SULLIVAN & CROMWELL LLP

2020 Proxy Season Review: Part 2

Say-on-Pay Votes and Equity Compensation

July 22, 2020

Say-on-pay:

- **Public companies continued to perform strongly, with support levels averaging 91% and less than 2% of companies failing**
- **Continued turn-over in failed votes, with 56% of companies that failed last year achieving over 70% support this year and only five companies failing in both 2019 and 2020**
- **ISS negative recommendations highlight the continued importance of the pay-for-performance assessment, with the most important factor continuing to be the alignment of CEO pay with relative total shareholder return**
- **The most important qualitative factors were performance standards that were not deemed sufficiently rigorous or were not clearly explained, followed by severance or change-in-control arrangements deemed not in the shareholders' interests and the use of time-based awards rather than performance-based awards**

Equity Compensation Plans:

- **Broad shareholder support for equity compensation plans, with only three Russell 3000 companies failing to obtain shareholder approval for an equity compensation plan, and overall support levels continuing to average around 93%**

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INTRODUCTION

Our annual proxy season review memo summarizes significant developments relating to the 2020 U.S. annual meeting proxy season. This year, our review comprises three parts: Rule 14a-8 shareholder proposals; compensation-related matters; and takeaways for 2021. This is Part 2. Part 1, which focuses on Rule 14a-8 shareholder proposals, was published on July 15, 2020 and is available here. We expect to issue Part 3 shortly. We will also host our annual webinar to discuss 2020 proxy season developments in September.

The data on say-on-pay negative recommendations derives from information provided by ISS summarizing the rationales with respect to the negative recommendations issued by ISS at annual meetings of Russell 3000 and S&P 500 companies through June 30, 2020. For a discussion of U.S. proxy contests and other shareholder activist campaigns, see our publication, dated November 6, 2019, entitled "Review and Analysis of 2019 U.S. Shareholder Activism."

More generally, for a comprehensive discussion of U.S. public company governance, disclosure, and compensation, see the *Public Company Deskbook: Complying with Federal Governance and Disclosure Requirements* (Practising Law Institute) by our colleagues Bob Buckholz and Marc Trevino, available at 1-800-260-4754 (1-212-824-5700 from outside the United States) or http://www.pli.edu.

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PART 2. ISS SAY-ON-PAY VOTES AND EQUITY COMPENSATION PLAN APPROVAL

A. COMPANIES MAINTAIN STRONG SAY-ON-PAY PERFORMANCE

The following summarizes say-on-pay voting results for 2019 full-year and 2020 through June 30. U.S. companies, broadly speaking, had similar results on say-on-pay votes in 2020 as compared to 2019 and other recent years, with the vast majority of companies achieving high levels of support. In addition, say-on-pay results between the S&P 500 and the broader Russell 3000 remained largely consistent.

	Russell 3000		*S&P 500*	
	2020	*2019*	*2020*	*2019*
Percentage passed (majority support)	***98%***	*97%*	***98%***	*99%*
Percentage with >70% support	***93%***	*91%*	***94%***	*93%*
Percentage with ISS "Against" recommendations	***11%***	*13%*	***11%***	*11%*
Average support with ISS "For" recommendations	***94%***	*95%*	***92%***	*93%*
Average support with ISS "Against" recommendations	***66%***	*65%*	***70%***	*65%*

There continues to be significant year-over-year turnover in failed votes. This year, companies with failed 2019 votes, in particular in the S&P 500, seem to have had increased success in engaging in, and disclosing, shareholder outreach efforts and, as appropriate, implementing program changes in a way that brings high support levels. However, of the 55 Russell 3000 companies that failed their say-on-pay votes in 2019 and have had their 2020 votes thus far, 37 achieved majority support in 2020, and 31 had support levels over 70%.[1] Of the 44 companies in the Russell 3000 that failed say-on-pay votes in 2020 so far, five had failed their 2019 vote and 13 had 2019 support levels below 70% (compared to 10 and 21 out of 51 in 2019, respectively). None of the eight S&P 500 companies that failed say-on-pay in 2020 so far failed their vote in 2019, although five had support levels below 70% (compared to two and four out of six in 2019, respectively).

