UNITED STATES

Pay-for-Performance Mechanics
ISS' Quantitative and Qualitative Approach

Updated December 16, 2024

This document is intended to provide general guidance and should not be construed as a guarantee as to how ISS' Governance Research Department will apply its benchmark policy in any particular situation.

WWW.ISSGOVERNANCE.COM

TABLE OF CONTENTS

1. Background

ISS' approach to evaluating pay-for-performance comprises an initial quantitative assessment and, as appropriate, an in-depth qualitative review. Investor feedback on the issue of pay-for-performance indicates a preference for a focus on long-term alignment, board decision-making, and pay relative both to market peers and company performance. The initial quantitative screens are designed to identify outlier companies that have demonstrated significant misalignment between CEO pay and company performance over time. The screens measure alignment on both a relative and absolute basis, over multiple time horizons, and consider long-term shareholder value and financial performance. The screening process applies to constituents of the Russell 3000E Index, which includes up to 4,000 of the largest equity securities traded on U.S. stock exchanges.

ISS reviews the Compensation Discussion and Analysis (CD&A) section of all companies' proxy statements and highlights noteworthy issues to investors regardless of the quantitative concern level. This qualitative evaluation, as well as any in-depth qualitative evaluation subsequent to the quantitative screens, is the most important part of the analysis and vote recommendation. The in-depth qualitative assessment uncovers mitigating factors or potential contributors to the perceived pay-for-performance misalignment.

2. Quantitative Pay-for-Performance Evaluation

Broadly speaking, ISS has three main goals in developing the pay-for-performance methodology:

- **Measure alignment over multiple time horizons**. Business cycles and compensation plans' performance cycles span multiple years. An assessment of the alignment between shareholders and executive pay should be conducted primarily over a long-term timeframe.
- **Use multiple measures to assess alignment**. The pay-for-performance evaluations are based on multiple measures, each of which assesses a company's pay-for-performance alignment from a distinct perspective.
- **Provide robust and standardized information about pay-for-performance concerns.** The evaluation is designed to quantify the degree of alignment between pay and performance, and provide results that can be compared between companies and across multiple years.

ISS' quantitative pay-for-performance screen uses four measures of alignment between executive pay and company performance: three *relative* measures where a company's CEO pay magnitude and the degree of pay-for-performance alignment are evaluated in reference to a group of comparable companies, and one *absolute* measure, where alignment is evaluated independently of other companies' pay or performance. The four measures, which are discussed in greater detail below, are:

- **Relative Degree of Alignment (RDA)**. This relative measure compares the percentile ranks of a company's CEO pay and TSR performance, relative to an ISS-derived comparison group, over the prior three-year period.
- **Multiple of Median (MOM)**. This relative measure expresses the prior year's CEO pay as a multiple of the median CEO pay of an ISS-derived comparison group for the most recently available annual period.
- **Pay-TSR Alignment (PTA)**. This absolute measure compares the trends of the CEO's annual pay and the change in the value of an investment in the company over the prior five-year period.
- **Financial Performance Assessment (FPA)**. This relative measure compares the percentile ranks of a company's CEO pay and financial performance across four EVA financial metrics, relative to an ISS-derived comparison group, over the prior three-year period.

The following table summarizes the measurement periods, and inputs, for each measure:

Measure	Absolute or Relative	Scope	Inputs
RDA	Relative	3 years[1]	CEO Pay & TSR
MOM	Relative	1 year	CEO Pay
PTA	Absolute	5 years[2]	CEO Pay & TSR
FPA	Relative	3 years[1]	CEO Pay & EVA

What We Measure

Executive Pay. The proxy statement for most companies includes an array of pay data, with a three-year look-back, for the five highest-paid executives, including the CEO and CFO. The centerpiece of these disclosures is the Summary Compensation Table, which enumerates the key elements found in typical top executive compensation packages:

- Salary
- Bonus
- Non-Equity Incentive Plan Compensation
- Stock Awards (grant date value)
- Stock Option Awards (grant date value)
- Annual Change in Pension Value/Nonqualified Deferred Compensation Earnings (above market rate)
- All Other Compensation

Other tables provide, among other details, summaries of equity- and non-equity-based grants in the last fiscal year, unexercised/unvested equity-based awards, and the realized gains of vested and exercised grants. However, the Summary Compensation Table presents the most comprehensive picture of each named executive officer's total planned and earned compensation for the year – specifically, the pay and pay opportunities that the compensation committee and board determined they should receive. ISS primarily focuses on the CEO's pay because it sets the compensation pace at most companies, and the compensation committee and board are most directly involved in and accountable for the decisions that generate the CEO's pay.

