Issues 2024 Benchmark Voting Policy Updates, Compensation and Equity Plan FAQs And Burn Rate Tables

In December 2023, Institutional Shareholder Services ("ISS") published its annual updates to its U.S. benchmark voting policy guidelines for the 2024 proxy season, and updated several supplemental documents that elaborate on its U.S. executive compensation benchmark policy guidelines for 2024. These documents include Frequently Asked Questions ("FAQs") for both its U.S. compensation and equity plan policies (including an updated equity burn rate table for the 2024 proxy season). While the updates cover a range of global topical areas, the updates and changes that apply to U.S. companies are relatively limited.

This Thoughtful Pay Alert summarizes the executive compensation policy and FAQ updates most relevant for technology and life sciences companies. It also includes a revised burn rate table calculated using ISS' Value-Adjusted Burn Rate ("VABR") methodology.

ISS' updated policies will generally be effective for annual meetings of shareholders taking place on or after February 1, 2024.

Executive Compensation Policies

Evaluation of Severance-Related Shareholder Proposals

In response to the increased frequency of severance-related shareholder proposals in the past two proxy seasons, ISS has codified the case-by-case approach it uses when analyzing these shareholder proposals, which seek to require that companies submit executive severance arrangements or payments (including change-in-control arrangements or payments) above specified thresholds for shareholder ratification. The updated policy (i) harmonizes the factors used to analyze both regular termination severance arrangements as well as change-in-control related severance arrangements ("golden parachutes") and (ii) clarifies the key factors it will consider in its analysis.

The factors that will be considered include, but are not limited to:

- The company's severance or change-in-control agreements in place, and the presence of "problematic" features in the agreements (such as excessive severance entitlements, single trigger arrangements, excise tax gross-ups, etc.);
- Any existing limits on cash severance payouts or policies which require shareholder ratification of severance payments exceeding a certain level;
- Any recent severance-related controversies; and
- Whether the proposal is overly prescriptive, such as requiring shareholder approval of severance that does not exceed market norms.

Executive Compensation Policy FAQs

ISS also has updated a number of its executive compensation policy FAQs.

Company Responses to ISS Identification of Pay-Related Concerns

ISS has updated its FAQ related to company actions (and disclosure thereof) following publication of ISS' Research Report to address the pay-related concerns identified in the report. ISS has introduced specific guidance regarding the timing by which such disclosure must be publicly filed, indicating that it is generally unable to change its vote recommendation if the filing is made within less than five business days before the annual meeting of shareholders.

Evaluating Adjustments to Financial Performance Metric Results (Including Non-GAAP Financial Performance Metrics

In recognition of the current widespread use of non-GAAP financial performance metrics in incentive compensation programs, and the fact that where a board of directors or board compensation committee adjusts the performance results it can have a dramatic effect on payouts to executives, ISS has added a new FAQ that expresses an expectation for better and more detailed disclosure of any such adjustments and their consequences. For example, if an adjustment materially increases payouts, ISS expects a company to provide clear disclosure in its definitive proxy statement of (i) the nature of the adjustment, (ii) its impact (either in dollars or as a percentage) on payouts under the program, and (iii) the board of directors' or board compensation committee's rationale for the adjustment. ISS considers line-item reconciliation of non-GAAP results to GAAP results to be "best practice." As expected, the failure to provide such disclosure will be viewed negatively, as will adjustments that appear to insulate executives from performance failures. This latter concern will be particularly problematic where a company is exhibiting a quantitative "pay-for-performance" misalignment. We note that Glass Lewis & Co. similarly expanded its 2024 benchmark voting policy last month, as discussed in our Thoughtful Pay Alert, *Glass Lewis Publishes Updates to 2024 U.S. Voting Policy Guidelines (Nov. 28, 2023).*

Distinguishing Between Problematic Change-in-Control Severance Arrangements and Incentive Awards That are Payable Upon a Change-in-Control

ISS has added a new FAQ that discusses how it distinguishes between problematic change-in-control severance arrangements versus incentive awards payable upon a transaction that results in a change-in-control. The FAQ acknowledges that a new or materially amended executive agreement that provides for "problematic" (that is, "single trigger" or "modified single trigger") arrangements is distinguishable from a bona fide

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incentive compensation award that becomes payable upon a transaction involving a change-in-control of the company. In this situation, ISS notes that where an agreement provides for a change-in-control transaction bonus linked to an acquisition premium, it will analyze the provision as a change-in-control incentive award and not as a problematic "single trigger" severance arrangement.

ISS goes on to caution, however, that change-in-control incentive awards will continue to be evaluated qualitatively. Consequently, issues such as excessive magnitude or an unclear rationale for the arrangement may still raise concerns from a "pay-for-performance" perspective. To make the appropriate distinction between a problematic change-in-control severance provision and a "single trigger" change-in-control incentive award, ISS will review the company's disclosure of the incentive award structure and award rationale, and whether separate non-problematic severance entitlements are in place.

Pay-For-Performance Evaluations

While there are no changes to the three primary screens (relative degree of alignment ("RDA"), multiple of median ("MOM"), and Pay-TSR Alignment ("TPA")) for 2024, for annual meetings held on or after February 1, 2024, the "Eligible for FPA Adjustment" thresholds in the Financial Performance Assessment ("FPA") secondary screen have been updated (as they will be each year). These changes for 2024 are covered in an update to ISS' "Pay-for-Performance Mechanics" white paper which can be accessed *here*

Equity Compensation Plan FAQs

Equity Plan Scorecard ("EPSC") Changes

Certain factor scores have been adjusted for each of ISS' proprietary scoring models other than the Special Cases – Non-Russell 3000 model. Among these adjustments, weighting of the SVT factor has been decreased for both the S&P 500 and Russell 3000 models (see "Plan Cost" in the table below). Weighting of the Grant Practices pillar for the S&P 500, Russell 3000, and non-Russell 3000 models has also decreased, while the weighting of the Plan Features pillar for the same models has been increased.

ISS has not made any changes to factor definitions or overall threshold passing scores for any model for 2024.

2024 Value-Adjusted Burn Rate Benchmarks

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. These tables set ISS' burn rate benchmarks using Standard & Poor's global industry classification standard ("GICS") codes as assigned to each company.

ISS is continuing to use the burn rate methodology adopted in 2021, the VABR methodology, for the 2024 proxy season. As we know, the VABR methodology calculates burn rate by using the actual stock price for full-value awards, and the Black-Scholes value for stock options. The denominator (common shares outstanding) will also be valued using a company's actual stock price. Specifically, the annual VABR equals (i) the number of options multiplied by the option's dollar value (based on a Black-Scholes option pricing model) plus (ii) the number of full-value awards multiplied by the stock price divided (iii) by the weighted average common shares outstanding multiplied by the stock price.

The updated 2024 burn rate table is set forth in an Exhibit to this Thoughtful Pay Alert.

The burn rate benchmark is primarily used by ISS as part of its EPSC evaluation. 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.

Observations: Given the ongoing downward stock price pressure experienced by many technology and life sciences companies during 2023, burn rates will be a factor to closely consider for any company planning to put an equity compensation plan proposal forward at its 2024 annual meeting of shareholders. As was the case in 2023, advanced preparations may be the key to maximizing shareholder support for an equity plan proposal.

Further Information

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

- ISS 2024 Benchmark Policy Updates – Executive Summary
- ISS 2024 Proxy Voting Guidelines Benchmark Policy Recommendations
- ISS 2024 "Pay for Performance" Mechanics:
- ISS 2024 U.S. Executive Compensation Policies FAQs:
- ISS 2024 U.S. Equity Compensation Plans FAQs:

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 Mark A. Borges at 415.462.2995 or mborges@compensia.com or Hannah Orowitz at 332-867-0566 or horowitz@compensia.com.

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EXHIBIT

ISS 2024 Value-Adjusted Burn Rate Benchmarks

GICS	Description	S&P 500	R3000 (Ex. S&P 500)	Non-R3000
1010	Energy	0.85%	2.18%	4.21%
1510	Materials	0.77%	1.48%	4.11%
2010	Capital Goods	0.77%	1.71%	4.23%
2020	Commercial & Professional Services	0.77%	2.28%	4.68%
2030	Transportation	0.77%	1.61%	3.76%
2510	Automobiles & Components	1.05%	1.87%	4.32%
2520	Consumer Durables & Apparel	1.05%	2.21%	3.41%
2530	Consumer Services	1.05%	2.37%	4.52%
2550	Consumer Discretionary Distribution & Retail	1.05%	3.01%	7.29%
3010	Food & Staples Retailing	0.77%	1.89%	8.32%
3020	Food Beverage & Tobacco	0.77%	1.89%	8.32%
3030	Household & Personal Goods	0.77%	1.89%	8.32%
3510	Health Care Equipment & Services	0.86%	3.61%	8.72%
3520	Pharmaceuticals, Biotechnology & Life Sciences	0.86%	5.24%	7.39%
4010	Banks	0.86%	1.05%	1.23%
4020	Financial Services	0.86%	3.36%	4.45%
4030	Insurance	0.86%	1.56%	1.90%
4510	Software & Services	1.99%	5.95%	9.19%
4520	Technology Hardware & Equipment	1.99%	4.03%	5.65%
4530	Semiconductor & Semi Equipment	1.99%	3.23%	4.83%
5010	Telecommunication Services	1.55%	3.08%	6.00%
5020	Media & Entertainment	1.55%	4.89%	6.00%
5510	Utilities	0.77%	1.05%	2.86%
6010	Equity Real Estate Investment Trusts (REITS)	0.77%	1.05%	2.21%
6020	Real Estate Management & Development	0.77%	2.85%	3.82%

NOTES:

De minimis threshold 0.77% burn rate for S&P 500

De minimis threshold 1.05% burn rate for Russell 3000 (excluding the S&P 500)

De minimis threshold 1.23% burn rate for non-Russell 3000

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About Compensia

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