Increasingly, year-round shareholder outreach has become a regular feature of corporate governance and investor relations for many public companies, facilitating dialogue between issuers and investors on compensation and other key topics. Shareholder outreach takes various forms at different companies, including face-to-face meetings (COVID-19 protocols permitting), one-on-one phone calls, group conference calls, and web meetings, and, in some cases, includes board members. Companies conducting such outreach must be mindful that company representatives may not disclose material non-public information in these discussions due to Regulation FD. Companies conducting such outreach also should be aware that large institutional investors regularly receive thousands of requests for engagement

1 If a company receives less than 70% shareholder support for any director's say-on-pay vote, ISS will conduct a qualitative review of the compensation committee's responsiveness to shareholder opposition at the next annual meeting, which could lead to negative recommendations against the members of the compensation committee.

and that these investors have noted that it may not be possible to hold meetings with every issuer on every topic. In response, many issuers have noted in their proxies both actual and attempted engagement with their major institutional investors.

Companies should ensure that the appropriate personnel at institutional investors are involved in the engagement process. Larger institutional investors generally have both environmental, social, and governance (ESG) experts and investment professionals, all of whom may provide input into the voting process, but may have differing views. Companies therefore should ensure that the appropriate company representatives are part of engagements and that materials are appropriately tailored. Institutional investors are likely to send representatives with a high degree of expertise and specialization, and generalized presentations may not suffice. Board representation in discussions, especially on topics such as succession planning or executive compensation, may be appropriate, but should be evaluated on a case-by-case basis, taking into account the engagement history, the purpose of the meeting, the experience of the relevant directors with direct shareholder engagement and Regulation FD (among other things), and the preferences of the investor with whom the company is engaging.

Companies have increasingly engaged with proxy advisory firms in the off-season as well. ISS[2] and Glass Lewis[3] post their engagement policies on their websites. The policies of both firms restrict their ability to engage with companies during the solicitation period for the annual meeting, which means any broader discussions with these firms must occur in the off-season.

Recommendations from proxy advisory firms continued to influence voting results this year, and the role of proxy advisory firms and their impact on shareholder voting continue to attract debate and legislative reform efforts. The Corporate Governance Fairness Act was introduced in the Senate in November 2018 to amend the Investment Advisers Act of 1940, but has not been passed as of the date of this publication. If passed, the Corporate Governance Fairness Act would require proxy advisory firms to register as investment advisers under the Investment Advisers Act, thus subjecting them to heightened SEC regulation, including periodic reviews of their conflicts of interest policies and whether they knowingly made false statements to clients.

The SEC has also indicated an interest in revising its own approach to regulating proxy advisory firms. In August 2019, the SEC issued guidance indicating that the proxy voting advice given by proxy advisory firms such as ISS generally constitutes a solicitation under the federal proxy rules.[4] As such, these firms

2 *See* ISS's engagement policies, *available at* http://www.issgovernance.com/policy/EngagingWithISS.

3 Glass Lewis's engagement policies are available at http://www.glasslewis.com/for-issuers/glass-lewis-corporate-engagement-policy/.

4 *See* Securities and Exchange Commission Release Nos. IA-5325, IC-33605, *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

would be precluded from any solicitations that contained statements that were false or misleading relating to any material fact. On November 5, 2019, the SEC took a further step in implementing its agenda for proxy reform, proposing amendments to the proxy solicitation rules with respect to proxy voting advice businesses, including new procedures for voting advice to qualify for the exemptions from the proxy information and filings requirements.[5] In particular, the SEC's proposed amendments provided that communications would be exempt from proxy rules if three procedural requirements were satisfied. First, the company must include disclosure of material conflicts of interest in its proxy voting advice and any electronic medium used to deliver the advice. Second, the issuer covered by the proxy voting advice and any other soliciting persons must be given an opportunity to review and provide feedback on the advice before it is issued, with the length of review dependent on the number of days between filing of the definitive proxy statement and the date of the shareholder meeting. Third, if requested by the issuer covered by the proxy voting advice or other soliciting persons, the firm must include in its advice and any electronic medium used to deliver the advice a hyperlink directing the recipient to a written statement that sets forth the registrant's or soliciting person's views on the proxy voting advice.