In evaluating pay and performance alignment, ISS' quantitative analysis focuses on CEO Total Compensation primarily as reflected in the Summary Compensation Table, although ISS utilizes a standard set of assumptions to value equity-based grants. All elements, including the Annual Change in Pension/Deferred Compensation Earnings (not generally considered "direct" pay) are taken into account, since companies that do not provide components such as supplemental pensions and nonqualified deferral plans may compensate executives by making larger equity grants; thus, all elements are considered for equitable comparisons.

Company Performance. There are numerous ways to measure corporate performance, and key metrics may vary considerably from industry to industry and from company to company depending on the particular business

[1] For companies with only two years of pay and TSR (or financial) data, a two-year scope will be used. For companies with less than two years of data, the measure will be excluded.

[2] For companies with only four years of pay and TSR data, a four-year scope will be used. For companies with less than four years of data, the measure will be excluded.

strategy at any given time. Investors expect that incentive plan metrics will stem from that strategy and be designed to motivate the behavior and executive decisions that will lead to its successful execution.

A key measure for investors in the context of a long-term pay-for-performance evaluation is total shareholder return (TSR). If the business strategy is sound and well-executed, the expectation is that it will create value for shareowners over time, as reflected in long-term total shareholder returns. For this reason, TSR, which is objective, transparent, and readily comparable across companies, is the primary metric ISS utilizes in evaluating quantitative pay and performance alignment.

Investors have indicated to ISS that TSR should be the primary performance consideration in the pay-for-performance context. However, investors have also indicated that it is appropriate to supplement TSR with other financial metrics to assess long-term performance. Accordingly, in addition to TSR, ISS' quantitative screen also analyzes long-term financial performance as part of the Financial Performance Assessment (FPA). The FPA utilizes four long-term Economic Value Added (EVA) metrics: EVA Margin, EVA Spread, EVA Momentum vs. Sales, and EVA Momentum vs. Capital. However, TSR is the most impactful performance measure for the purposes of the pay-for-performance quantitative screen. The use of TSR and EVA is not ISS' suggestion that those metrics should be used to form a company's compensation program (and ISS does not advocate that companies utilize any particular metric in the compensation program). Rather, these metrics serve as a guide for ISS to assess long-term alignment between pay and a broader view of performance.

Measures of Relative Alignment

Relative Degree of Alignment (RDA)

This relative measure seeks to determine if the pay opportunity delivered to the CEO is commensurate with the performance achieved by shareholders, relative to the ISS-derived peer group. The Relative Degree of Alignment (RDA) compares the percentile ranks of a company's CEO pay and TSR performance, relative to a comparison group of 12-24 companies selected by ISS on the basis of size, industry, market capitalization, and other factors, generally measured over a three-year period (for more information on ISS' peer selection methodology, see ISS' U.S. Peer Group FAQ). In cases where three complete years of pay or TSR data is unavailable, an abbreviated two-year scope will be used if data are available. Otherwise, RDA will be excluded.

To determine RDA, the subject company's percentile ranks are calculated for three-year average pay and for annualized three-year TSR performance. The RDA measure is equal to the difference between the ranks: the performance rank minus the pay rank. The table below illustrates how the factors combine to determine the final measure – in this case, the relative degree of alignment is -20.

	Performance	Pay	Difference
3-year percentile rank	30	50	-20

Values for the RDA measure range between -100 and +100, with -100 representing high pay for low performance (i.e., 100th percentile pay with 0th percentile performance), zero representing a high degree of alignment (the pay rank is equal to the performance rank), and 100 representing high performance for low pay. Three-year average pay for the subject company and each peer company is based on the most recently disclosed three years of pay data available in ISS' executive compensation database.

Because of the sensitivity of TSR to overall market performance, annualized TSR performance for all companies (subject company and peer companies) will be measured for the same period: that is, the three-year period ending closest to the fiscal-year end of the subject company. ISS smooths the TSR calculation by averaging the daily

closing prices for the beginning and end months of the TSR measurement period. The impact of dividends and stock splits occurring during the averaging period will be factored into the TSR calculation.

To illustrate the TSR calculation: if a company's fiscal year ends on November 29, 2024, then for the subject company and its peers, TSRs will be measured by averaging the daily closing prices of the end month, November 2024, and the beginning month, November 2021.

Multiple of Median (MOM)

1-Year Multiple of Median. This relative measure compares CEO pay magnitude to pay amounts typical for the ISS-derived peer group, independent of company performance. Calculating MOM is straightforward: the company's one-year CEO pay is divided by the median pay for the comparison group (for more information on ISS' peer selection methodology, see ISS' U.S. Peer Group FAQ). Values can therefore range from zero (if the subject company reported no CEO compensation in the most recent fiscal year) to any positive value, with no upper limit. A MOM value of 1.00 indicates that one-year CEO pay is equivalent to the peer median.

