HUNTON ANDREWS KURTH

Upcoming Proxy Season: Compensatory Thoughts from ISS (Annual Program)

Presentation for:
Executive Compensation Academy
January 7, 2021

Presentation by:
Anthony Eppert

Housekeeping: Questions

- Questions during this presentation
  - We encourage questions (even though your audio lines are muted)
  - To submit a question, simply type the question in the blank field on the right-hand side of the menu bar and press return
  - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

Housekeeping: Recording, CE Credits and Disclaimer

HUNTON ANDREWS KURTH

- Recording
  - This presentation is being recorded for internal purposes only
- Continuing education credits
  - A purpose of the webinar series is to provide FREE CE credits
  - To that end, each presentation is intended to provide 1 credit hour in the following areas:
    - CLE: 1 credit hour (CA, FL, GA, NC, NY, TX and VA)
    - CPE: 1 credit hour (Texas)
    - HRCI: This activity has been approved for 1 (HR (General)) recertification credit hours toward California, GPHR, PHRi, SPHRI, PHR, and SPHR recertification through the HR Certification Institute
    - SHRM: This program is valid for 1 PDC for the SHRM-CPSM or SHRM-SCPSM
  - If you have any questions relating to CE credits, please direct them to Anthony Eppert at AnthonyEppert@HuntonAK.com or 713.220.4276
- Disclaimer
  - This presentation is intended for informational and educational purposes only, and cannot be relied upon as legal advice
  - Any assumptions used in this presentation are for illustrative purposes only
  - No attorney-client relationship is created due to your attending this presentation or due to your receipt of program materials

About Anthony "Tony" Eppert

Anthony Eppert , Partner
Hunton Andrews Kurth LLP
Tel: +1.713.220.4276
Email: AnthonyEppert@HuntonAK.com

- Tony practices in the areas of executive compensation and employee benefits
- Before entering private practice, Tony:
  - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
  - Obtained his LL.M. (Taxation) from New York University
  - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
    - Editor-in-Chief, Journal of Medicine and Law
    - President, Tax and Estate Planning Society

Upcoming 2020 & 2021 Webinars

HUNTON ANDREWS KURTH

- 2021 webinars:
  - Proxy Disclosure Tips on COVID-Related Compensation Decisions (2/11/21)
  - Executive Compensation Clawbacks: A Robust Analysis of Design Features (3/11/21)
  - Finding Value: How to Negotiate Compensatory Economic Drivers in a Change in Control Transaction (4/8/21)
  - Is a Global Employment Company the Solution to Help Manage Internationally Mobile Employees? (5/13/21)
  - Training Course on Designing an Equity Incentive Plan (6/10/21)
  - Training Course on Stock Option Awards and Stock Appreciation Rights (7/8/21)
  - Training Course on Restricted Stock and Restricted Stock Unit Awards (8/12/21)
  - Preparing for Proxy Season: Start Now (Annual Program) (9/9/21)
  - How to Properly Hire and Fire an Executive Officer (10/14/21)
  - A Review of Unique Non-Employee Director Compensation Arrangements (11/11/21)
  - Thoughts on Maximizing the Deductibility of Compensatory Arrangements (12/9/21)

Sign up here: https://www.huntonak.com/en/insights/executive-compensation-webinar-schedule.html

Our Compensation Practice – What Sets Us Apart

HUNTON ANDREWS KURTH

- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
  - Tax,
  - Securities,
  - Accounting,
  - Governance,
  - Surveys, and
  - Human Resources

- Historically, compensation issues were addressed using multiple service providers, including:
  - Tax lawyers,
  - Securities/corporate lawyers,
  - Labor & employment lawyers,
  - Accountants, and
  - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

HUNTON ANDREWS KURTH

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation

Our Compensation Practice – What Sets Us Apart (cont.)

HUNTON ANDREWS KURTH

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement "best practices"
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

Purpose of this Presentation

- The purpose of this presentation is to help publicly-traded issuers prepare for the upcoming proxy season with respect to compensation-related matters covered by ISS

- To that end, this presentation covers:
  - Recent pronouncements from ISS since the last proxy season;
  - Areas where ISS is likely to focus their attention this proxy season;
  - The impact the foregoing could have on compensation design; and
  - Practical compensatory thoughts regarding ISS for issuers preparing for the 2021 annual shareholders' meeting