ISS had strongly disagreed with these proposals, filing a lawsuit in the U.S. District Court for the District of Columbia on October 31, 2019, asserting that the SEC's guidance was "unlawful" and "arbitrary and capricious" and that it should be rescinded.[6]

For a more detailed discussion on trends in shareholder engagement, institutional investor influence, and shareholder activism, see our publication, dated November 6, 2019, entitled "Review and Analysis of 2019 U.S. Shareholder Activism."

B. OVERALL ISS APPROACH ON SAY-ON-PAY EVALUATION

ISS has a multipronged approach to assessing executive compensation for the purposes of recommending a vote for or against the management say-on-pay proposal.[7] While an analysis of ISS's

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5 *See* Securities and Exchange Commission Fact Sheet, Proposed Rule Amendments for Proxy Voting Advice, *available at* https://www.sec.gov/news/press-release/2019-231.

6 *See Institutional Shareholder Services Inc.* v. *Securities and Exchange Commission* (1:10-cv-03275), *available at* https://www.issgovernance.com/file/duediligence/iss-oct-31-2019-complaint.pdf.

7 Glass Lewis's executive compensation assessment policy appears to be less formulaic than ISS's, though Glass Lewis publicly discloses fewer details on its policy than does ISS. Based on Glass Lewis's published information, it evaluates compensation based on five factors: overall compensation structure, implementation and effectiveness of compensation programs, disclosure of executive compensation policies and procedures, amounts paid to executives, and the link between pay and performance. In evaluating pay-for-performance, Glass Lewis looks at the compensation of the top five executive officers, not just the CEO. In addition, Glass Lewis looks at performance measures other than total shareholder return—it measures performance based on a variety of financial measures and industry-specific performance indicators. Glass Lewis has made some recent updates to its policies, and now, for example, has a process that permits issuers to provide a written response statement in which subjects of Glass Lewis's proxy research have an opportunity to submit feedback

(footnote continued...)

2020 negative recommendations for S&P 500 companies suggests that the most important criterion continues to be the pay-for-performance assessment (with nearly three-quarters of the negative recommendation reports indicating high concern on this issue), high concern with respect to severance or change-in-control arrangements itself can be sufficient to trigger a negative recommendation.

ISS's policies provide that it will recommend a vote against a company's say-on-pay proposals if any of the following is true:

- there is a significant misalignment between CEO pay and company performance (pay-for-performance);
- the company maintains significant problematic pay practices (for example, excessive change-in-control or severance packages, benchmarking compensation above peer medians, repricing or backdating of options, or excessive perquisites or tax gross-ups); or
- the board exhibits a significant level of poor communication and responsiveness to shareholders.

ISS applies these standards by assigning companies a "high," "medium," or "low" level of concern for each of the five evaluation criteria listed in the following table, which shows the number of "high concerns" under each criterion for S&P 500 companies that received a negative say-on-pay recommendation from ISS:[8]

S&P 500 Companies with Negative ISS Recommendations	***2020***	***2019***
Total with negative recommendations	48	46
Number that had "high concern" on:		
• Pay-for-Performance	35	41
• Compensation Committee Communication and Responsiveness	6	8
• Severance/Change-in-Control Arrangements	11	6
• Peer Group Benchmarking	1	0
• Non-Performance-Based Pay Elements	7	3

As the table illustrates, although pay-for-performance is just one factor in the overall compensation assessment, it continues to remain an important and perhaps the main determinant of ISS's recommendation on the say-on-pay vote. This year, however, ISS has also increased its focus on severance and change-in-control concerns, ascribing high concern to almost twice the number of companies this year than in 2019 due to these issues. Of the 11 companies that received a high concern rating on severance or change-in-control arrangements, seven received a rating of low concern with respect to pay-for-performance (and another received a low initial quantitative concern rating with respect

about the analysis of their proposals and to have those comments delivered directly to Glass Lewis's investor clients. *See* Glass Lewis Launches Report Feedback Statement Service, *available at* https://www.glasslewis.com/glass-lewis-launches-report-feedback-statement-service/.