3-Year Multiple of Median. ISS research reports also include a three-year MOM view of CEO pay as a measure of long-term pay magnitude relative to the ISS-derived peer group. The three-year MOM compares average CEO pay over the last three years to the three-year average pay of the comparison group, and as a multiple of the median of that average. The comparison group pay figure uses the same peer group for all three years of the measurement period. The display also shows the subject company's three-year cumulative CEO pay total. The three-year MOM is not part of the quantitative screen methodology and is displayed for informational purposes only, though the results may inform ISS' qualitative evaluation.

Financial Performance Assessment (FPA)

This relative measure of alignment between CEO pay and company financial performance is applied as a secondary measure after the three primary screens (Multiple of Median, Relative Degree of Alignment, and Pay-TSR Alignment) have been calculated.

The FPA compares the company's financial and operational performance over the long term (in most cases, three years) to the ISS-derived peer group. The FPA generally utilizes four equally weighted EVA-based metrics:

- EVA Margin
- EVA Spread
- EVA Momentum vs. Sales
- EVA Momentum vs. Capital

Financial performance for these EVA metrics is measured across a three-year period (or a shortened two-year period depending on trading history and data availability), and the subject company is ranked against the comparison group across each of the metrics (for more information on ISS' peer selection methodology, see ISS' U.S. Peer Group FAQ). Performance is measured using the 12 most recent trailing quarters (16 for momentum metrics) as of ISS' Quarterly Data Download. Data is derived from company-reported income statement, balance sheet, and footnote financial data, which is obtained from S&P Compustat. A minimum of 8 trailing quarters of valid data is required for the EVA Margin and EVA Spread metrics to be calculated, and 12 trailing quarters of valid data for EVA momentum metrics – this applies to the subject company as well as ISS-derived peers. As with the other screens, a minimum of 12 peers with valid data is required for the FPA.

The metric performance ranks are combined into an average performance rank, which is compared to the subject company's CEO pay rank. In a similar fashion to the operation of the RDA measure, the FPA generates a relative financial performance result that may range from -100 to +100. A negative result represents a CEO pay rank that is greater than the average financial performance rank, zero represents a CEO pay rank that is equal to the average

financial performance rank, and a positive result represents a CEO pay rank that is below the average financial performance rank.

Note that there are exceptional cases where the FPA screen will not be applied. These exceptions generally are meant to address EVA metric calculation considerations for companies reporting limited revenue or capital, and merger, acquisition, and spinoff activity. See the Appendix for more information.

EVA Metrics. The FPA screen utilizes EVA-based metrics, which improve comparisons between companies with different capital structures, different operating leverage levels, different operating models (asset-heavy vs. asset-light), different business cycles, and companies with peers that span across multiple industries, among other cases.

EVA represents the economic profit a company earns after meeting all its obligations – including the demands of capital providers. As a formula, EVA is net operating profit after taxes (NOPAT), less a capital charge computed by multiplying the firm's capital base by its cost of capital. Unlike GAAP-based measures of profit, EVA cuts through accounting distortions and charges for the use of capital. EVA uses a rules-based method of translating accounting data into economic performance information through a consistent framework, thus making it comparable across companies, industries, and countries.

The four EVA-based metrics used in the FPA:

Metric	Definition
EVA Margin *(EVA ÷ Sales)*	The percent of sales remaining after covering all operating and capital costs, a combined measure of profit and loss (P&L) efficiency and balance sheet asset management.
EVA Spread *(EVA ÷ Capital)*	The EVA yield on capital, which equals the spread between the firm's return on capital (ROC) and its cost of capital (COC).
EVA Momentum vs. Sales *(ΔEVA ÷ Prior Sales)*	The trend line annual growth rate in EVA over the past three years, scaled to Sales.
EVA Momentum vs. Capital *(ΔEVA ÷ Prior Capital)*	The trend line annual growth rate in EVA over the past three years, scaled to Capital.

All ISS-covered companies are entitled to download their EVA Profile for free. The profile provides a high-level breakdown of a company's EVA calculation and the four metrics used in the FPA using the most recently available Quarterly Data Download applicable to the company's next annual meeting. For more information on the EVA methodology, including the adjustments used to calculate EVA, and to download your company's free EVA Profile, visit the ISS EVA Resource Center.

