November 2019

ISS Clarifies 2019 Compensation Policy Updates

The updates provide clarification on how ISS will implement changes to its equity plan scorecard methodology, director pay, equity dilution and more.

Similar to prior years, Institutional Shareholder Services (ISS) has provided clarification regarding several of its compensation-related policies through a supplemental FAQs document, published on November 21, 2018. While not fully comprehensive at this point, the FAQs address several important compensation policies, which we summarize in this alert.

ISS' final 2019 global policy updates are available here.

Economic Value Added will not be Impactful for 2019

ISS says that there will be no changes to the quantitative screens for the 2019 proxy season (Pay-for-Performance, Relative Degree of Alignment, and Multiple of Median). The secondary Financial Performance Assessment screen will continue to use GAAP/accounting performance measures, which vary by industry. However, ISS will explore the potential for future use of Economic Value Added (EVA) measures to add additional insight as part of the financial performance analysis in future proxy seasons. To that end, EVA measures will be featured in ISS research reports for informational purposes during the 2019 proxy season — just not as part of the formal quantitative screen methodology. It's worth noting that ISS purchased EVA Dimensions, a firm that focuses on measuring performance using EVA, in February 2018, likely marking its first step in utilizing the firm's expertise.

Delayed Implementation of the Director Compensation Policy

Last year, ISS introduced a policy that provides for potential adverse vote recommendations for the board committee responsible for establishing non-employee director compensation. This is used when there is an established pattern (i.e., two or more consecutive years) of excessive pay levels without a compelling rationale or other clearly explained mitigating factors.

In light of recent feedback received through its annual policy survey and investor roundtables, ISS plans on revising its methodology for identifying director compensation outliers for the purposes of this policy. As such, ISS will not be issuing adverse director recommendations in 2019. The proxy advisory firm is delaying the first possible adverse vote recommendations under this policy until at least the 2020 proxy season. ISS says it will provide more details on the revised methodology in the comprehensive FAQs coming in December 2018.

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Equity Plan Scorecard Quantitative Thresholds to Remain the Same

The passing scores for all equity plan scorecard (EPSC) models in the United States will remain the same for 2019 as they did during the 2018 proxy season. However, consistent with prior years, there will be point reallocations among some of the individual factors within each EPSC model. Additional information will likely be provided in ISS' U.S. Equity Compensation Plan FAQs, which are often published in December and updated throughout the proxy season.

Dilution is an "Overriding Factor" under the Equity Plan Scorecard

ISS is introducing a new negative overriding factor related to excessive dilution for the S&P 500 and Russell 3000 EPSC models to address investor concerns around potentially highly dilutive equity compensation programs. The new overriding factor will be triggered when the company's equity compensation program is estimated to dilute shareholders' holdings by more than 20% for the S&P 500 and 25% for the Russell 3000. These levels are relatively high and are unlikely to impact many companies. However, while most institutional investors use dilution as one factor in their voting decisions, exceeding ISS' dilution levels will result in a negative vote recommendation by the firm.

Clarification of the Change-in-Control Factor under the Equity Plan Scorecard

The change-in-control (CIC) vesting factor will be updated to provide points based on the quality of disclosure within the actual plan document and related proxy proposal rather than based on the actual vesting treatment of awards. Full points for this factor will be earned where the company's equity plan specifically discloses the CIC vesting treatment for both performance- and time-based awards. If the plan is silent on the CIC vesting treatment for either type of award, or if it provides for merely discretionary vesting for either type of award, then no points will be earned for this factor.

Next Steps

We will continue to monitor the impact of these policy updates ahead of the 2019 proxy season, including any clarifying matters ISS makes in its final FAQs to be published next month. In the meantime, if you have any questions about these policy updates or want to speak to a member of our consulting team about related compensation and governance issues, please write to consulting@radford.com.

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