8 The numbers for the categories add up to more than the total because some companies received "high concerns" in more than one category.

to pay-for-performance). Of these eight companies, half received a high concern rating only on severance and change-in-control arrangements (and received low concern ratings on each of the other four criterion).

These results may reflect ISS's greater emphasis on severance and change-in-control issues. In the most recent "Frequently Asked Questions" guide on compensation policies issued December 6, 2019, ISS added a new question and answer regarding how it evaluates disclosure around terminations and severance payments. ISS stated that "severance is intended for involuntary or constructive job loss; it is not appropriate for executives that voluntarily resign or retire […] Disclosure indicating that an executive 'stepped down' does not clearly indicate an involuntary termination – companies should identify in such cases the type of termination (*e.g.* termination without cause or resignation for good reason) and the provision by which severance payments were made under the arrangement."[9] Though companies have issued updated disclosures in the past clarifying the circumstances behind an executive's departure, ISS's latest guidance indicates the importance of these issues to ISS.

C. ISS PAY-FOR-PERFORMANCE ANALYSIS

A more detailed discussion of ISS's pay-for-performance policies and how they were applied in 2020 follows.

Since the 2012 proxy season, ISS's methodology for evaluating the pay-for-performance prong of its assessment of executive compensation in the context of say-on-pay proposals begins with a quantitative analysis of both relative and absolute alignment of pay-for-performance.[10] Even if a company receives a low concern rating through this quantitative pay-for-performance model, ISS will still review all companies' Compensation Discussion and Analysis sections and incentive programs to highlight noteworthy issues to investors. Problematic incentive designs, such as multi-year guaranteed payments, discretionary pay components, inappropriate perquisites, or lack of rigorous goals are generally addressed in the qualitative analysis and may result in a high overall concern with respect to pay-for-performance despite a low initial quantitative concern level.[11]

1. Components of Quantitative Analysis

In 2020, there are four components of ISS's quantitative assessment:

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9 *See* ISS United States Compensation Policies Frequently Asked Questions for 2020, *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

10 Technical information and guidance on ISS's say-on-pay methodology is available on https://www.issgovernance.com/file/policy/active/americas/Pay-for-Performance-Mechanics.pdf.

11 *See* ISS United States Compensation Policies Frequently Asked Questions for 2020, *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

- ***Relative Degree of Alignment, or RDA (relative alignment of CEO pay and total shareholder return over three years).*** The metric that is given the greatest weight in the quantitative assessment is the alignment of CEO pay and TSR,[12] relative to those of a peer group. The relative alignment metric looks at the difference between (a) the percentile rank within the ISS-selected peer group of a company's TSR and (b) the percentile rank within that peer group of a company's CEO pay.[13] The company's score is based on this difference calculated on a three-year basis. The threshold for receiving "high concern" is a difference of 50 percentile points or more. *As discussed below, this metric continues to be the strongest predictor of ISS recommendations and of overall voting results.*
- ***Multiple of Median, or MOM (relative CEO pay to peer group median over one year)*.** The second relative component of the pay-for-performance assessment is prior-year CEO pay as a multiple of the peer group median. This metric considers pay independent of company performance. ISS's scoring system may trigger a "high concern" if this multiple is 3.33x or higher.
- ***Pay-TSR Alignment, or PTA (absolute alignment of CEO pay and TSR over five years)*.** The third component measures alignment between the long-term trend in the CEO's pay and the company's shareholder returns over a five-year period. This does not depend on year-by-year sensitivity of CEO pay to changes in TSR, but instead compares the straight-line slopes of five-year trend lines (based on a linear regression) for each of CEO pay and TSR. A "high concern" may be triggered if the CEO pay trend slope exceeds the TSR trend slope by 35 percentage points or more.
- ***Financial Performance Assessment, or FPA (relative alignment of CEO pay and financial performance over three years).*** The metrics used in the secondary FPA screen have been updated. For meetings on or after February 1, 2020, the measures utilized by the secondary FPA screen will be Economic Value Added (EVA) metrics instead of the GAAP metrics that were used in 2019. The FPA relative measure compares the percentile ranks of a company's CEO pay and financial performance across four EVA metrics, relative to an ISS-developed comparison group, over the prior two-year or three-year period. The FPA requires a minimum two-year period of CEO pay and EVA data; if insufficient data exists for either pay or the EVA metrics, the FPA screen will be excluded. The FPA screen generally utilizes four equally weighted EVA-based metrics: (1) EVA margin; (2) EVA spread; (3) EVA momentum vs. sales; and (4) EVA momentum vs. capital.[14]

