# ISS Publishes Final FAQs and Burn Rate Tables for 2021 Proxy Season

Just prior to the holidays, Institutional Shareholder Services ("ISS") has published several supplemental documents that elaborate on its U.S. executive compensation benchmark policy guidelines for 2021. These documents include FAQs for both its U.S. compensation and equity plan policies (including updated equity burn rate tables for the 2021 proxy season).

This Thoughtful Pay Alert summarizes the key new ISS FAQs for its executive compensation and equity plan-related policies. A summary of ISS' benchmark policy changes for 2021 is available at the following link. These updates will be effective for annual meetings of shareholders taking place on or after February 1, 2021.

## Executive Compensation Policy FAQs

ISS made no significant changes to its U.S. benchmark voting policy guidelines covering executive compensation matters for the 2021 proxy season. (See our Thoughtful Pay Alert, *ISS Issues 2021 Benchmark Policy Updates* (November 24, 2020).) As a result, there have been just two additions to its updated executive compensation policy FAQs.

### *Pay-for-Performance Evaluation*

ISS evaluates the alignment between a company's executive compensation program and its financial performance using a methodology that includes an initial quantitative assessment of the relationship between the compensation of a company's CEO and its stock price/financial performance and, as appropriate, an in-depth qualitative review of the program. ISS conducts the initial quantitative assessment through a series of four "screens": a Relative Degree of Alignment test, a Multiple of Median ("MOM") test, a Pay-TSR Alignment test, and a Financial Performance assessment test.

The MOM test is a relative measure that expresses the prior year's CEO pay as a multiple of the median CEO pay of an ISS-constructed group of peer companies for the most recently available annual period. In other words, this test identifies instances where the magnitude of CEO pay is significantly higher than amounts typical for its comparator group. For purposes of performing this test on S&P 500 companies in 2021, ISS has lowered the "high concern" threshold for this test from 3.33x to 3.00x the peer median. As a result, it will now be easier for a CEO's total pay to trigger a high level of concern under this test.

### *COVID-Related Pay Decisions*

In response to a question as to how it will assess compensation decisions that were related to the COVID-19 pandemic, ISS reiterates that the exceptional circumstances of the COVID-19 pandemic and its impact on company operations will be factored into its qualitative evaluation of the executive compensation program and refers readers to its October 2020 FAQs on the COVID-19 pandemic. (See also our Thoughtful Pay Alert, *ISS Issues FAQs on U.S. Compensation Policies and COVID-19 Pandemic* (October 23, 2020).)

## Equity Compensation Plan FAQs

Similarly, ISS only added a couple of new FAQs concerning equity compensation plans.

### *Excluding Remaining Shares from Prior Plan from SVT Analysis*

While many companies will transfer the remaining shares reserved for awards from an existing equity plan that is being terminated to a new shareholder-approved equity plan, some companies do not plan to make future use of these remaining shares. In this situation, in order for ISS not to include the remaining shares in its Share Value Transfer ("SVT") analysis, it should disclose the following information in its annual report on Form 10-K or proxy statement as of the same date:

- The total number of shares remaining available for future awards, including any impact from fungible counting provisions, that will no longer be available upon approval of the successor plan;
- The total number of full value awards (such as restricted shares and RSUs) and appreciation awards (such as stock options and SARs) outstanding, disclosed separately and including the

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weighted average exercise price and remaining term of appreciation awards (and for performance-contingent awards, the updated number of shares with respect to earned/unearned portions); and

- A commitment that no further shares will be granted as awards under the existing plan unless the successor plan is not approved by shareholders. This commitment should be as of the same date as the disclosures set forth in the previous two bullets.

### *Equity Plan Scorecard ("EPSC")*

ISS' only substantive change to its EPSC was to increase the threshold passing score for the S&P 500 model (from 55 points to 57 points) and the Russell 3000 model (from 53 points to 55 points). The threshold passing score for other models were unchanged, and there were no new factors added or factor scores adjusted.

## Burn Rate Tables

Each year, ISS updates its burn rate tables and stated benchmarks for S&P 500, Russell 3000 (excluding the S&P 500), and non-Russell 3000 companies for the upcoming proxy season. Generally, ISS measures "burn rate" using the total number of equity awards (full value stock awards and stock options) granted in a given year (or earned for performance-based awards if sufficient disclosure) and expresses the computation as a percentage of the number of common shares outstanding. These tables set ISS' burn rate benchmarks (based on one standard deviation above the industry mean) using Standard & Poor's global industry classification standard ("GICS") codes as assigned to each company.