GAAP Metrics. ISS research reports also include a "GAAP Financial Performance" assessment that compares the subject company's financial and operational performance over the long term to the ISS-derived peer group, using GAAP metrics of ROE, ROA, ROIC, and EBITDA Growth (Cash Flow Growth for certain industries). The GAAP Financial Performance assessment is not part of the quantitative screen methodology and is displayed for informational purposes only, though the results may inform ISS' qualitative evaluation.

Measure of Absolute Alignment

Pay-TSR Alignment (PTA)

This absolute measure is intended to identify whether shareholders' and executives' experiences, in terms of shareholder returns and granted pay, have followed the same long-term trend. PTA is not designed to measure whether pay and performance go up and down together on a year-over-year basis; rather, PTA measures long-term directional alignment.

At a high level, PTA is calculated as the difference between the slopes of weighted linear regressions for pay and for shareholder returns over a five-year period. This difference indicates the degree to which CEO pay has changed more or less rapidly than shareholder returns over that period. In cases where five complete years of pay or TSR data is unavailable, an abbreviated four-year scope will be used if data are available. Otherwise, PTA will be excluded.

The regressions that calculate Pay and TSR trends are weighted least-squares regressions of pay and TSR against the independent (x) variable time. Because the timing of the measurements for pay and for TSR is different, however, the regressions are handled differently. The indexed TSR values represent "fence posts" – fiscal year-end markers – that connect the "fence rails" of pay delivered between those markers.

- For the pay regression, five values are measured, at times (years) 1, 2, 3, 4, and 5. The dependent (y) values for the pay regression are the total CEO compensation values for the five most recent fiscal years.
- For the TSR regression, six values are measured, at times (years) 0, 1, 2, 3, 4, and 5. The dependent (y) values for the TSR regression are determined by hypothetically "investing" $100 in the company on the day five years prior to the most recent fiscal year end, and measuring the value of that $100 investment on each of the subsequent five year fiscal year end dates, for a total of six indexed TSR values.

The following table traces a hypothetical company's Pay and Indexed TSR values for the five-year period in question. The TSR % Change column indicates the percentage return over the one-year period in question, for reference.

Year (X)	Pay	Indexed TSR	TSR % Change
2019 (0)	-	100	-
2020 (1)	1,231	109	9.0%
2021 (2)	2,553	118	8.3%
2022 (3)	1,821	91	-22.9%
2023 (4)	1,789	99	8.8%
2024 (5)	2,226	104	5.1%

The regressions are weighted to place slightly more emphasis on recent experience. Because there are a different number of data points for the two regressions, pay and TSR each have their own weights calculated. The weights are constructed such that the geometric mean of the weights is equal to 1, and that the weight for a pay period is equal to the geometric mean of the weights for the TSR periods that "fencepost" it (e.g., the weight for pay period 2 is equal to the geometric mean of the weight for TSR periods 1 and 2). Finally, the weight for any period is equal to the weight for the next period times a decay factor (set to .85 for the ISS model), yielding weights as follows:

	Period 0	Period 1	Period 2	Period 3	Period 4	Period 5
Indexed TSR weights	0.6661	0.7837	0.9220	1.0847	1.2761	1.5012
Pay weights	n/a	0.7225	0.8500	1.0000	1.1765	1.3841

The indexed TSR calculation depends on a continuous series of TSR data. If TSR data for only the first period is missing, PTA will be calculated on the basis of 4 years of data. If pay data are missing for any one period, then that period carries zero weight for both pay and TSR in the calculation.

The slope of the weighted least-squares regression is calculated as follows, if P_i represents the pay or performance value for period *i*, W_i represents the corresponding weight for period *i*, and X_i is simply *i*:

$$slope = \frac{\sum W_i \sum W_i X_i P_i - \sum W_i X_i \sum W_i P_i}{\sum W_i \sum W_i X_i X_i - \sum W_i X_i \sum W_i X_i}$$

In order that the two slopes are comparable to one another, each must be normalized by dividing by their respective weighted-average values:

$$norm.factor = \frac{\sum W_i P_i}{\sum W_i}$$

The normalized slopes are therefore analogous to a 5-year "trend rate" for pay and performance, weighted to reflect recent history. The final PTA result is simply equal to the difference: performance slope minus the pay slope. Potential values for PTA are theoretically unbounded, but in practice they range from just over -100 percent to just over 100 percent.

Quantitative Screening Methodology

Philosophy. The quantitative screening measures (RDA, MOM, PTA and FPA) together provide an important signal for ISS' initial quantitative evaluation of pay-for-performance alignment. ISS has developed a framework to determine whether the measures indicate the presence or absence of a pay-for-performance misalignment. The philosophy of the framework is that if a pay-for-performance measure for a company lies within a range of typical values, then it has demonstrated some evidence of pay-for-performance alignment. If the company's measure falls outside that range, a misalignment may exist.