The "medium concern" and "high concern" thresholds for non-S&P 500 companies are summarized as follows:

Primary Quantitative Measure	*Medium Concern Threshold*	*High Concern Threshold*
Relative Degree of Alignment	-40	-50
Multiple of Median	2.33x	3.33x
Pay-TSR Alignment	-20%	-35%

12 TSR measures how much an investment in the stock would have changed over the relevant period, assuming the reinvestment of dividends.

13 *See* Section C.3.a for a discussion of how "CEO pay" is calculated and some potential comparative problems this may cause.

14 ISS, U.S. Compensation Policies: Frequently Asked Questions (Dec. 6, 2019), *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

For S&P 500 companies, the only difference in concern thresholds compared to non-S&P 500 companies is the lower MOM medium concern threshold, which is 2.00x. Use of the lower threshold is likely the result of intensified investor scrutiny on the escalating CEO compensation among large-cap companies.

Primary Quantitative Measure	*Medium Concern Threshold*	*High Concern Threshold*
Relative Degree of Alignment	-40	-50
Multiple of Median	***2.00x***	3.33x
Pay-TSR Alignment	-20%	-35%

Based on the preceding, ISS will assign an initial quantitative score (ISS may deem multiple "medium concern" levels as the equivalent of an overall "high" quantitative concern). ISS then applies the FPA score as a potential modifier. The FPA will modify the initial score only if a company has either (a) a medium concern or (b) a low concern that borders on a medium concern threshold under one of the three primary measures.

2. 2020 Results of ISS Quantitative Analysis

The following table summarizes the outcome of these quantitative tests for S&P 500 companies that received a negative ISS recommendation on say-on-pay in 2020:

	2020			*2019*		
S&P 500 Companies with Concern Level	*High*	*Medium*	*Low*	*High*	*Medium*	*Low*
Overall pay-for-performance concern level (quantitative + qualitative)	*17*	*1*	*11*	*26*	*1*	*3*
Overall concern level on quantitative screen only	*18*	*15*	*15*	*27*	*11*	*8*
Number that had "high concern" on each quantitative test:						
• RDA – Relative Alignment of CEO Pay and TSR (3-year)	*17*	*5*	*26*	*20*	*6*	*20*
• MOM – Relative CEO Pay to Peer Group Median (1-year)	*6*	*9*	*33*	*8*	*5*	*33*
• PTA – Absolute Alignment of CEO Pay and TSR (5-year)	*2*	*7*	*39*	*2*	*5*	*39*

Impact of FPA on S&P 500 Company Concern Level	*2020*	*2019*
Remain High Concern	*18*	*27*
Remain Medium Concern	*0*	*0*
Remain Low Concern	*15*	*7*
Move from Low Concern to Medium Concern	*4*	*4*

As the first table indicates, 35% of the S&P 500 companies that received negative ISS recommendations had a "high concern" on the RDA test, the highest correlation of any individual quantitative factor. In contrast, most of these companies had "low concern" on the MOM and PTA tests.

So far this year, 15 companies received a negative recommendation on their say-on-pay proposals despite attracting only low overall concern on the quantitative screen (compared to eight such companies in 2019). Moreover, 11 companies received a negative recommendation despite attracting low overall concern on both the quantitative and qualitative screens (compared to only three in 2019). These results appear to suggest that, in issuing a negative recommendation against a company's say-on-pay proposal, ISS has placed a greater emphasis on its evaluation of the problematic pay practices described in the previous section and has been willing to overlook favorable quantitative metrics derived from an analysis of RDA, MOM, and PTA. In other words, even if the relative alignment of a company's CEO pay and TSR, relative CEO pay to the peer group median, and absolute alignment of CEO pay and TSR all fall within ISS's target range for low concern, ISS may still recommend against a company's say-on-pay proposal if it determines that there are problematic issues with a company's severance or change-in-control arrangements, pay-for-performance, or non-performance compensation arrangements.