Background: 5 Global Compensation Principles of ISS

- From the compensatory perspective, the framework of ISS is built around the following 5 global principles:
  - Maintain appropriate pay-for-performance alignment, with an emphasis on long-term shareholder value,
  - Avoid say-for-failure arrangements or risk of such arrangements,
  - Maintain an independent Compensation Committee,
  - Provide clear and comprehensive compensation disclosures, and
  - Avoid inappropriate pay for non-executive directors (*i.e.*, do not allow pay to compromise independence)

COVID-19 Pay Actions

- On October 15, 2020, ISS released U.S. Compensation Policies and the COVID-19 Pandemic Frequently Asked Questions
  - The purpose is to provide general guidance on pay-for-performance qualitative evaluation in light of pay decisions resulting from COVID-19
  - Conceptually, the qualitative evaluation will take into account the impact of COVID-19 on the issuer's operations

- Pursuant to the above FAQs:
  - Temporary reductions in salary will have little mitigating weight unless such reduction also works to decrease targeted incentive payout opportunities
  - Addressing annual incentives, an issuer's changes to metrics, performance targets and measurement periods, or a suspension of the foregoing in lieu of a one-time discretionary payment, may be considered by ISS as a reasonable response to COVID-19 so long as the justifications and rationale are clearly disclosed and the resulting outcome is reasonable. Disclosures that will help ISS determine reasonableness include:
    - The challenges the issuer faced as a result of COVID-19, and how such challenges rendered the original program design obsolete or impossible to achieve, and too, the disclosure should address how such changes are not reflective of poor management performance
    - If the issuer made mid-year changes instead of going the route of a 1x discretionary award, the disclosure should explain why such approach was taken and how such was in the best interests of the shareholders
    - Performance-based considerations with respect to 1x discretionary awards should disclose the underlying criteria even if not based on original metrics or targets. Descriptions such as "strong leadership" are not likely sufficient

COVID-19 Pay Actions (cont.)

HUNTON ANDREWS KURTH

- [Cont. from prior slide] Pursuant to the above FAQs:
  - Discuss how the resulting payouts reflect both executive and issuer annual performance. There should be a comparison to what would have been earned under the original program had COVID-19 not occurred
  - With respect to changes to equity or long-term incentive awards, any changes to programs currently outstanding will generally be viewed negatively
  - Bonuses and 1x awards for the purpose of retention should contain a long-term performance-based vesting condition with contingencies to avoid windfall scenarios if the executive's employment is terminated
  - For issuers who received less than 70% support on their say-on-pay proposal in the prior proxy season, ISS typically would be looking to see whether the issuer was responsive to the "low" vote by reviewing 3 factors: (i) disclosure of shareholder engagement efforts, (ii) disclosure of feedback from dissenting shareholders, and (iii) actions or changes the issuer undertook in response to shareholder concerns (among other things). But in the COVID-19 environment:
    - ISS will pass on (iii) if the issuer discloses how COVID-19 impeded its ability to address such concerns, and the issuer discloses it long-term plans for addressing shareholder concerns

What's New – ISS Equity Compensation Plans

HUNTON ANDREWS KURTH

- ISS updated its FAQs on Equity Compensation Plans on December 21, 2020

- The term "shareholder value transfer" is a concept ISS uses to help it project the cost of an equity incentive plan (i.e., the estimated value of the issuer that will be transferred to employees and directors)
  - ISS calculates an SVT benchmark for each issuer based upon market cap, industry, etc.
  - The FAQs were updated to address what disclosures should an issuer make when it intends to terminate an existing equity incentive plan and cancel the shares available thereunder and such occurs when the shareholders approve a new plan
    - Goal is to not have such upcoming terminated shares counted in the SVT analysis

  - For ISS to exclude such shares in the SVT analysis, the issuer should disclose:
    - Number of shares that will no longer be available when new plan approved
    - A commitment that no awards will be granted under the existing plan unless the new plan is not approved by the shareholders
    - Total number of equity awards outstanding broken apart by full-value awards and appreciation-only awards, including the weighted average exercise price and remaining term of appreciation awards

- There are no changes to the Equity Plan Scorecard, "problematic pay practices" or option repricing policies, however:
  - ISS did increase the EPSC passing score to 57 points (for S&P 500) and 55 points (for Russell 3,000), effective for meetings as of February 1, 2021

What's New – No Changes Made

- No changes were made by ISS to its FAQs on Peer Group Selection Methodology

- No changes were made by ISS to its FAQs on Pay-for-Performance Mechanics (Quantitative and Qualitative Approach)

Don’t Forget Next Month’s Webinar

- Title:
  - Proxy Disclosure Tips on COVID-Related Compensation Decisions
- When:
  - 10:00 am to 11:00 am Central
  - February 11, 2021