The evaluative approach begins by identifying companies that are outliers. The approach is based on empirical observation of the distribution of the measures within the back-testing universe, and on the relative strength of the relationship of each measure to voting outcomes. Additionally, the methodology, where possible, avoids arbitrary threshold effects by using a continuous scoring approach. As a result, scores are additive – concerns raised for multiple measures can accumulate to provide evidence for a pay-for-performance misalignment.

Quantitative Concern Levels. ISS' quantitative screen will produce two results: (i) an "Initial Quantitative Concern" level and (ii) an "Overall Quantitative Concern" level. The Initial Quantitative Concern level is determined by the results of the three primary screening measures: RDA, MOM, and PTA. The "Overall Quantitative Concern" level reflects the final concern level for the quantitative screen, which may or may not have been impacted by the FPA results, as described below.

The Overall Quantitative Concern, which will display a Low, Medium or High result, will be the indicator for any pay-for-performance misalignment necessitating an in-depth qualitative evaluation. A Low concern generally indicates long-term alignment between CEO pay and company performance. A Medium concern indicates a

moderate misalignment. A High concern indicates a more severe misalignment. Every Medium or High Overall Quantitative Concern receives a subsequent in-depth qualitative evaluation. A Low concern does not automatically receive an in-depth qualitative evaluation, although ISS may conduct the evaluation at its discretion. See the "Qualitative Evaluation" section below for more information.

Sample of Pay-for-Performance Screen Summary

PAY-FOR-PERFORMANCE QUANTITATIVE SCREEN

The pay-for-performance quantitative screen uses four measures that together evaluate the alignment of CEO pay and company performance. The screen measures alignment over multiple time horizons, on both an absolute and relative basis, using multiple performance measures. The screen is designed to identify outlier companies that demonstrate a significant quantitative misalignment over time.

Measure	Result
Relative Degree of Alignment	-29.68
Multiple of Median	1.84
Absolute Pay-TSR Alignment	-15.56
Initial Quantitative Concern	Low
Financial Performance Assessment	-46.05
Overall Quantitative Concern	**Medium**

P4P Run # 202301080506

FPA Modifications to Concern Levels. There are no changes to the basic mechanics of the FPA screen for 2025. Most companies do not have their Overall Quantitative Concern level modified by the FPA. ISS back-testing indicates that approximately 9% of companies subject to the quantitative screen will have their Overall Quantitative Concern level modified by the FPA. The FPA potentially modifies a company's Overall Quantitative Concern level – by increasing/decreasing the Initial Quantitative Concern level upon a poor/strong FPA result – in one of four ways:

i. From a Low to Medium, for a company with an Initial Quantitative Concern level that is a Low concern but bordering the Medium concern threshold under any of the three primary screens (RDA, MOM, PTA).
ii. From a Medium to Low, for a company with an Initial Quantitative Concern level that is a Medium concern under any of the three primary screens.
iii. From a Medium to High, for a company with only one individual Medium concern (and two Low concerns) under the three primary screens.
iv. From a High to Medium, for a company with only one individual High concern (and two Low concerns) under the three primary screens.

The determination of whether the FPA score is relatively poor or strong takes into consideration the individual company's index membership and Initial Quantitative Concern result. An FPA threshold is established based on these factors and is compared to a company's FPA score to potentially increase or decrease the Initial Quantitative Concern level and determine the Overall Quantitative Concern level.

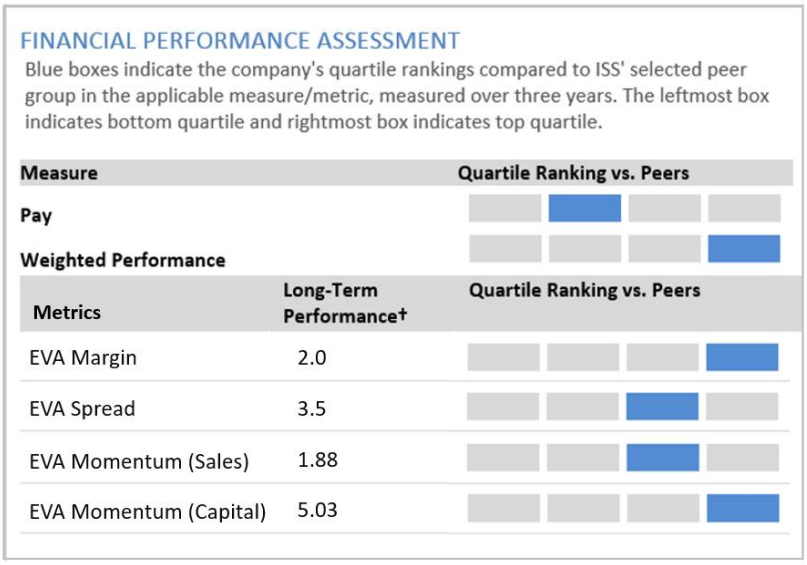
Companies that produce two or more individual elevated (Medium or High) concerns under the three primary screens are not eligible to have their Overall Quantitative Concern level modified by the FPA. If two or three of the primary screens produce a Medium concern, then the Overall Quantitative Concern level will be a High concern and will not be subject to potential modification by the FPA. Similarly, if two or three of the primary screens produce a High concern, the Overall Quantitative Concern level will be a High concern and will not be subject to potential modification by the FPA. In addition, the FPA cannot modify an Overall Quantitative Concern level from a High to Low concern or from a Low to High concern.