Once again, FPA seems to have an insignificant impact on ISS's analysis of the pay-for-performance concerns it identified, only impacting ISS's concern level with respect to four companies that were moved from low to medium concern. Thirty-three companies remained at the same level of concern as they were following the RDA, MOM, and PTA tests.

3. ISS Qualitative Analysis

Under ISS's policies, the qualitative review takes into account a range of factors, including:

- the ratio of performance-based equity awards to time-based equity awards;
- the overall ratio of performance-based compensation to total compensation;
- the completeness of disclosure and rigor of performance goals;
- peer group benchmarking practices;
- financial and operational performance (both absolute and relative to peers);
- realizable pay compared to grant pay; and
- any special circumstances, such as a new CEO or anomalous equity grant practices.

Based on our review of the narrative in the relevant ISS reports, the qualitative factor that most commonly contributed to the negative recommendation for S&P 500 companies in 2020 was the inclusion of limited, opaque, or undisclosed performance goals. This concern was discussed by ISS for 29 of the 48 S&P 500 companies that received negative ISS recommendations on say-on-pay. This is perhaps not surprising, because it would seem to be closely related to the pay-for-performance alignment that the quantitative tests are intended to address. The other concerns ISS identified generally fall into the following categories (with most companies receiving more than one of these concerns):

- ***The use of performance conditions that are not sufficiently rigorous, or insufficient disclosure of performance goals*.** Even if a company does utilize performance-based awards, ISS will see the awards as problematic if ISS views the goals as too easy to meet, or if the goals are not disclosed in sufficient detail for ISS to make an assessment. Twenty-five of the 48 S&P 500 companies receiving negative ISS recommendations were identified as either having performance standards that were not sufficiently rigorous or were limited, opaque, or undisclosed.

- ***The use of severance or change-in-control arrangements not in the shareholders' interests*.** ISS referenced problematic severance or change-in-control arrangements in the pay-for-performance analysis sections in 23 of the 48 cases. ISS viewed some of these arrangements as being excessive and others as being tied to a voluntary retirement.
- ***The use of time-based awards rather than performance-based awards*.** ISS identified this concern at 23 of the 48 S&P 500 companies that received negative recommendations. ISS's failure to consider time-vested option awards or other equity awards to be performance-based has been the subject of criticism because such awards can give the holders a stake in the performance of the company and align the interests of executives with those of shareholders.
- ***The use of above-target payouts*.** ISS referenced the existence of payouts that exceeded the company's target in 14 of the 48 cases. ISS viewed these above-target payouts as suggestive of weak performance standards, or, at least, the need for the company to closely examine its performance standards.
- ***The use of subjective criteria for determining compensation*.** ISS cited the use of subjective criteria for the determination of a bonus or the ability to use discretion to increase an executive's bonus as a negative factor for 13 of the 48 companies. ISS viewed companies using these discretionary measures as excusing poor performance. While ISS did cite these provisions with approval when companies elected to use this discretion to reduce the size of an award, these cases were rare and ISS largely viewed discretion as suspect.

D. EQUITY COMPENSATION PLAN APPROVALS

	ADOPTION OR AMENDMENT OF OMNIBUS STOCK PLANS			
	Russell 3000		*S&P 500*	
	2020 YTD	*2019*	*2020 YTD*	*2019*
Number of proposals voted on	***544***	503	***91***	76
Percentage with ISS "against" recommendations	***19%***	25%	***12%***	12%
Average level of support with ISS "for" recommendations	***93%***	93%	***94%***	93%
Average level of support with ISS "against" recommendations	***75%***	76%	***74%***	80%
Number of failed proposals (<50% support)	***3***	2	***0***	0

U.S.-listed companies are required under stock exchange rules to obtain shareholder approval for the plans under which they award executive compensation to employees and directors.[15] Because shareholders generally support the use of equity compensation by public companies as a means to align the interests of employees with those of investors, in most cases these proposals are uncontroversial and pass by a wide margin. As indicated in the table above, the average support levels for these proposals are typically around 90% and only three proposals failed to achieve majority support this year.

