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# DON'T FORGET! REFRESHER ON GLASS LEWIS COVID-19-RELATED GUIDANCE AND ISS COMPENSATION-RELATED FAQS

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For companies knee deep in proxy statement drafting and 2021 executive compensation decisions, we recommend a quick refresher on Glass Lewis' December 2020 Approach to Executive Compensation in the Context of the COVID-19 Pandemic and ISS' October 2020 COVID-19-related compensation FAQs, as well as ISS' more general December 2020 compensation-related FAQs and equity plan-related FAQs. Highlights include:

## GLASS LEWIS APPROACH TO EXECUTIVE COMPENSATION IN THE CONTEXT OF THE COVID-19 PANDEMIC

Glass Lewis released this December 2020 guidance to illustrate how it will apply its executive compensation policies in 2021 in the wake of COVID-19. Glass Lewis noted that the pandemic has not changed its approach to executive pay, which is a "pragmatic, contextual approach that applies in good times and bad." Some of the key topics covered are:

**Pay-for-Performance Analysis.** Glass Lewis does not expect the macroeconomic climate to have a drastic impact on its pay-for-performance model and will continue to take a holistic approach when evaluating the alignment between executive pay and company performance within the context of the pay-for-performance model and the pandemic.

**Say-on-Pay Proposals.** Glass Lewis notes that how companies respond to changing macroeconomic conditions resulting from the pandemic will dominate say-on-pay votes. Given that an executive's base salary represents a relatively low portion of his or her total compensation, Glass Lewis will view temporary base salary reductions in the face of the pandemic to be token gestures. Glass Lewis will instead look closely at overall pay levels, including scrutinizing mid-cycle pay adjustments to performance awards or their replacement with time-based awards. Glass Lewis notes factors that include the following in describing its approach to say-on-pay this year:

> *Increases to Quantum.* Unless companies have performed very well, Glass Lewis will view with "great scrutiny" increases to short-term pay levels or above-target payouts. Glass Lewis

lists factors it will consider such as the rationale for removal of caps or excessive changes to metrics or calculation methodologies and the justification for the exercise of upward discretion on payouts.

*Forwards vs. Backwards.* Glass Lewis generally views year-over-year increases in opportunities more favorably than high payouts for backward-looking performance.

*One-Off Awards.* Glass Lewis is wary of one-off awards made to executives outside of a company's regular incentive programs. Glass Lewis will review with caution any one-off awards that offset officer base salary reductions or below-target incentive payouts and, in the guidance, lists certain factors that it may consider in evaluating such awards.

*Major Structural Program Changes.* Glass Lewis will view major structural program changes with caution. While Glass Lewis will take into account the need for increased flexibility given the pandemic, Glass Lewis may still view changes as potentially problematic, including decisions to replace performance awards with guaranteed or time-based awards and changes to performance-based awards in the middle or end of their performance cycles. In making its evaluation, Glass Lewis will consider the company's rationale, whether the changes align pay with performance, and the "granting basis and quantum" for the replacement of performance-based awards.

*Potential Windfalls.* Glass Lewis will evaluate the potential for program changes to result in windfall benefits to executives due to improving conditions outside of an executive's control. Circumstances requiring additional consideration include companies that have (1) deviated from historic equity grant practices or priced equity awards at the lowest stock price in recent history and/or (2) replaced performance-based awards with guaranteed or time-based awards or made changes to performance awards late in the performance period (provided the decision to grant time-based awards may be mitigated by applying longer vesting periods).

*No Penalties for "Late Bloomers."* Glass Lewis will not penalize companies that did not provide extensive discussion of their response to the pandemic in their 2020 proxy filings but will credit companies that in their 2020 periodic reports provided some insight into the board's approach for their willingness to address the pandemic.

*Company History.* Also, companies with a track record of good governance, pay-for-performance alignment and appropriate use of board discretion prior to the pandemic are likely to be viewed more favorably than companies without that history.

**Equity Plan Proposals.** While Glass Lewis' approach to equity plan proposals is not changing, Glass Lewis recognizes that in view of COVID-19, companies may take a different approach to the granting of equity awards to put themselves in a position to provide incentives for employees without drawing on cash. Glass Lewis notes that in analyzing share requests, it will (1) continue to require clear and sufficient justification for share requests that result in significant dilution, with the

justification requirements being stricter for companies with multiple large share requests in the prior two years, and (2) consider whether equity is being awarded to executives vs. other employees – if the majority of equity grants have historically been allocated to NEOs, executive pay practices will be factored in more heavily in Glass Lewis' analysis.

**Repricing and Option Exchange Proposals.** Glass Lewis remains opposed to the repricing of executive and director stock options but recognizes there are certain circumstances in which factors such as macroeconomic conditions may make repricing acceptable. If companies in industries highly affected by the pandemic cite unforeseeable downturns outside of the officers' control in seeking repricing approval, Glass Lewis may recommend the proposal if sufficient justification is furnished, if companies demonstrate they have exhaustively searched for alternatives, and if the companies' eligible options are late enough in their life cycle that a meaningful stock price recovery would be unlikely.

**Golden Parachute Proposals.** When evaluating golden parachute proposals, Glass Lewis will consider a company's background of merger-related payments, along with the impact and treatment of earlier pay adjustments made in response to COVID-19. Glass Lewis expresses concern that a quick cash-out in volatile times raises the possibility of pay-for-failure outcomes.