Quantitative Concern Thresholds. The pay-for-performance thresholds were first established based on back testing and are annually reviewed and periodically updated. The tables below show the levels for each measure that indicate where a company would be considered to have a misalignment between pay and performance triggering a Medium or High concern under the three primary screens (with differentiation for the Multiple of Median screen between S&P 500 and non-S&P 500 companies). The "Eligible for FPA Adjustment" thresholds displayed below indicate RDA, MOM, and PTA results that are deemed to be bordering the Medium concern

threshold, whereby such companies will be eligible for their Overall Quantitative Concern to be modified from a Low to Medium concern depending on the FPA result, as outlined under criteria (i) above.

Quantitative Concern Thresholds (beginning for meetings Feb. 1, 2025)			
Measure	Eligible for FPA Adjustment	Medium Concern	High Concern
Relative Degree of Alignment	-38	-50	-60
Multiple of Median (Non-S&P 500)	1.84x	2.33x	3.33x
Multiple of Median (S&P 500 only)	1.69x	2.00x	3.00x
Pay-TSR Alignment	-25%	-30%	-45%

Sample of Financial Performance Assessment (FPA)



FINANCIAL PERFORMANCE ASSESSMENT

Blue boxes indicate the company's quartile rankings compared to ISS' selected peer group in the applicable measure/metric, measured over three years. The leftmost box indicates bottom quartile and rightmost box indicates top quartile.

Measure	Quartile Ranking vs. Peers
Pay	
Weighted Performance	

Metrics	Long-Term Performance†	Quartile Ranking vs. Peers
EVA Margin	2.0	
EVA Spread	3.5	
EVA Momentum (Sales)	1.88	
EVA Momentum (Capital)	5.03	

3. Qualitative Evaluation

An important step when pay and performance appear misaligned is to assess how various pay elements may be working to encourage, or to undermine, long-term value creation and alignment with shareholder interests. It is the outcome of the qualitative evaluation that determines the vote recommendation for the say-on-pay proposal (or, in some cases, for the election of directors when there is no say-on-pay proposal on the ballot). ISS conducts an in-depth qualitative evaluation for all companies that exhibit a quantitative pay-for-performance misalignment, and for some companies that do not, depending on the circumstances. The below provides a summary of key considerations in the qualitative evaluation, and further information is available in ISS' U.S. Executive Compensation Policies FAQ.

What We Assess

This second step in the pay-for-performance evaluation reviews the full picture of compensation decisions and practices at the company. The below illustrates typical factors considered, although this is not intended to be a comprehensive list.

Strength of performance-based compensation and rigor of performance goals. This key consideration includes a review of the ratio of performance- to time-based awards as well as the overall ratio of performance-based compensation to discretionary or fixed compensation, focusing particularly on the compensation committee's most recent decision-making (which reflects its current direction).

A company that exhibits significant quantitative pay-for-performance misalignment would be expected to strongly emphasize performance-based compensation (though not by simply increasing the size of the pay package). Pay programs that heavily emphasize discretionary or subjective criteria will be viewed negatively. ISS will review all pay elements, including both recent cash awards paid and long-term award opportunities intended to drive future performance, to evaluate their design and performance criteria. Time-based awards (including standard stock options and time-vesting stock awards) that are not granted based on the attainment of pre-set goals are not considered to be strongly performance-based in this context. Adaptations to ISS' evaluation of regular cycle equity awards in the qualitative review are noted below.

