SULLIVAN & CROMWELL LLP

10th Anniversary Edition

2022 Proxy Season Review: Part 2

Say-on-Pay and Equity Compensation Plan Voting

August 22, 2022

Say-on-Pay Voting:

- **Although public companies continue to perform strongly, with overall support levels averaging 88% among the S&P 500 and 90% among the Russell 3000, more companies fail compared to prior years**
- **Continued turnover in failed votes, with 57% of companies that failed last year achieving over 70% support this year**
- **Four S&P 500 companies fail in both 2021 and 2022, all of which are criticized by ISS for limited or inadequate responsiveness to shareholders' concerns**
- **ISS negative recommendations highlight continued importance of pay-for-performance assessment, with the most important factor remaining alignment of CEO pay with relative total shareholder return**
- **The most significant qualitative factors in negative recommendations are limited, opaque, or undisclosed performance goals and the use of above-target payouts**

Equity Compensation Plan Voting:

- **Broad shareholder support for equity compensation plans, with only two 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%**

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INTRODUCTION

In the tenth edition of our annual proxy season review memo, we summarize significant developments relating to the 2022 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 August 8, 2022 and is available here. We will also host our annual webinar in September to discuss 2022 proxy season developments.

The data on say-on-pay negative recommendations derives from ISS publications and SEC disclosure 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, 2022. We estimate that around 90% of U.S. public companies held their 2022 annual meetings by that date. For a discussion of U.S. proxy contests and other shareholder activist campaigns, see our publication, dated December 20, 2021, entitled "Review and Analysis of 2021 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.

Table of Contents

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

A. COMPANIES MAINTAIN STRONG SAY-ON-PAY PERFORMANCE

The following summarizes say-on-pay voting results for full-year 2021 and through June 30 for 2022. The number of failed say-on-pay votes has increased meaningfully since 2018. Among the S&P 500, the number of failed votes has more than doubled since 2018 (18 in 2022 compared to seven in 2018), while the number among the Russell 3000 has increased from 54 in 2018 to 64 in 2022. However, broadly speaking, U.S. companies received similar support on say-on-pay votes in 2022 as they did in prior years. This year, shareholder support on say-on-pay votes averaged 88% among S&P 500 companies (same as 2021, compared to 90% in 2020 and 2019 and 91% in 2018), and 90% among the broader Russell 3000 (compared to 91% in 2018 through 2021).

	Russell 3000		***S&P 500***	
	2022	***2021***	***2022***	***2021***
Percentage passed (majority support)	***97%***	*97%*	***96%***	*96%*
Percentage with >70% support	***91%***	*93%*	***90%***	*91%*
Percentage with ISS "Against" recommendations	***13%***	*12%*	***12%***	*11%*
Average support with ISS "For" recommendations	***94%***	*94%*	***92%***	*92%*
Average support with ISS "Against" recommendations	***63%***	*65%*	***54%***	*56%*

In addition, there continues to be significant year-over-year turnover in failed votes. Of the 14 S&P 500 companies that failed say-on-pay votes in 2021 and have had their 2022 votes thus far, 10 have achieved majority support in 2022 (compared to seven out of 10 in 2021). This turnover suggests that companies (particularly those in the S&P 500) having losing say-on-pay votes in one year are generally succeeding in implementing program changes that result in better say-on-pay outcomes in the subsequent year. Only four of the 18 S&P 500 companies that failed say-on-pay in 2022 to date failed their vote in the prior year, although three additional companies that failed in 2022 had support levels below 70% in the prior year (compared to three and four out of 16 in 2021, respectively).[1] All four companies in the S&P 500 that failed say-on-pay in both 2021 and 2022 were criticized by ISS for limited or inadequate responsiveness to shareholders' concerns, which is indicative of the significance ISS attributes to this criteria.[2] Of the 43

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1 If a company receives less than 70% shareholder support for its 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.

2 The four S&P 500 companies were Halliburton Company, Intel Corporation, Norwegian Cruise Lines Holdings Ltd. and Paycom Software, Inc. In all cases, ISS cited some of the same concerns in both 2021 and 2022, suggesting that in subsequent years ISS will focus on areas of concerns previously cited. *See* ISS Proxy Analysis & Benchmark Policy Voting Recommendations: Halliburton Company (May 4, 2021) *and* ISS Proxy Analysis & Benchmark Policy Voting Recommendations: Halliburton Company (May 4, 2022) (in both of which ISS criticized Halliburton Company for allowing maximum

(footnote continued...)

companies in the Russell 3000 that failed their say-on-pay votes in 2021 and have had their 2022 votes thus far, 33 achieved majority support in 2022, and 24 had support levels over 70%. Of the 64 companies in the Russell 3000 that failed say-on-pay votes in 2022 to date, 10 failed their vote in the prior year and 10 additional companies had support levels below 70% in the prior year (compared to 10 and 10 out of 53 in 2021, respectively).

