HUNTON ANDREWS KURTH

ISS: New Compensatory Thoughts & Practices (Annual Program)

Presentation for:
Executive Compensation Academy –
(Monthly Training Series)
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Presentation by:
Anthony J. Eppert
AnthonyEppert@HuntonAK.com
512.542.5013

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About Anthony “Tony” Eppert

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Anthony Eppert , Partner
Hunton Andrews Kurth LLP
Tel: +1.512.542.5013
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 2023 Webinars

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- 2023 webinars:
  - Start-Up Compensation Designs: Focus on Founders (Part 1 of 2) (2/9/23)
  - Start-Up Compensation Designs: Focus on Key Employees (Part 2 of 2) (3/9/23)
  - Current 280G Mitigation Techniques (4/13/23)
  - Private Equity Compensatory Design Trends & Practices (5/11/23)
  - Equity Awards & Employment Taxes: Design Considerations (6/8/23)
  - Form 4 Training Course (7/13/23)
  - Anatomy of ISS: A Current Compensatory Perspective (8/10/23)
  - Preparing for Proxy Season: Start Now (Annual Program) (9/14/23)
  - PubCo Governance & Internal Controls: A Compensatory Perspective (10/12/23)
  - Keep It Boring: Drafting Miscellaneous Provisions in a Contract (11/9/23)
  - [Topic TBD] (12/14/23)

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

Our Compensation Practice – What Sets Us Apart

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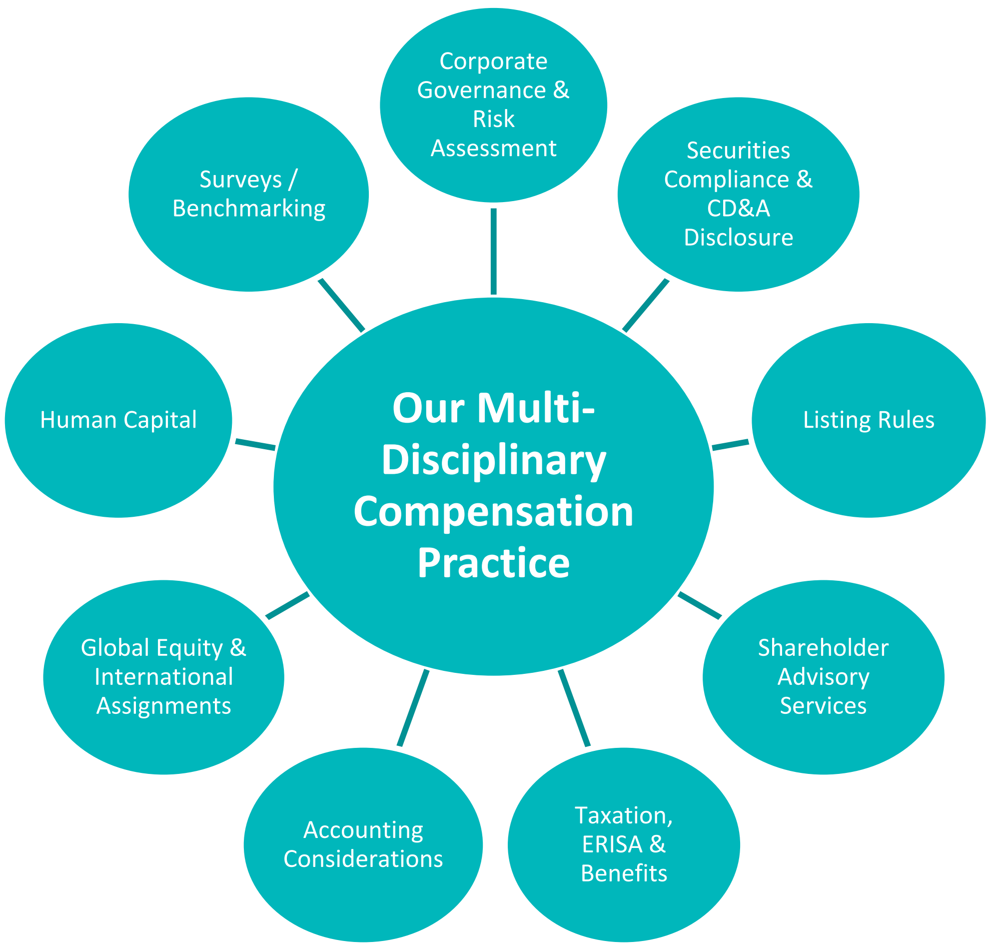
- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
  - Tax,
  - Securities,
  - Accounting,
  - Governance,
  - Surveys, and
  - Human Resources

- 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.)

