SULLIVAN & CROMWELL LLP

2021 Proxy Season Review: Part 2

Say-on-Pay Votes and Equity Compensation

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Say-on-Pay Votes:

- **Public companies continue to perform strongly, with support levels averaging 93% and less than 3% of companies failing**
- **Continuing turnover in failed votes, with 79% of companies that failed last year achieving over 70% support this year and no companies failing in both 2020 and 2021**
- **ISS negative recommendations highlight continued importance of pay-for-performance assessment, with the most important factor continuing to be alignment of CEO pay with relative total shareholder return**
- **The most important qualitative factors are performance standards that are deemed not sufficiently rigorous or are not sufficiently disclosed, followed by the use of subjective criteria for determining compensation**
- **ISS also frequently cited the adjustment of previously granted awards, often due to the impact of COVID-19**

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 at Russell 3000 and S&P 500 companies averaging around 91%**

INTRODUCTION

Our annual proxy season review memo summarizes significant developments relating to the 2021 U.S. annual meeting proxy season. This year, our review comprises two parts: Rule 14a-8 shareholder proposals and compensation-related matters. This is Part 2. Part 1, which focuses on Rule 14a-8 shareholder proposals, was published on July 27, 2021 and is available here. We will also host in September our annual webinar to discuss 2021 proxy season developments.

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, 2021. For a discussion of U.S. proxy contests and other shareholder activist campaigns, see our publication, dated December 2, 2020, entitled "Review and Analysis of 2020 U.S. Shareholder Activism and Activist Settlement Agreements."

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 full-year 2020 and through June 30 for 2021. U.S. companies, broadly speaking, had similar results on say-on-pay votes in 2021 as in 2020 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*	
	2021	***2020***	***2021***	***2020***
Percentage passed (majority support)	***97%***	*97%*	***97%***	*98%*
Percentage with >70% support	***93%***	*93%*	***92%***	*93%*
Percentage with ISS "Against" recommendations	***11%***	*11%*	***10%***	*11%*
Average support with ISS "For" recommendations	***94%***	*94%*	***92%***	*93%*
Average support with ISS "Against" recommendations	***64%***	*66%*	***57%***	*62%*

There continues to be significant year-over-year turnover in failed votes. Of the 11 S&P 500 companies that failed say-on-pay votes in 2020 and have had their 2021 votes thus far, nine have achieved majority support in 2021 (compared to three out of five in 2020). This suggests that companies (particularly S&P 500 companies) that have losing 2020 say-on-pay votes seem to have had increased success in implementing program changes that result in better 2021 say-on-pay outcomes. None of the 14 S&P 500 companies that failed say-on-pay in 2021 to date failed their vote in 2020, although two had support levels below 70% (compared to zero and six out of 11 in 2020, respectively). Of the 52 companies in the Russell 3000 that failed their say-on-pay votes in 2020 and have had their 2021 votes thus far, 39 achieved majority support in 2021, and 37 had support levels over 70%.[1] Of the 53 companies in the Russell 3000 that failed say-on-pay votes in 2021 to date, none failed their 2020 vote and 24 had 2020 support levels below 70% (compared to five and 39 out of 52 in 2020, 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. Despite the COVID-19 pandemic presenting an obstacle to hosting face-to-face meetings with shareholders, companies

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.

continued to find ways to engage with shareholders.[2] 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 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. Institutional ESG expertise is particularly important with respect to compensation programs as companies increasingly consider tying pay to ESG metrics and shareholders expect alignment between compensation and ESG outcomes.[3] 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[4] and Glass Lewis[5] post their engagement policies on their websites. The policies of both firms restrict their

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[2] *See* Director-shareholder engagement: getting it right, *available at* https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-director-shareholder-engagement-getting-it-right.pdf (noting that over 50% of directors surveyed indicated they had direct engagement with shareholders in the year prior to the survey). According to one source, prior to COVID-19, fewer than half of companies' investor relations professionals participated in virtual outreach, but more than 90% expected to do so due to COVID-19. IROs adopting virtual meetings en masse, study finds, *available at* https://www.irmagazine.com/technology-social-media/iros-adopting-virtual-meetings-en-masse-study-finds.

[3] *See* ESG and Executive Compensation: Hearing from board members globally, *available at* https://www.willistowerswatson.com/-/media/WTW/Insights/2021/04/ESG-and-Executive-Compensation-Report-2021.pdf?modified=20210419083740 (highlighting that a majority of directors surveyed stated that incentive plans should incorporate ESG metrics).

