

GICS Code Changes Will Affect Many Technology Companies

This Thoughtful Pay Alert has been revised to reflect the Frequently-Asked Questions and Answers on the GICS Code 5020 Implementation published by Institutional Shareholder Services, Inc. on September 20, 2018.

Changes to the Global Industry Classification Standard (“GICS”) structure announced late last year to better reflect modern communication activities took effect at the end of September 2018. These changes, which represent the biggest reclassification of companies in the history of GICS, affect numerous Internet and e-commerce companies, including Google, Netflix, and Facebook. For technology companies, the changes may prompt a reassessment of their compensation peer group, as well as their understanding of how their executive compensation program will be evaluated by Institutional Shareholder Services (“ISS”), the major proxy advisory firm. This Thoughtful Pay Alert describes the changes and provides our initial observations on their potential implications in the ISS evaluation process.

Background

The GICS structure is an industry taxonomy developed in 1999 by S&P Dow Jones Indices and MSCI, Inc. for use by the global financial community. As revised, the GICS structure consists of 11 sectors, 24 industry groups, 69 industries, and 158 sub-industries into which Standard & Poor’s has categorized all major public companies. The GICS structure is used as a basis for Standard & Poor’s and MSCI’s financial market indexes in which each company is assigned to a sub-industry, and to a corresponding industry, industry group, and sector, according to the definition of its principal business activity.

Certain ISS policies, procedures, and products rely on GICS classifications, including executive compensation peer group development, equity compensation plan evaluation, and the recently-introduced Environmental & Social QualityScore.

Changes to the GICS Structure

On November 17, 2017, S&P Dow Jones and MSCI [announced](#) revisions to the GICS structure to take effect at the end of September 2018 “to reflect the evolution in the mode in which people communicate and access entertainment content and other

information.” Citing this evolution as a result of the integration between telecommunications, media, and internet companies, the revisions are as follows:

- The “Telecommunication Services” sector has been renamed the “Communication Services” sector and broadened to contain two industry groups: “Telecommunication Services” and “Media & Entertainment”;
- The “Media Industry” group has been moved from the new “Consumer Discretionary” sector to the “Communication Services” sector, and renamed “Media & Entertainment.” It remains an Industry Group and contains three industries: “Media,” “Entertainment,” and “Interactive Media & Services”;
- The “Internet & Direct Marketing Retail” sub-industry under the “Consumer Discretionary” sector has been updated to include companies providing online marketplaces for consumer products and services. This sub-industry includes e-commerce companies regardless of whether they hold inventory;
- The “Internet Software & Services” industry and sub-industry have been discontinued. A new sub-industry has been created under the “IT Services” industry called “Internet Services & Infrastructure.” This sub-industry includes companies providing services and infrastructure for the internet industry, including data centers, cloud networking & storage infrastructure, and web hosting services.

These changes were effective on September 28, 2018.

Implications for ISS Analyses

ISS uses the GICS structure classifications to construct compensation peer groups that are used in formulating its voting recommendations on compensation-related proposals submitted for shareholder action at companies’ annual meeting of shareholders, including the “Say-on-Pay” proposal, to evaluate and formulate its voting recommendations on employee stock plan proposals, and to determine a company’s Environmental & Social QualityScore.

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On September 20, 2018, ISS published a paper entitled "[Global Industry Classification Standard \(GICS\) Code 5020 Implementation](#)," which seeks to answer the most frequently asked questions regarding how the adjustment to the GICS structure will impact ISS analyses, and when those changes will be effective.

ISS' initial responses to the restructuring, as reflected by the compensation-related FAQs, are as follows:

Equity Plan Scorecard for New and Amended Equity Plan Proposals

Burn Rate Benchmarks: The FAQs indicate that ISS will immediately establish new burn rate benchmarks for companies in the "Media & Entertainment" industry group (GICS 5020). These benchmarks will be reflective of historical burn rates of companies now included in GICS 5020. These burn rates will be effective for annual meetings of shareholders on or after December 1, 2018, with the timing established to ensure that share value transfer ("SVT") benchmarks and burn rate benchmarks remain congruent.

