

Hot Topics within Executive Compensation

Presentation for:

Executive Compensation Academy -
(Monthly Training Series)
April 14, 2022

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About Anthony “Tony” Eppert



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- 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 2021 Webinars

- 2022 webinars:
 - Current Compensation Designs within Partnership and LLC Entities (5/12/22)
 - Granting Equity Abroad: Applicable Tax Considerations (6/9/22)
 - How to Effectively Vet and Hire a Compensation Consultant (7/14/22)
 - Navigating Compensation Rules Applicable to Financial Institutions (8/11/22)
 - Preparing for Proxy Season: Start Now (Annual Program) (9/8/22)
 - Compensation Considerations Due to Upcoming Loss of EGC Status (10/13/22)
 - Aging Executives: Thoughts on Designing Succession Strategies (11/10/22)
 - [Topic TBD] (12/8/22)

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

Our Compensation Practice – What Sets Us Apart

- 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.)

- 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.)

- 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 Presentation

- The purpose of this presentation is to discuss various hot topics within executive compensation, including:
 - Proxy trends,
 - Status of clawback policies and other SEC rulemaking,
 - SEC’s Rule 10b5-1 proposal and its impact on the timing of equity grants,
 - Spring-loaded equity awards, and
 - Taxation of remote workers

Big Picture Considerations

- Talent wars and the “Great Resignation”/”Great Reshuffle”/”Great Reevaluation”
 - The labor market is tight and there are unprecedented levels of turnover
 - Inflation will decrease an employee’s purchasing power, thus applying upward pressure on wages
 - Pay increases are a critical issue for 2022
 - Creativity is required to attract and retain talent (e.g., flexibility on how and where to perform the job, off-cycle equity awards, retention bonuses, etc.)
- President Biden’s tax plan will increase corporate tax rates and individual tax rates
- There has been a push over the past two years to incorporate ESG into incentive compensation designs
- The role of the Compensation Committee continues to evolve due to D&I and human capital disclosure rules

Big Picture Considerations (cont.)

- There may be generational issues associated with advancement opportunities, requiring employers to dip further into the “youth” pool for leadership positions

- As background:
 - Baby Boomers II
 - Born 1955-1964
 - Ages 58-67

 - Gen X
 - Born 1965-1980
 - Ages 42-57

 - Millennials
 - Born 1981-1996
 - Ages 26-41

 - Gen Z
 - Born 1997-2012
 - Ages 10-25x

- A number of compensation designs were enacted during the COVID-19 pandemic in response to uncertainty and volatile stock prices. A number of these designs will likely continue in the future, two of which are worth mentioning:
 - For annual bonus programs, consider adopting performance targets with respect to the first 6 months of the year, and then near the end of such period, set performance targets with respect to the last 6 months of the year
 - Add or increase the weighting of qualitative metrics so that the Compensation Committee can apply discretion within certain parameters. By way of example:
 - Allow for the Compensation Committee to utilize its discretion, up or down, within 20% (or other parameter)
 - Incorporate a “soft” metric (e.g., leadership) that can only be assessed if any of the financial goals and metrics are wholly or partially satisfied. For example, annual bonus is earned 10% if X financial target satisfied, 30% if Y financial target satisfied, and 40% if Z financial target satisfied. Another target worth 20% is leadership, however, it can only be assessed if any of the other three financial targets are satisfied

Dodd-Frank Clawback Policy

- As background, Dodd-Frank clawback policies would (when contrasted to Section 304 of SOX):
 - Apply to current and former executive officers (whereas SOX applies only to the CEO and CFO)
 - Triggered when an accounting restatement results from “material” noncompliance with a financial reporting requirement under securities laws (whereas SOX applies only if a restatement is “required” and is the result of “misconduct”, thus, SOX has a fault requirement)
 - Once triggered, it applies to all “incentive-based” compensation
 - The look-back period is the 3-year period preceding the date on which the restatement is required (whereas the look-back period under SOX is 12 months)

- The SEC reopened the comment period, seeking comments on the original proposed rules and 10 new questions