[4] *See* ISS's engagement policies, *available at* https://www.issgovernance.com/contact/faqs-engagement-on-proxy-research/.

[5] Glass Lewis's engagement policies are available at https://www.glasslewis.com/engagement-policy/.

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 continues to attract debate and legislative reform efforts.[6]

On July 22, 2020, the SEC issued a final rule stating that proxy voting advice given by proxy advisory firms generally constitutes solicitation under the federal proxy rules, effective December 1, 2021.[7] The final rule also amended the proxy rules to exempt communications by proxy advisory firms, if a company has (1) included disclosure of material conflicts of interest in its proxy voting advice and any electronic medium used to deliver the advice, (2) adopted and publicly disclosed policies reasonably designed to ensure that proxy voting advice is made available to the issuer covered by the advice at or prior to the time when it is disseminated to clients and (3) adopted and publicly disclosed written policies reasonably designed to ensure that it provides clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by issuers covered by its proxy voting advice in a timely manner before the shareholder meeting.

On June 1, 2021, SEC Chair Gary Gensler directed the SEC's staff to consider whether to recommend further regulatory action regarding proxy voting advice, with an emphasis on whether the 2019 guidance and 2020 final rule should be revisited.[8] Commissioners Hester Peirce and Elad Roisman expressed concern about the Commission's ability to evaluate the appropriateness of further changes without considering the practical implications of the 2020 rules.[9]

Proxy advisory firms generally reacted positively to Chair Gensler's statement. ISS strongly disagreed with the SEC's August 2019 guidance, filing a lawsuit in the U.S. District Court for the District of Columbia

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6 For example, in November 2018, the Corporate Governance Fairness Act was introduced in the Senate to amend the Investment Advisers Act of 1940. If passed, the Corporate Governance Fairness Act would have required 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 Corporate Governance Fairness Act did not receive a vote and died in Congress.

7 *See* Securities and Exchange Commission Release No. 34-89372, *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf; SEC Adopts New Rules for Proxy Advisors and Provides Supplemental Guidance on Voting Responsibilities of Investment Advisers, *available at* https://www.sullcrom.com/files/upload/sc-publication-new-rules-proxy-advisors-guidance-investment-advisers.pdf.

8 Statement on the Application of the Proxy Rules to Proxy Voting Advice, *available at* https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01.

10 *See Institutional Shareholder Services Inc.* v. *Securities and Exchange Commission* (1:19-cv-03275), *available at* https://www.issgovernance.com/file/duediligence/iss-oct-31-2019-complaint.pdf.

on October 31, 2019, asserting that the guidance was "unlawful" and "arbitrary and capricious" and that it should be rescinded.[10] Following Chair Gensler's June 2021 statement, ISS supported a motion by the SEC to stay the case until the earlier of December 31, 2021 or the adoption of new rules.[11] The motion was granted on June 2, 2021.

For a more detailed discussion on trends in shareholder engagement, institutional investor influence, and shareholder activism, see our publication, dated December 2, 2020, entitled "2020 U.S. Shareholder Activism Review and Analysis."

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.[12] While an analysis of ISS's 2021 negative recommendations for S&P 500 companies suggests that the most important criterion continues to be the pay-for-performance assessment (with more than three-quarters of the negative recommendation reports indicating high concern on this issue), high concern with respect to severance or change-in-control arrangements or compensation committee responsiveness can themselves 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);

[10] *See Institutional Shareholder Services Inc.* v. *Securities and Exchange Commission* (1:19-cv-03275), *available at* https://www.issgovernance.com/file/duediligence/iss-oct-31-2019-complaint.pdf.

[11] *See Institutional Shareholder Services Inc.* v. *Securities and Exchange Commission*, *available at* https://www.chamberlitigation.com/sites/default/files/cases/files/21212121/Stay%20Order%20--%20ISS%20v.%20SEC%20%28D.D.C.%29.pdf.

[12] 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 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/.

- 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's communication with and responsiveness to shareholders are significantly poor.