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- 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 program is to discuss recent pronouncements from ISS and other institutional shareholder advisory services with respect to compensation matters, including:
  - Areas where ISS and other institutional shareholder advisory services are likely to focus their attention this proxy season;
  - The impact of the foregoing on compensation designs; and
  - Practical compensatory thoughts as issuers begin preparing for the 2023 annual shareholders' meetings

Background: 5 Global Compensation Principles of ISS

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- With respect to compensation matters, and by way of introduction, ISS has a framework that is built around the following 5 global principals:
  - Maintain appropriate pay-for-performance alignment, with an emphasis on long-term shareholder value;
  - Avoid pay-for-failure 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)

Updates

- No significant changes were made to the ISS U.S. benchmark voting policy guidelines covering executive compensation matters for the 2023 proxy season

- That said, ISS did update some of its FAQs relating to executive compensation, as follows:
  - ISS updated the factors it considers when performing the qualitative review of its pay-for-performance analysis, to now consider:
    - The complexity of the compensation program,
    - Any risks associated with the pay program design,
    - Financial or operational results with respect to both absolute and relative to peers, and
    - Recent pay program changes and forward looking commitments
  - Transition pay relating to an incoming CEO
    - ISS thinks that investors are aligned with issuers on the concept that transition pay for a CEO is needed to onboard a new CEO, however, ISS thinks such transition pay should be temporary and that compensation should thereafter normalize
    - Such transition pay could include inducement grants (if such are predominantly performance-based awards) and make-whole grants
    - ISS indicates that issuers should clearly disclose such pay amounts and the rationale for paying such amounts

Updates (cont.)

- [continued from prior slide]
  - ISS expanded its list of most problematic pay practices, the existence of which causes an ISS no-vote campaign against an issuer's say-on-pay vote, to now include:
    - Severance payouts if the employment termination was not clearly disclosed as "voluntary" (*e.g.*, termination without Cause or quit for Good Reason)
  - Employee Plan Scorecard threshold is increased
    - For S&P 500 it increase from 57 points to 59 points considered as passing,
    - For Russell 3000 it increased from 55 points to 57 points considered as passing,
    - Non-Russell 3000 it increased from 53 points to 55 points considered as passing,
    - For all others the passing threshold is 53 points
  - Employee Plan Scorecard and clawback policies
    - To receive full points for the clawback policy, the policy should be triggered with respect to both time-based and performance-based vesting (*i.e.*, policies that only comply with Dodd-Frank to the minimum extent necessary will receive no points)
  - New considerations are being used with respect to equity plan proposals and burn rates

Updates (cont.)

- This is just a reminder that ISS has returned to pre-COVID pandemic policies with respect to issuers who receive less than 70% support on their say-on-pay proposal. As a result, issuers who receive less than 70% say-on-pay support should, according to ISS, be responsive in the following three ways:
  - Disclose in the proxy statement all efforts that the Board took with respect to shareholder engagement,
  - Disclose in the proxy statement the specific feedback the issuer received from dissenting shareholders, and
  - Disclose in the proxy statement what actions or changes the issuer made to its pay programs and practices to address concerns of its shareholders

- Long-term equity incentives
  - No changes from ISS
  - Glass Lewis increased its recommended minimum percentage of outstanding awards that should be performance based from 33% to 50%
    - Violating this percentage will raise concerns from Glass Lewis but will not trigger an against recommendation on the say-on-pay vote unless there are other related issues or unless Glass Lewis notices a trajectory of non-performance based grants of equity awards

Proxy Season: Action Items to Consider

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- Counting the say-on-pay vote
  - The most common reason for a negative recommendation from ISS is a pay-for-performance disconnect in the issuer's compensation of its executive officers
  - Robust disclosure on this point can help, especially disclosure that specifically addresses why certain performance criteria were used and the degree of difficulty in attaining such criteria
  - Shareholder outreach programs are important towards achieving a passing say-on-pay vote

- Large swings in share price and certain stock grant practices
  - It is common practice that grants of equity awards are first denominated in dollars (*e.g.*, 100% of base salary), and then converted into a number of shares
  - An issue with the foregoing is whether shareholders might allege that the executives took advantage of a downward slide in stock price by timing the grant of dollar-denominated equity awards to coincide with low stock price, thus resulting in a higher share award than if the stock had a higher stock price
  - Having a documented annual grant policy could provide an affirmative defense to an allegation that the equity grant was intended to time the market (and too, an issuer's consistent grant practice over the prior years could have the same effect)

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Don't Forget Next Month's Webinar

- Title:
  - Start-Up Compensation Designs: Focus on Founders (Part 1 of 2)

- When:
  - 10:00 am to 11:00 am Central
  - February 9, 2023