- We “might” see finalized rules in the near future

Proposed Changes to Rule 10b5-1 Trading Plans

- Rule 10b-5 imposes a presumption in favor of liability, such that if a person is “aware” of material non-public information at the time a security is bought or sold, such person is then presumed to be trading based upon such material non-public information
 - But a properly designed trading plan under Rule 10b5-1 would shift the focus from whether an insider had material non-public information at the time of a trade, to whether the insider had material non-public information at the time he or she became committed to the trade. In essence, a trading plan provides insiders with an affirmative defense

- In December 2021, the SEC proposed new requirements that would have to be satisfied before the affirmative defense under Rule 10b5-1 could be applied. Such proposed amendments include:
 - There must be at least a 120-day cooling off period between the adoption of the plan by an insider and any trade commencing under such plan (such cooling off period would apply equally to changes/amendments to existing plans)
 - A requirement that issuers disclose in their quarterly reports the adoption and termination of 10b5-1 trading plans by directors, officers and issuers, and include within such disclosure the terms of such arrangements
 - A requirement that Section 16 officers and directors disclose on Forms 4 and 5 (by checking a box) whether the reported transaction was made pursuant to a 10b5-1 trading plan

Document an Annual Grant Policy

- Issuers with volatile stock price should consider having an annual (or more frequently, *e.g.*, quarterly, monthly, etc.) equity grant policy. Reason is that with respect to dollar-denominated awards that are then converted into equity based upon such dollar amount, and assuming there is no such equity grant policy, such issuers could be susceptible to claims from plaintiffs that the executives (or the Board) was timing the market price
 - This topic is not new. Having an equity grant policy became a hot topic during the financial crisis in '08ish

- And too, the SEC guidance on spring-loaded equity awards is yet another reason why issuers should consider whether it makes sense to have an equity grant policy. Under such SEC guidance:
 - Spring-loading occurs when an equity award is granted just prior to a public announcement that the issuer expects will increase its stock price
 - There are two issues with spring-loaded awards. First, the compensation expense will be lower than it would have been had the award been granted immediately following such public announcement. Second, for issuers with dollar-denominated grants, the executive will have received many more shares than he or she would have received had the award been granted after the public announcement when the issuer's stock price would have been higher
 - The SEC guidance differentiates between routine and non-routine grants, and as a result, such implies that routine grants would not be subject to this guidance. Can having an equity grant policy create "routine"? Such policy could, by example, reflect that grants will only occur on the 10th day of each quarter

Tweak to Retirement-Eligible Vesting

- It is common within equity awards to have accelerated vesting if the employee's employment is terminated due to his or her "retirement"
- For this purpose, retirement is often defined as attaining a certain age plus a certain number of years of service with the issuer
 - Example: Retirement means a separation from service with the Company after attaining age 63 and completing 10 years of continuous service with the Company
- Consider whether it makes sense to modify "retirement" provisions to require the employee to provide advance written notice (e.g., 6 months, 12 months, etc.) of his or her intention to "retire"
 - Such advance written notice will help smooth transitions and provide the issuer with time to find or train up a successor
 - Of course, the advance notice requirement would only apply to the situation where the employee is terminating his or her service with the issuer, and would not apply to the situation where the issuer is effectuating the adverse employment action

Remote Workers

- Remote workers and work anywhere policies raise the following issues to consider include:
 - State business tax issues;
 - State payroll and employment tax issues; and
 - Employment issues such as workers compensation, unemployment, handbooks and other policies

- The foregoing is further complicated because state laws on the issue had not anticipated the explosive growth of remote workers caused by the COVID-19 pandemic
 - Some states adopt “convenience of the employer”
 - Some states have a 1-day rule,
 - Some states have reciprocity agreements,
 - Etc.

- If the issuer is interested in attracting remote workers, then to streamline administration consider:
 - Set up a remote worker employment entity in a state with no state income tax
 - Have that entity register to do business in any state where a remote worker may reside
 - Develop service agreements between the remote worker entity and the other divisions or subsidiaries of the larger employer

Don't Forget Next Month's Webinar

- Title:
 - Current Compensation Designs within Partnership & LLC Entities

- When:
 - 10:00 am to 11:00 am Central
 - May 12, 2022

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