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:[13]

S&P 500 Companies with Negative ISS Recommendations	***2021***	***2020***
Total with negative recommendations	45	48
Number that had "high concern" on:		
• Pay-for-Performance	36	35
• Compensation Committee Communication and Responsiveness	12	6
• Severance/Change-in-Control Arrangements	8	11
• Peer Group Benchmarking	0	1
• Non-Performance-Based Pay Elements	4	7

As the table illustrates, although pay-for-performance is just one factor in the overall compensation assessment, it remains the main determinant of ISS's recommendation on the say-on-pay vote, as has been the case in recent years. This year, however, ISS has also increased its focus on compensation committee communication and responsiveness, ascribing high concern to twice the number of companies this year compared to 2020. This increased focus by ISS highlighted the importance of engagement by public companies with their shareholders on matters relating to compensation.[14] Of the 12 companies that received a high concern rating on compensation committee communication and responsiveness, four received a rating of low concern with respect to pay-for-performance (and another three received a low initial quantitative concern rating with respect to pay-for-performance). For five of these 12 companies, compensation committee communication and responsiveness was the only category in which the issuer received a high concern rating.[15]

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[13] The numbers for the categories add up to more than the total because some companies received "high concern" in more than one category.

[14] ISS policies emphasize the importance of clear communication with shareholders on compensation issues, particularly for companies that receive low support for say-on-pay proposals. *See* ISS United States Compensation Policies that Asked Questions for 2020, *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf ("When a say-on-pay proposal receives less than 70% support of votes cast (for and against), ISS will conduct a qualitative review of the compensation committee's responsiveness . . . tak[ing] into consideration . . . disclosure of details on the breadth of engagement . . . [and] disclosure of specific feedback received from investors on concerns that led them to vote against the proposal. . . .").

[15] The five companies include AmerisourceBergen Corporation, Johnson & Johnson, Textron Inc., Nucor Corporation and NXP Semiconductors N.V. The ISS narrative for a number of these

(footnote continued...)

C. ISS PAY-FOR-PERFORMANCE ANALYSIS

A more detailed discussion of ISS's pay-for-performance policies and how they were applied in 2021 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.[16] 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.[17]

1. Components of Quantitative Analysis

In 2021, as in prior years, there are four components of ISS's quantitative assessment:

- ***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,[18] 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.[19] The company's score is based on this difference calculated on a two-year or three-year basis. The threshold for receiving high concern is a difference of 60 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 expressed as a multiple of the peer group median. This metric considers pay

companies emphasized inadequate responses to low say-on-pay votes in prior years. Although ISS did not explicitly cite the effect of virtual outreach due to COVID-19, the increased number of companies that received a high concern rating on compensation committee communication and responsiveness serves to emphasize the significance of engaging with shareholders, whether virtually or in person.

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

17 *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.

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

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

independent of company performance. Notably, in 2021, ISS decreased the high concern threshold for S&P 500 companies. For meetings held on or after February 1, 2021, ISS's scoring system may trigger a "high concern" if this multiple is 3.00x 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 45 percentage points or more.

- ***Financial Performance Assessment, or FPA (relative alignment of CEO pay and financial performance over three years).*** The FPA relative measure compares the percentile ranks of a company's CEO pay and financial performance across four Economic Value Added (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 metric, 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.[20]

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

Primary Quantitative Measure	***Medium Concern Threshold***	***High Concern Threshold***
Relative Degree of Alignment	-50	-60
Multiple of Median	2.33x	3.33x
Pay-TSR Alignment	-30%	-45%

For S&P 500 companies, the MOM medium and high concern thresholds are slightly lower, likely due to greater investor scrutiny on CEO compensation among large-cap companies. The medium concern and high concern thresholds for S&P 500 companies are summarized below.

Primary Quantitative Measure	***Medium Concern Threshold***	***High Concern Threshold***
Relative Degree of Alignment	-50	-60
Multiple of Median	2.00x	3.00x
Pay-TSR Alignment	-30%	-45%

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.

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20 ISS, U.S. Compensation Policies: Frequently Asked Questions (Dec. 21, 2020), *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

2. 2021 Results of ISS Quantitative Analysis

So far this year, 19 companies received a negative recommendation on their say-on-pay proposals despite attracting only low overall concern on the quantitative screen (compared to 15 companies in 2020). Moreover, 14 companies received a negative recommendation despite attracting low overall concern on both the quantitative and qualitative screens (compared to 11 in 2020). 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. For example, of the 45 S&P 500 companies that received a negative ISS recommendation on say-on-pay, only 10 received a "high concern" for RDA (compared to 17 out of 48 companies in 2020). 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 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-eight 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;
- application of compensation committee discretion;
- 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.

