for 2014 based on then-current 2013 limits may have less flexibility with their equity programs than originally anticipated (depending on program goals, equity plan funding, competitive needs, etc.).

Further Information

To obtain a copy of ISS 2014 Burn Rate Policy, [please click this link »](#)

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Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

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