Year-round shareholder outreach remains a regular feature of corporate governance and investor relations for many public companies in 2022, 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, one-on-one phone calls, group conference calls, and web meetings, and, in some cases, includes board members. Regardless of engagement method, companies conducting shareholder outreach must be mindful that company representatives may not disclose material non-public information in these discussions due to Regulation FD. Furthermore, appropriate company personnel should be in attendance at such engagement sessions. 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. Accordingly, if companies are engaging with investors on whether compensation outcomes should be linked to ESG metrics, company representatives having ESG expertise should participate. Participation of 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 which the company is engaging.[3]

Companies 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 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.

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payouts when returns are negative, targeting awards at median performance despite regular above-target achievement and providing sizable compensation related to expatriate assignment for one named executive officer).

3 In a recent survey, 17% of investors indicated that having board members directly involved in engagement conversations would be beneficial, although overall perspectives on the topic remained mixed. *See* What investors expect from the 2022 proxy season, *available at* https://www.ey.com/en_us/board-matters/what-investors-expect-from-the-2022-proxy-season.

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/.

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 regulatory attention. On June 13, 2022, the SEC voted to adopt amendments to the rules governing proxy voting advice provided by proxy advisory firms (the "2022 Proxy Advisor Rule").[6] The 2022 Proxy Advisor Rule rescinded Rule 14a-2(b)(9)(ii), which required proxy advisor firms to both make their advice available to the company subject to that advice by the time it is disseminated to clients and provide clients with a mechanism by which they can become aware of a company's statement in response before they vote. The 2022 Proxy Advisor Rule also rescinded Note (e) to Rule 14a-9, which set forth examples of material misstatements or omissions related to proxy voting advice, specifically providing that failure to disclose material information (such as a firm's methodology, sources of information, or conflicts of interest) regarding proxy voting advice could be misleading. The 2022 Proxy Advisor Rule are intended to be effective on September 19, 2022, but may be delayed because the SEC is facing a number of lawsuits[7] challenging the 2022 Proxy Advisor Rule.

For a more detailed discussion on trends in shareholder engagement, institutional investor influence, and shareholder activism, see our publication, dated December 20, 2021, entitled "2021 U.S. Shareholder Activism Review and Analysis".

B. OVERALL ISS APPROACH ON SAY-ON-PAY EVALUATION[8]

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.[9] While an analysis of ISS's

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[6] For a more detailed discussion of these amendments, see our publication, dated July 21, 2022, entitled "SEC Reverses Aspects of Proxy Voting Advice Regulations".

[7] *See* Statement from Institutional Shareholder Services on New SEC Rules for Proxy Advice (Jul. 13, 2022), *available at* https://insights.issgovernance.com/posts/statement-from-institutional-shareholder-services-on-new-sec-rules-for-proxy-advice/ (stating that ISS will continue its prior lawsuit in light of the continued classification of proxy advice as proxy solicitation); *National Association of Manufacturers* v. *Securities and Exchange Commission* (7:21-cv-00183), *available at* https://documents.nam.org/law/nam_sec_complaint.pdf (arguing that the SEC's non-enforcement of Rule 14a-2(b)(9)(ii) prior to its rescission was unlawful); *Chamber of Commerce of the United States of America* v. *Securities and Exchange Commission* (3:22-cv-00561), *available at* https://www.law360.com/articles/1516068/attachments/0 (arguing that the SEC did not follow proper procedures or provide adequate justification for rescinding Rule 14a-2(b)(9)(ii)).

[8] This portion of the memo compares data on proposals for shareholder meetings held between January 1 through June 30 in each of 2021 and 2022.

[9] 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 design and 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

(footnote continued...)

2022 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), as discussed in detail in Section C below;
- 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 during January 1 through June 30 in each of 2021 and 2022:[10]

S&P 500 Companies with Negative ISS Recommendations	***2022***	***2021***
Total with negative recommendations	50	45
Number that had "high concern" on:		
• Pay-for-Performance	40	36
• Compensation Committee Communication and Responsiveness	12	12
• Severance/Change-in-Control Arrangements	5	8
• Peer Group Benchmarking	2	0
• Non-Performance-Based Pay Elements	3	4

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. Consistent with 2021, ISS also maintained its focus on compensation committee communication and responsiveness in 2022. This continued focus by ISS highlights the

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/.

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

importance of engagement by public companies with their shareholders on matters relating to compensation.[11] 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 six of these 12 companies, compensation committee communication and responsiveness was the only category in which the issuer received a high concern rating.[12] This year, ISS continued its trend of decreasing focus on severance/change-in-control arrangements, ascribing high concern to five companies this year compared to eight in 2021 and 11 in 2020.

C. ISS PAY-FOR-PERFORMANCE ANALYSIS

A more detailed discussion of ISS's pay-for-performance policies and how they were applied in 2022 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.[13] Even if a company receives a low concern rating through this quantitative pay-for-performance model, ISS will still review all of the company's 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.[14]

[11] 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 Frequently Asked Questions (Dec. 17, 2021), *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. . . .").