Notably, despite the uncertainty created by COVID-19, the exercise of discretion by compensation committees can be viewed negatively by ISS. For example, ISS FAQs on compensation policies and the

COVID-19 pandemic indicate that changes to in-progress long-term incentive awards will generally be viewed negatively, especially with respect to companies having a pay-for-performance misalignment.[21]

Based on our review of the narrative in the relevant ISS reports, in 2021 the inclusion of limited, opaque, or undisclosed performance goals continued to contribute to the negative recommendation for S&P 500 companies. This concern was discussed by ISS for 22 of the 42 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-six of the 42 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 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 22 of the 42 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.
- ***The use of above-target payouts.*** ISS referenced the existence of payouts that exceeded the company's target in 19 of the 42 cases. In many 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.
- ***Award adjustments*.** ISS cited the decisions by many companies to make adjustments to previously granted awards as a factor for at least 19 of the 42 companies. In many, if not all, cases, such modifications were due to the financial impact of COVID-19. ISS seemed to view these decisions critically, in some cases noting the adjustments were not a proportionate response to the effects of COVID-19.
- ***The use of time-based awards rather than performance-based awards.*** ISS identified this concern at 16 of the 42 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 severance or change-in-control arrangements not in the shareholders' interests.*** ISS referenced problematic severance or change-in-control arrangements in the

[21] *See* ISS, U.S. Compensation Policies and the COVID-19 Pandemic: Frequently Asked Questions (Oct. 15, 2020), *available at* https://www.issgovernance.com/file/policy/active/americas/US-Preliminary-Compensation-Policies-FAQ-regarding-COVID.pdf.

pay-for-performance analysis sections in 14 of the 42 cases. ISS viewed some of these arrangements as being excessive and others as being tied to a voluntary retirement.

D. EQUITY COMPENSATION PLAN APPROVALS

	ADOPTION OR AMENDMENT OF OMNIBUS STOCK PLANS			
	Russell 3000		***S&P 500***	
	2021 YTD	***2020***	***2021 YTD***	***2020***
Number of proposals voted on	***562***	661	***97***	101
Percentage with ISS “against” recommendations	***22%***	22%	***6%***	13%
Average level of support with ISS “for” recommendations	***94%***	93%	***94%***	94%
Average level of support with ISS “against” recommendations	***74%***	77%	***77%***	73%
Number of failed proposals (<50% support)	***3***	4	***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.[22] 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.

Since 2015, ISS has applied an “equity scorecard” approach to assessing equity plans. The scorecard method considers factors under three main categories:[23]

- ***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.

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

23 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 57, and the Russell 3000 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.”

ISS recommended against approximately 22% of equity plan proposals in the case of Russell 3000 companies, but recommended against only 6% 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 continue to have a fairly significant impact on voting results: in 2021, the average support level for equity plan proposals at S&P 500 companies was 94% when ISS recommended "for" approval and 77% when ISS recommended "against."

So far in 2021, ISS has issued "against" recommendations for only around 6% of equity plan proposals at S&P 500 companies. For most of these companies, ISS cited excessive plan cost and excessive burn rate among the reasons for its negative recommendation. Other common reasons included broad discretionary accelerated vesting authority, 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.[24]

E. LOOKING FORWARD TO 2022

In 2021, companies continued to address challenges posed by the COVID-19 crisis, including by making discretionary adjustments to compensation. ISS previously noted that decisions to adjust 2020 compensation programs would be analyzed and addressed at the following year's annual general meetings. Such scrutiny was apparent in ISS's coverage of the 2021 proxy season, with ISS frequently commenting on modifications to previously granted awards, in many cases explicitly due to the effects of COVID-19. Although it remains to be seen whether the changes to compensation programs made in response to the COVID-19 pandemic will be transitory or become permanent aspects of compensation on a going-forward basis, ISS is likely to remain focused on the exercise of discretion by a compensation committee and any perceived resulting pay-for-performance misalignment.

* * *

[24] According to ISS, proposals to adopt or amend omnibus stock plans failed to receive greater than 50% shareholder support at three Russell 3000 issuers: Simulations Plus, Inc. (45.8%), Cassava Sciences, Inc. (41.6%) and Penumbra, Inc. (44%). ISS recommended against the proposals for Simulations Plus and Cassava Sciences while recommending for the proposal at Penumbra.

SULLIVAN & CROMWELL LLP

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