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Executive Law & Regulatory Group

ISS issues COVID-related executive pay FAQs

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As compensation committees grapple with year-end executive pay decisions, including whether and how to address the impact of the pandemic on incentive awards, proxy adviser Institutional Shareholder Services (ISS) has weighed in with 11 FAQs. The FAQs explain how ISS will apply its pay-for-performance qualitative analysis to COVID-related pay decisions. As in the past, an elevated concern from the quantitative screen will result in a more in-depth qualitative review.

Although support from ISS is important, it is more critical for companies to engage with their top shareholders as to what they would consider a reasonable response to the challenges presented by the pandemic. Compensation committees must consider multiple factors in making pay decisions — including the company's business strategy, broader workforce actions and executive retention risks — even if decisions may negatively impact the company's say-on-pay vote result.

Key themes

The FAQs indicate how ISS will apply its case-by-case approach to COVID-related pay decisions. While they offer few details as to what will be deemed "acceptable", several themes emerge:

- In light of the extraordinary circumstances of the pandemic and related current economic downturn, ISS may find actions it would normally view as problematic to be reasonable.
- Long-term incentive award adjustments will generally be viewed less favorably than adjustments to annual incentive awards. Of note, ISS appears to be more open to special one-time awards than to adjustments of outstanding awards.
- Pay outcomes should be "reasonable" (e.g., in magnitude and consistent with external factors and changes to the underlying business strategy) with justifications and rationale clearly disclosed.
- Proxy statements should include detailed disclosure (not boilerplate or generic statements) of the rationale for pay decisions to help ISS and investors understand the impact of the pandemic on the company's business and pay outcomes.

The FAQs

The FAQs cover salary and incentive award adjustments, one-time awards, board responsiveness to low say-on-pay votes, equity plan scorecard changes, and option repricings as shown in the table below:

Topic	FAQ
Temporary salary reductions	May mitigate the impact of a quantitative concern if reductions decrease total pay, particularly if incentive payout opportunities are also decreased to reflect salary reduction
Annual incentive plan changes (e.g., mid-year changes to metrics, performance targets, and measurement periods; replacing existing awards with one-time discretionary awards; and lowering performance targets)	**ISS evaluation:** May deem actions reasonable as long as justifications and rationale are clearly disclosed, and resulting outcomes appear reasonable **Disclosure:** Key disclosures to help investors evaluate changes include: • Specific challenges resulting from the pandemic and how those challenges rendered original program design obsolete or original performance targets impossible to achieve, and how they are not reflective of poor management • For mid-year changes vs. one-time discretionary awards, why the approach was taken (versus alternative approach) and how actions further investors' interests • Performance-based considerations for one-time discretionary awards, even if not based on original metrics or targets; generic descriptions (i.e. "strong leadership during challenging times") may be insufficient • How resulting payouts compare with what would have been paid under original program design (payouts should reflect executive and company performance, and above-target payouts will be closely scrutinized) • Positive changes to 2021 annual incentive programs which may mitigate qualitative evaluation • For lowered targets, how board considered corresponding payout opportunities, particularly if payout opportunities are not commensurately reduced
Long-term incentives	**Changes to in-flight awards:** Generally, will be viewed negatively (including performance periods ending in 2020), particularly if there is a quantitative pay-for-performance misalignment **Award cycles beginning in 2020.** A move to relative or qualitative metrics may be reasonable if long-term financial forecasting is unclear, but a move to predominantly time-vesting equity or short-term measurement periods would be viewed negatively

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One-time awards	**Retention or other one-time awards:** • Disclosure should clearly state the rationale for the grants (including magnitude and structure), and how the awards further investors' interests • Awards should be reasonable in magnitude and an isolated practice • Vesting schedule should be long-term, strongly performance-based, and clearly linked to underlying concerns that the award aims to address • Awards should contain shareholder-friendly guardrails to avoid windfall scenarios, including limitations on termination-related vesting • If awards are in lieu of forfeited incentives, companies should explain the rationale (e.g., fairness considerations, lowered realizable pay, etc.) and how the awards do not merely insulate executives from lower pay
Board responsiveness to low say-on-pay vote	Companies that received less than 70% support for their prior year's say-on-pay proposal but were unable to make pay program changes to address shareholder feedback because of the pandemic, should disclose how the pandemic impeded their ability to address shareholders' concerns and provide a longer-term plan on how they intend to address investors' concerns
Equity plan scorecard	No changes to policies related to the pandemic. Changes for 2021 policy year will include increases in passing scores for most companies: • S&P 500 increases from 55 to 57 points • Russell 3000 increases from 53 to 55 points • All other models remain at 53 points
Problematic pay practices	No changes to policies that flag problematic contractual provisions in executive agreements
Option repricings	No changes to case-by-case approach: • Generally oppose repricings within one year of a precipitous drop in stock price • If boards reprice without shareholder approval, directors' actions will be scrutinized under policies on board accountability

For a detailed discussion of how to address the impact of COVID-19 and the economic downturn on incentive compensation, see Addressing In-Flight Incentive Awards: A Holistic Approach for Compensation Committee.

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