Burn rates for the "Software & Services" industry grouping (GICS 4510) will not be updated as part of this December 1 update, and will be updated as part of ISS' annual burn rate calculations in December 2018. As of December 1, 2018, the "Media" industry grouping (GICS 2540) will no longer be used for equity compensation plan evaluation in the U.S.

Within the S&P 500, the burn rate change will affect all companies in the "Communication Services" sector (GICS 50). ISS notes that as the new benchmark for GICS 50 is substantially greater than the legacy GICS 50 benchmark, there should be no prejudicial impact on legacy GICS 50 companies.

These burn rate benchmarks, along with the benchmarks for all other GICS groupings, will be recomputed in the normal December update cycle, effective for annual meetings of shareholder starting on February 1, 2019.

Shareholder Value Transfer ("SVT") Benchmarks: ISS has performed new regressions for SVT benchmarks for companies in the "Media & Entertainment" industry group. SVT benchmarks have been calculated based on this new model for the September 1 Quarterly Data Download, and are effective for annual meetings of shareholders starting December 1, 2018. For annual meetings prior to December 1, a company's SVT benchmarks will be calculated based on its legacy GICS.

Peer Group Construction

ISS uses the GICS structure to develop peer groups for purposes of pay benchmarking and relative "pay-for-performance" comparisons. The FAQs indicate that the peer groups used for companies with annual meetings of shareholders starting September 15, 2018, have been updated to reflect the updated GICS classifications. All subsequent peer group construction cycles will reflect the updated GICS groupings.

Director Compensation

ISS reviews the compensation arrangements for the non-employee members of a company's Board of Directors relative to the competitive market to identify "excessive compensation" using the company's GICS-constructed peer group. The FAQs state that director compensation will continue to be evaluated based on comparators in the company's legacy GICS for annual meetings of shareholders taking place before February 1, 2019. However, director compensation will be evaluated within the context of the company's newly-assigned GICS code for annual meetings of shareholders starting February 1, 2019.

Relative TSR Performance

ISS evaluates a company's total shareholder return ("TSR") performance (on a one-year, three-year, and five-year basis) relative to companies with similar GICS classifications for purposes of a number of its policies, such as the director performance evaluation policy. The FAQs indicate that ISS will update the GICS groupings used in determining median one-year, three-year, and five-year TSRs in each GICS industry group starting with the September 30, 2018 report, and will be shown on this [webpage](#) within ISS' Policy Gateway.

Initial Observations

Although the FAQs address many of the immediate issues that have arisen as a result of the GICS structure reclassification, undoubtedly other questions will come up in the months ahead as companies begin to assess the impact of the changes on their specific situation. We expect that some of the changes will be nominal (for example, grouping internet software and other software companies together), while others may have significant ramifications for how companies will be evaluated for comparative purposes (for example, moving internet retail companies from the "Information Technology" sector to the "Consumer Discretionary" sector). The most prominent technology companies affected by the changes, along with their new classifications, are listed on Exhibit A to this article.

GICS Code Changes Will Affect Many Technology Companies (continued)**About the Authors**

The authors of this Thoughtful Pay Alert are Mark Borges and Jason Borrevik, principals at Compensia. If you have any questions about this Thoughtful Pay Alert or the implications of the changes to the GICS structures generally, Mark can be reached at 415.462.2995 or mborges@compensia.com and Jason can be reached at 408.876.4035 or jborrevik@compensia.com.

Need Assistance?

Compensia has significant experience in helping companies understand and address ISS' corporate governance and executive compensation policies. If you have any questions on the topics covered in this Thoughtful Pay Alert or would like assistance in assessing how the policies are likely to affect your executive compensation program, please feel free to contact Jason Borrevik or Mark A. Borges. ■

GICS Code Changes Will Affect Many Technology Companies (continued)

Exhibit A

(as disclosed as of September 2018)