One-time or special awards will be closely evaluated and should contain a strong performance basis. The quality of disclosure, including whether the company has fully disclosed performance metrics and goals, and the rigor of performance goals are important considerations. If goals were set lower compared to the prior year's goals or actual performance levels, the company should explain the reason for this and how that was considered in setting corresponding pay opportunities. ISS may also review goals from prior award cycles and the level at which those awards were earned or forfeited. Use of a single metric or overlapping metrics in both of the short- and long-term incentive programs may indicate duplicative awards or suggest inappropriate focus on one aspect of business results at the expense of others. If the company uses non-GAAP metrics, adjustments should be clearly disclosed (along with compelling rationale if such adjustments are nonstandard and/or reflect factors within the control of management). Companies should also provide clear disclosure on the reconciliation between non-GAAP and GAAP results, as used to determine incentive plan results, especially when such adjustments materially change resulting payouts.

Evolving viewpoints on performance-conditioned equity awards. A growing number of investors have expressed to ISS their concerns with the potential pitfalls surrounding performance equity programs. These investors have raised various concerns around program rigor, complexity and transparency. For these reasons, beginning with the 2025 proxy season ISS will place a greater focus on performance-vesting equity disclosure and design aspects in the qualitative review for companies that exhibit a quantitative pay-for-performance misalignment. Multiple concerns identified with respect to performance equity programs will be more likely to result in an adverse vote recommendation in the context of a quantitative pay-for-performance misalignment. For further information, see ISS' U.S. Executive Compensation Policies FAQ.

Some investors have advocated for replacing performance-conditioned equity awards with time-based equity awards that have extended vesting periods. A potential policy update remains under consideration for 2026 (or later) regarding the evaluation of the equity pay mix for regular-cycle equity awards whereby a preponderance of time-vesting equity awards generally would not in itself raise significant concerns in the qualitative review of pay programs. ISS continues to welcome additional feedback on this topic, which can be submitted through the ISS Help Center.

Financial/operational performance. ISS may consider a company's financial and operational metric results (on an EVA and GAAP basis). In addition to the FPA measure, ISS may also consider a company's general financial performance in the qualitative review, which may give context to award opportunities and/or incentive payouts. For example, strong results in a performance metric may justify above-target payouts relating to that metric, despite poor TSR performance.

Realized and realizable pay. As noted above, the value of pay opportunities that depend on future stock prices and/or achievement of performance goals may not ultimately be delivered, and many investors believe that this should be a consideration in a pay-for-performance analysis. ISS has generally considered amounts of "realized" equity and performance grants in the qualitative analysis. ISS also utilizes a defined calculation of "realizable pay"

that may be considered in the qualitative review of S&P 1500 companies. The fact that realizable pay is lower than grant-date pay will not necessarily obviate other indications that a company's compensation programs are not sufficiently tied to performance objectives. However, in the absence of such indications, realizable pay that demonstrates a pay-for-performance outcome will be a positive consideration. For information on how ISS calculates realizable pay and how it is evaluated in a qualitative review, see ISS' U.S. Executive Compensation Policies FAQ.

Peer group pay benchmarking practices. ISS closely examines a company's disclosed pay benchmarking approach to determine whether it is a contributing factor to a pay-for-performance misalignment. For example, a preponderance of self-selected peers that are larger than the subject company may drive up compensation without sufficient link to performance. Above-median pay benchmarking may have the same effect.

Executive transitions. In cases of executive transitions, ISS will consider compensation arrangements for both outgoing and incoming executives. Severance and termination-related incentive award treatment as well as sign-on awards will be closely evaluated. The nature of the employment termination (i.e., voluntary, involuntary, retirement, etc.), any previously disclosed severance arrangements, and any apparent windfalls or pay-for-failure risk will also be considered. Further, while shareholders may welcome a new CEO in light of lagging performance, the new CEO's pay should be primarily conditioned on performance improvement. Any make-whole and/or one-time inducement compensation should also be explained and clearly disclosed.

Special circumstances. ISS will also review unusual situations as a part of the qualitative analysis, such as a company's responsiveness to receiving low support for the say-on-pay proposal in prior years or when a company has a history of pay-for-performance misalignments or concerns. The qualitative analysis will consider any other special circumstances, such as unusual equity grant practices (e.g., bi- or triennial awards). Given the limitations in disclosure and in order to provide a consistent comparison across all companies, the quantitative screen relies on information disclosed in the proxy pay tables for the year in review. However, if an elevated concern is raised, ISS will consider special circumstances and unusual grant practices in the qualitative review, if this information is clearly disclosed. We note, however, that such circumstances do not automatically invalidate other aspects of the analysis, including the quantitative results, since that methodology's long-term orientation is designed to smooth the impact of timing anomalies. Though the quantitative screen looks at CEO pay, compensation for other NEOs will also be reviewed. Companies should provide robust disclosure on the rationale and other relevant considerations for such circumstances.