[15] *See* Section 303A.08 of the NYSE Listed Company Manual; Nasdaq Stock Market Rule 5635.

Since 2015, ISS has applied an "equity scorecard" approach to assessing equity plans. The scorecard method considers factors under three main categories:[16]

- ***Plan cost.*** Cost is calculated as the Shareholder Value Transfer relative to industry/market-cap peers; this measures the dilutive effect of the new shares requested as well as shares remaining for issuance under existing plans (often called "dilution" or "overhang"), and is calculated both with and without outstanding unvested awards.
- ***Plan features.*** Specifically, penalizing lack of minimum vesting periods, broad discretionary vesting authority, liberal share recycling, lack of specific disclosure regarding change-in-control provisions, and the ability to pay dividends prior to the vesting of the underlying award.
- ***Grant practices.*** Specifically, three-year "burn rate" relative to market and industry peers, among other factors.

ISS recommended against around 19% of equity plan proposals in the case of Russell 3000 companies, but recommended against only 12% in the case of S&P 500 companies. This difference is likely due to the impact of the larger public float on the plan cost and the movement away from problematic plan features. ISS recommendations have a fairly significant impact on voting results—in 2020, the average support level was 93% when ISS recommended "for" approval and 75% when ISS recommended "against."

ISS issued "against" recommendations for only around 12% of equity plan proposals at S&P 500 companies so far in 2020. For most of these companies, ISS cited excessive plan cost and broad discretionary accelerated vesting authority among the reasons for its negative recommendation. Other common reasons included excessive burn rate, inadequate disclosure of change-in-control vesting provisions, and liberal share recycling. Despite the negative recommendations, all of the proposals at S&P 500 companies (and all but three proposals at Russell 3000 companies) received majority support.

E. LOOKING FORWARD TO 2021

Moving forward this year and next, many companies will continue to deal with the challenges posed by the COVID-19 crisis. Some companies already have announced changes to their compensation programs, with boards announcing plans to revise performance metrics used in short-term and, potentially, long-term compensation plans and some executive officers and board members voluntarily reducing their compensation. ISS has noted that decisions by directors to make such adjustments to 2020 compensation programs will generally be analyzed and addressed by shareholders at next year's

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16 ISS's current equity plan scorecard approach is described in its U.S. Equity Compensation Plans FAQs, *available at* https://www.issgovernance.com/file/policy/active/americas/US-Equity-Compensation-Plans-FAQ.pdf. The passing score is 53 for all models except the S&P 500 model, which has a passing score of 55. Certain egregious equity plan features may result in a negative ISS recommendation, regardless of the "equity scorecard." These egregious features include, for example, "a liberal change-of-control definition that could result in vesting of awards by any trigger other than a full double trigger."

annual general meetings and has encouraged boards to provide contemporaneous disclosure to shareholders of their rationales for making changes. It is unclear, however, how early disclosure will influence 2021 voting recommendations. In terms of long-term compensation plans, ISS's benchmark voting policies generally do not support changes to performance metrics during ongoing performance periods, and ISS has stated that it will look at any changes on a case-by-case basis to determine if directors exercised appropriate discretion and provided adequate explanation to their shareholders. Peer group benchmarking also may provide unique challenges in the coming year due to the effects of the pandemic. ISS has acknowledged that the COVID-19 pandemic has created a fluid situation for all companies and has suggested that the case-by-case discretion that it will exercise will enable it to deal with "many company-specific situations, market disruptions, recessions and natural disasters in a thoughtful and considerate way."[17]

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[17] *See* ISS Policy Guidance on the Impacts of the COVID-19 Pandemic, *available at* https://www.issgovernance.com/file/policy/active/americas/ISS-Policy-Guidance-for-Impacts-of-the-Coronavirus-Pandemic.pdf.

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