Company	Existing GICS Sector	Existing GICS Sub-Industry	New GICS Sector	New GICS Sub-Industry
Netflix	Consumer Discretionary	Internet and Direct Marketing Retail	Communication Services	Movies and Entertainment Interactive Media and Services
TripAdvisor	Consumer Discretionary	Internet and Direct Marketing Retail	Communication Services	Movies and Entertainment Interactive Media and Services
2U	Information Technology	Internet Software and Services	Information Technology	Application Software
Activision Blizzard	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Akamai Technologies	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Alarm.com Holdings	Information Technology	Internet Software and Services	Information Technology	Application Software
Alphabet	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Alteryx	Information Technology	Internet Software & Services	Information Technology	Application Software
Angi Homeservices	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Appfolio	Information Technology	Internet Software & Services	Information Technology	Application Software
Apptio	Information Technology	Internet Software & Services	Information Technology	Application Software
Benefitfocus	Information Technology	Internet Software & Services	Information Technology	Application Software
Box	Information Technology	Internet Software and Services	Information Technology	Application Software
Channeladvisor	Information Technology	Internet Software & Services	Information Technology	Application Software
Cloudera	Information Technology	Internet Software and Services	Information Technology	Application Software
Comscore	Information Technology	Internet Software & Services	Communication Services	Advertising
Cornerstone OnDemand	Information Technology	Internet Software and Services	Information Technology	Application Software
Coupa Software	Information Technology	Internet Software & Services	Information Technology	Application Software
DocuSign	Information Technology	Internet Software & Services	Information Technology	Application Software
Dropbox	Information Technology	Internet Software & Services	Information Technology	Application Software
eBay	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Electronic Arts	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Envestnet	Information Technology	Internet Software and Services	Information Technology	Application Software
Etsy	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Facebook	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Five9	Information Technology	Internet Software & Services	Information Technology	Application Software
Glu Mobile	Information Technology	Application Software	Communication Services	Interactive Home Entertainment
Godaddy	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Gogo	Information Technology	Internet Software & Services	Communication Services	Wireless Telecommunication Services
Grubhub	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
IAC Interactive	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services

GICS Code Changes Will Affect Many Technology Companies (continued)

Exhibit A (Continued)

(as disclosed as of September 2018)

Company	Existing GICS Sector	Existing GICS Sub-Industry	New GICS Sector	New GICS Sub-Industry
Instructure	Information Technology	Internet Software & Services	Information Technology	Application Software
J2 Global	Information Technology	Internet Software and Services	Information Technology	Application Software
Limelight Networks	Information Technology	Internet Software & Services	Information Technology	Internet Services & Infrastructure
LogMeIn	Information Technology	Internet Software and Services	Information Technology	Application Software
Marin Software	Information Technology	Internet Software & Services	Information Technology	Application Software
Match Group	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Mindbody	Information Technology	Internet Software & Services	Information Technology	Application Software
MongoDB	Information Technology	Internet Software & Services	Information Technology	Internet Services & Infrastructure
New Relic	Information Technology	Internet Software and Services	Information Technology	Application Software
Nutanix	Information Technology	Internet Software and Services	Information Technology	Application Software
Okta	Information Technology	Internet Software & Services	Information Technology	Internet Services & Infrastructure
Pandora	Information Technology	Internet Software & Services	Communication Services	Movies & Entertainment
Q2 Holdings	Information Technology	Internet Software & Services	Information Technology	Application Software
Quotient Tech	Information Technology	Internet Software & Services	Consumer Discretionary	Internet & Direct Marketing Retail
Rightmove	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Shopify	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Snap	Information Technology	Application Software	Communication Services	Interactive Media and Services
Spotify	Information Technology	Internet Software & Services	Communication Services	Movies & Entertainment
SPS Commerce	Information Technology	Internet Software & Services	Information Technology	Application Software
Stamps.com	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Take-Two Interactive	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Trade Desk	Information Technology	Internet Software and Services	Information Technology	Application Software
Trivago	Information Technology	Internet Software & Services	Communication Services	Interactive Media & Services
Truecar	Information Technology	Internet Software & Services	Communication Services	Interactive Media & Services
Twilio	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Twitter	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
VeriSign	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Yelp	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Zillow	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Zynga	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment

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About Compensia

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

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