The burn rate benchmark is primarily used by ISS as part of its EPSC evaluations. The specific benchmark for each industry sector is a point in the middle of the sliding scale. Full credit is given to companies with burn rates at 50% of the burn rate benchmark or less. Companies with burn rates above 50% of the burn rate benchmark will earn partial (or even negative) credit based on a sliding scale.

If a company grants both full value stock 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 2021, this premium or "multiplier," is unchanged from prior years as follows:

| Stock Price Volatility | Multiplier (Full Value Awards to Option Shares) |
|---|---|
| 54.6% or higher | 1 full value award = 1.5 option shares |
| 36.1% or higher and less than 54.6% | 1 full value award = 2.0 option shares |
| 24.9% or higher and less than 36.1% | 1 full value award = 2.5 option shares |
| 16.5% or higher and less than 24.9% | 1 full value award = 3.0 option shares |
| 7.9% or higher and less than 16.5% | 1 full value award = 3.5 option shares |
| Less than 7.9% | 1 full value award = 4.0 option shares |

## Observations

While ISS' burn rate methodology remains the same as in 2020, overall the 2021 burn rate benchmarks for key technology and life science industry sectors are generally down from the prior year. Notable burn rate benchmark changes include:

**S&P 500**

| GICS | Description | 2021 Burn Rate Benchmark | 2020 Burn Rate Benchmark | Absolute Δ from 2020 |
|---|---|---|---|---|
| 4520 | Technology Hardware & Equipment | 3.87% | 4.65% | -0.78% |
| 3510 | Healthcare Equipment & Services | 2.22% | 2.65% | -0.43% |
| 5020 | Media & Entertainment | 3.42% | 3.50% | -0.08% |

**Russell 3000**

| GICS | Description | 2021 Burn Rate Benchmark | 2020 Burn Rate Benchmark | Absolute Δ from 2020 |
|---|---|---|---|---|
| 4510 | Software & Services | 9.24% | 9.94% | -0.70% |
| 4520 | Technology Hardware & Equipment | 6.57% | 6.95% | -0.38% |
| 4530 | Semiconductor & Semiconductor Equipment | 6.23% | 7.07% | -0.84% |
| 3510 | Healthcare Equipment & Services | 5.69% | 6.46% | -0.77% |
| 3520 | Pharmaceuticals & Biotechnology | 7.91% | 8.08% | -0.17% |
| 5020 | Media & Entertainment | 6.62% | 7.66% | -1.04% |

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| Non-Russell 3000 | | | | |
|---|---|---|---|---|
| GICS | Description | 2021 Burn Rate Benchmark | 2020 Burn Rate Benchmark | Absolute Δ from 2020 |
| 4510 | Software & Services | 10.45% | 9.77% | 0.68% |
| 4520 | Technology Hardware & Equipment | 6.41% | 7.96% | -1.55% |
| 4530 | Semiconductor & Semiconductor Equipment | 6.30% | 7.83% | -1.53% |
| 3510 | Healthcare Equipment & Services | 9.91% | 9.70% | 0.21% |
| 3520 | Pharmaceuticals & Biotechnology | 9.46% | 9.51% | -0.05% |
| 5020 | Media & Entertainment | 6.27% | 7.94% | -1.67% |

Companies should consider these updated benchmarks as one factor in their annual equity strategy review. Due to the lower benchmarks above in many groupings, companies that developed equity budgets for 2021 with consideration of the then-current 2020 limits may have less flexibility with their equity compensation plans than originally anticipated (depending on program goals, equity plan funding, competitive needs, etc.).

## Further Information

To obtain a copy of each of the materials discussed in this article, please click on the applicable link:

- ISS 2021 U.S. Executive Compensation Policies FAQs
- ISS 2021 U.S. Equity Compensation Plans FAQs
- ISS 2021 U.S. Pay-for-Performance Mechanics

## 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 is assessing how the policies are likely to affect your executive compensation program, please feel free to contact Jason Borrevik at 408.876.4035 or Mark A. Borges at 415.462.2995. ■

## About Compensia

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