4. Summary

ISS' quantitative methodology combines two analytical perspectives – pay and performance relative to a comparison group of companies, and pay relative to absolute shareholder returns – to detect significant long-term misalignment. The use of EVA metrics in addition to TSR broadens the assessment of company performance. The comparison groups are based on a transparent methodology that reasonably accounts for company size, market cap, and general industry categorization – not for the purpose of benchmarking pay (or picking stocks) but to evaluate whether pay is generally commensurate with market peers and performance.

The qualitative evaluation, which ultimately determines the vote recommendation, identifies whether the pay-and-performance misalignment is mitigated or otherwise reinforced. While shareholders are not interested in micro-managing executive pay programs, they certainly have a stake in ensuring that compensation programs have a strong performance basis and are effectively driving value creation.

ISS' robust and transparent pay-for-performance methodology seeks to facilitate investor evaluations of this critical aspect of corporate governance and shareholder value. This methodology evolves with investor expectations, and feedback from all market participants is both welcome and appreciated. To provide feedback on ISS' pay-for-performance quantitative and/or qualitative evaluation process, please visit the ISS Help Center.

Appendix

Financial Metric Measurement Periods

Under the FPA, EVA metrics are generally measured over a three-year period (unless the subject company has only two years of data). For a three-year period, the metrics are calculated over the trailing 12 quarters (or 16 quarters for EVA momentum metrics) as of the applicable Quarterly Data Download (QDD) for each company, using quarterly financial data.

ISS downloads the financial model inputs for all companies four times per year. Downloads occur on the dates below, with the QDD used for a given analysis depending on the shareholder meeting date for the company as shown:

Shareholder Meeting Date	Data Download Date
March 1 through end of May	December 1
June 1 through end of August	March 1
September 1 through end of November	June 1
December 1 through end of February	September 1

FPA and EVA Metric Exceptions

The FPA will not be applied in the following cases:

- The subject company does not have at least 2 years of CEO pay data as of the most recent fiscal year.
- The subject company does not have at least 2 years of financial history as of the most recent QDD date.
- The subject company does not have at least 1 valid EVA metric with a minimum 2-year history.

EVA metric history may be truncated if one or more of the below cases apply. These exclusions can limit the available data for some or all of the EVA metrics and effectively exclude the FPA from the pay-for-performance screen:

- In the case of material merger or spinoff activity during the FPA measurement period, the analysis will exclude the performance history preceding the transaction date. An EVA metric will still be used if sufficient data exists following the merger or spinoff activity so that ISS can calculate a minimum 2-year measurement period (through the calculation date), excluding the impacted quarters.
- Performance periods in which company revenue was below $5 million will be excluded from the EVA Margin and EVA Momentum vs. Sales metrics.
- Performance periods in which company capital was below $5 million will be excluded from the EVA Spread and EVA Momentum vs. Capital metrics.

For more information on the EVA methodology, including the adjustments used to calculate EVA, and to download your company's free EVA Profile, visit the ISS EVA Resource Center.

We empower investors and companies to build for long-term and sustainable growth by providing high-quality data, analytics, and insight.

GET STARTED WITH ISS SOLUTIONS

Email sales@issgovernance.com or visit www.issgovernance.com for more information.

Founded in 1985, Institutional Shareholder Services group of companies (ISS) empowers investors and companies to build for long-term and sustainable growth by providing high-quality data, analytics and insight. ISS, which is majority owned by Deutsche Bourse Group, along with Genstar Capital and ISS management, is a leading provider of corporate governance and responsible investment solutions, market intelligence, fund services, and events and editorial content for institutional investors and corporations, globally. ISS' 2,600 employees operate worldwide across 29 global locations in 15 countries. Its approximately 3,400 clients include many of the world's leading institutional investors who rely on ISS' objective and impartial offerings, as well as public companies focused on ESG and governance risk mitigation as a shareholder value enhancing measure. Clients rely on ISS' expertise to help them make informed investment decisions. This document and all of the information contained in it, including without limitation all text, data, graphs, and charts (collectively, the "Information") is the property of Institutional Shareholder Services Inc. (ISS), its subsidiaries, or, in some cases third party suppliers.

The Information has not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), or a promotion or recommendation of, any security, financial product or other investment vehicle or any trading strategy, and ISS does not endorse, approve, or otherwise express any opinion regarding any issuer, securities, financial products or instruments or trading strategies.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information.

ISS MAKES NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION AND EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY, AND FITNESS for A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by law, in no event shall ISS have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits), or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited.