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ISS Publishes Updated FAQs Regarding
2016 U.S. Compensation Policies

Last week, ISS published more than 100 Frequently Asked Questions (FAQs) regarding U.S. Executive Compensation Policies and U.S. Equity Compensation Plans (inclusive of its U.S. Equity Plan Scorecard (EPSC) FAQs published on November 20, 2015, effective for shareholder meetings occurring on or after February 1, 2016). These updated FAQs primarily repeat previously stated ISS principles, but also include some limited new guidance worth highlighting.

Compensation Committee Member Withhold/Against Votes. The previous year's FAQs generally limited the circumstances that would result in a negative recommendation on compensation committee members, if an annual say-on-pay (SOP) vote was on the ballot, to egregious practices being identified or a failure by the company to address an ongoing issue following a prior negative recommendation on a SOP resolution. The updated FAQs lower the threshold for withhold/against vote recommendations by requiring that either egregious practices are identified or there are "recurring problematic issues or responsiveness concerns." ISS also affirmatively clarified that if no SOP vote is on the ballot, any adverse recommendations related to executive compensation may apply to compensation committee members.

Acceleration of Vesting of Equity Awards for New CEOs. ISS has added to its list of problematic pay practices to be considered in determining recommendations regarding SOP votes and director elections "problematic termination-related equity vesting provisions" as part of what will be considered "overly generous" CEO new-hire packages.

EPSC Treatment of Equity Awards in a Change in Control. ISS has clarified the EPSC scoring of change-in-control equity award vesting provisions as follows: (1) no EPSC points for automatic acceleration of time-vesting awards or above-target vesting of performance awards; (2) full points for time-vesting awards that only accelerate if not converted into replacement awards (or which do not accelerate at all) and performance-vesting awards that only accelerate on a prorated basis, adjusted for both actual performance and the time that has elapsed in the performance period (or which otherwise terminate); and (3) half points for any other provisions.

EPSC Treatment of Holding Periods. ISS has extended, from 12 months to 36 months, the holding periods to be imposed on executives for shares acquired under vested/exercised equity awards, in order for the plan to receive full points under the EPSC scoring of holding periods. Half points will be awarded for holding periods of less than 36 months (even if more than 12 months).

Non-Employee Director Equity Plans. The FAQs reconfirm that stand-alone non-employee director equity plans are not evaluated under the EPSC, and clarify that the 3-year average burn rate policy for equity plans does not apply to director plans unless the number of equity awards granted to non-employee directors exceeds the number of awards granted to employees. However, if the aggregate share reserves of the non-employee director and employee equity plans exceed ISS' Share Value Transfer benchmark for the company, ISS will undertake a qualitative review of board compensation to determine whether the director plan, together with total non-employee director compensation, is "beneficial to shareholders interests."

Equity Plan Vote for Section 162(m) Purposes. ISS has confirmed that where a company with an independent compensation committee is requesting shareholder approval of its equity plan solely to allow for the tax deductibility of performance-based compensation granted under the plan as required under Section 162(m) of the Internal Revenue Code (and do not seek additional shares for grants or a plan extension), ISS will recommend in favor of the proposal. This policy does not extend to equity plans adopted prior to a company's initial public offering (*i.e.*, that have not been previously approved by public shareholders).

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The embedded links to the U.S. Executive Compensation Policies FAQs (link here) and the U.S. Equity Compensation Plans FAQs (link here) contain the full set of these newly released compensation-related FAQs. In these latest versions of the FAQs, ISS continues to refine and expand the extraordinary degree to which ISS has endeavored to micromanage both executive compensation and equity plan compensation policies.

We continue to note that although companies should review these FAQs as they prepare for the 2016 proxy season and be mindful of the impact that the design and operation of their compensation programs can have on ISS' recommendations for withhold/against votes on its say-on-pay votes and director elections, companies should also remain mindful of their obligation to design appropriate incentives for attracting and retaining the talent needed for long-term shareholder value creation in light of their individual circumstances.

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