## ISS COMPENSATION POLICIES: FREQUENTLY ASKED QUESTIONS

ISS' December 2020 compensation-related FAQs include:

**COVID-Related FAQs (FAQ 69).** ISS confirms that, in qualitatively evaluating pay practices, ISS will continue to (1) consider the exceptional circumstances of the COVID-19 pandemic and the pandemic's impact on company operations and (2) assess a company's COVID-related compensation decisions under ISS' U.S. Compensation Policies and the COVID-19 Pandemic FAQs released in October 2020. The October 2020 COVID-related FAQs are discussed in our November 2, 2020 post.

**Problematic Severance Arrangements (FAQ No. 46).** When a company discloses that it has made severance payments to a departing executive officer, ISS expects that the disclosure will be sufficiently specific to enable shareholders to assess whether the payment was (1) appropriate as a result of an involuntary or adverse constructive termination (e.g., a "good reason" resignation) or (2) instead represents a discretionary and potentially problematic pay practice (e.g., severance paid as a result of voluntary retirement or resignation). ISS confirms and clarifies its position as follows:

- Investors expect a company to clearly disclose (1) the nature of and reasons for the termination, (2) how the board determined to pay severance and (3) the provision in the applicable agreement or plan pursuant to which severance was paid.
- ISS' example of sufficient disclosure is "the board determined the termination to be 'without cause' as defined in the executive's employment agreement and paid the severance amount

provided under the agreement."

- If a company discloses that severance was paid after an officer "stepped down" or the company and the officer "mutually agreed" on the officer's termination, the disclosure does not clearly indicate that the termination was one for which the payment of severance was appropriate.

Editors' Note: In the case of involuntary termination, companies and their officers are sometimes reluctant to expressly state - due to the potentially embarrassing nature of the disclosure for both parties - that an officer has been involuntarily terminated. Companies sometimes disclose a termination that was initiated by the company and that may legitimately trigger severance as a "mutually agreed" termination, reasoning that the fact that severance was paid sufficiently demonstrates the involuntary circumstances of the termination. As noted, ISS would not find that disclosure to be clear for the purpose of determining whether the payment of severance is appropriate.

**Pay-for-Performance Evaluations – ISS Lowers Multiple of Median High Concern Trigger for S&P 500 Companies (FAQs 16 and 17).** For S&P 500 companies, Russell 3000E Index companies and certain other companies, ISS conducts an annual quantitative pay-for-performance evaluation. In the evaluation, ISS uses four measures to assess how well a company's CEO pay has been aligned with the company's shareholder returns and fundamental financial performance. One of the four measures is the Multiple of Median ("MOM"). The MOM expresses the prior year's CEO compensation as a multiple of the median CEO pay of the company's peer group (as determined by ISS) for the most recently available annual period.

FAQ 16 provides that for shareholder meetings on and after February 1, 2021 and for S&P 500 companies only, ISS has lowered its "high concern threshold" from 3.33 times the peer median to 3.00 times the peer median. This means ISS will find "high concern" beginning at a lower level of the multiple (i.e., when CEO pay exceeds the peer median by 3.00x). The MOM high concern threshold for Russell 3000E Index and the other companies subject to the annual evaluation is unchanged at 3.33 times the peer median.

## ISS EQUITY COMPENSATION PLANS: FREQUENTLY ASKED QUESTIONS

ISS' December 2020 equity compensation plan-related FAQs include:

**Changes to Equity Plan Scorecard (EPSC) Framework for 2021; Threshold Passing Scores for EPSC Models (FAQs 32 and 35).** ISS' EPSC model is the methodology it employs to evaluate management proposals to adopt new equity compensation plans or amend existing plans. ISS has revised the threshold passing scores for these evaluations. Out of a total of 100 possible points and effective for meetings on and after February 1, 2021, the threshold passing scores increased

from 55 points to 57 points for the S&P 500 model and from 53 points to 55 points for the Russell 3000 model. The threshold passing score for all other models remained at 53. There were no new EPSC factors or factor score adjustments.

**New Equity Plan Proposal Involving Termination of Existing Equity Plan (FAQ 11).** ISS analyzes employee stock incentive programs under its EPSC policy. When a company's proxy statement includes a proposal for approval of a new equity plan and, if the new plan is approved, the company intends to terminate an existing equity plan and to cancel any remaining shares available for awards thereunder, ISS expects the company to make certain proxy statement disclosures if the company wants ISS to exclude the remaining shares under the existing plan from its shareholder value transfer ("SVT") analysis relating to the new plan. SVT is the "plan cost" part of ISS' EPSC analysis. The disclosures that ISS expects to see are summarized briefly below:

- 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 new plan;
- The total number of full value awards (i.e., restricted shares and RSUs) and appreciation awards (i.e., options and SARs) outstanding, disclosed separately and including the weighted average exercise price and remaining term of appreciation awards and additional detail on the earned/unearned portions of performance awards; and
- A commitment that the company will not grant any new awards under the existing plan unless the new plan is not approved by shareholders.

**Updated Burn Rate Benchmarks (Appendix).** ISS updates its burn rate benchmarks annually. ISS uses these benchmarks, based on the Global Industry Classification Standard, or GICS, codes assigned to each company, primarily as part of its EPSC evaluation. ISS measures "burn rate" using the total number of shares subject to equity awards granted each year expressed as a percentage of total common shares outstanding. ISS' updated 2021 burn rate benchmarks for S&P 500, Russell 3000 and non-Russell 3000 companies are set forth in the Appendix to the FAQs.

## RELATED PRACTICE AREAS

- Securities & Corporate Governance

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