[12] The six companies include Walgreens Boots Alliance, Inc., Hologic, Inc., Paycom Software, Inc., Ceridian HCM Holding, Inc., Sealed Air Corporation and Biogen Inc. ISS narratives for these companies emphasized inadequate responses to low say-on-pay votes in prior years.

[13] 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.

[14] *See* ISS United States Compensation Policies: Frequently Asked Questions (Dec. 17, 2021), *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

1. Components of Quantitative Analysis

In 2022, 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,[15] 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.[16] 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 independent of company performance. 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.[17]

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%

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

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

17 ISS United States Compensation Policies: Frequently Asked Questions (Dec. 17, 2021), *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-FAQ.pdf.

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.

2. 2022 Results of ISS Quantitative Analysis

So far this year, 13 companies received a negative recommendation on their say-on-pay proposals despite attracting only low overall concern on the quantitative screen (compared to 19 companies during the same period in 2021). Six companies received a negative recommendation despite attracting low overall concern on both the quantitative and qualitative screens (compared to 14 in 2021). These results appear to suggest that ISS has not placed as much emphasis on the problematic pay practices described in the following section as it did in 2021, and has instead aligned its recommendations more closely with the quantitative metrics derived from an analysis of RDA, MOM, and PTA. For example, of the 50 S&P 500 companies that received a negative ISS recommendation on say-on-pay, 28 received a “high concern” for RDA (compared to 10 out of 45 companies in 2021).

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 three companies that were moved from low to medium concern (as compared to four companies in 2021). Thirty-five 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.[18]

Based on our review of the narrative in the relevant ISS reports, in 2022 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 over half (27 of 50) of the S&P 500 companies that received negative ISS recommendations on say-on-pay (compared to 22 of 45 S&P 500 companies in the first half of 2021). 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.[19] The other concerns ISS identified generally fall into the following categories (with most companies receiving more than one of these concerns):

- ***The use of above-target payouts*.** ISS referenced the existence of payouts that exceeded the company's target for 21 of the 50 S&P 500 companies that received negative ISS recommendations (compared to 19 of 45 in 2021). 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.
- ***Large perquisites*.** ISS identified 17 of the 50 companies as providing excessive perquisites. ISS specifically mentioned aircraft use in at least seven of these cases. Compared to recent years, this was the first year in which we noticed a significant focus on large perquisites by ISS in its qualitative assessment.
- ***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 compensation as a negative factor for 16 of the 50 companies (compared to 22 of 45 in 2021). ISS generally viewed the use of discretion by companies as a means of excusing lackluster performance. Although we did see examples of ISS citing 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.

18 *See* ISS, U.S. Compensation Policies and the COVID-19 Pandemic – Updated for 2022 U.S. Proxy Season Frequently Asked Questions (Dec. 7, 2021), *available at* https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-and-the-COVID-19-Pandemic.pdf.

19 Companies should also pay attention to requirements that may be imposed by the SEC regarding performance metric disclosures. *See* U.S. Securities and Exchange Commission, SEC Reopens Comment Period for Pay Versus Performance (Jan. 27, 2022), *available at* https://www.sec.gov/news/press-release/2022-11; Reopening of Comment Period for Pay Versus Performance, Release No. 34-94074; File No. S7-07-15 (Jan. 27, 2022), *available at* https://www.sec.gov/rules/proposed/2022/34-94074.pdf.

- ***The use of time-based incentive awards rather than performance-based incentive awards*.** ISS identified this concern at 12 of the 50 S&P 500 companies that received negative recommendations (compared to 16 of 45 companies in 2021). The failure by ISS to consider time-based vesting awards to be a robust measure of performance has been the subject of criticism because time-based equity awards can give holders a stake in the performance of the company and align the interests of executives with those of shareholders. However, awards granted subject to performance-based conditions are considered to be a matter of good governance.
- ***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 for 12 of the 50 companies (compared to 14 of 45 companies in 2021). ISS viewed some of these arrangements as being excessive and others as being tied to a voluntary retirement.
- ***The use of performance conditions that are not sufficiently rigorous*.** 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 not sufficiently meaningful. Twelve of the 50 S&P 500 companies receiving negative ISS recommendations were identified as either having performance standards that were not sufficiently rigorous for reasons such as short performance periods or outdated performance metrics (compared to 26 of 45 companies in 2021).

D. EQUITY COMPENSATION PLAN VOTING[20]

	ADOPTION OR AMENDMENT OF OMNIBUS STOCK PLANS			
	Russell 3000		*S&P 500*	
	2022 YTD	*2021*	*2022 YTD*	*2021*
Number of proposals voted on	**455**	*678*	***73***	*109*
Percentage with ISS "against" recommendations	**27%**	*33%*	***8%***	*6%*
Average level of support with ISS "for" recommendations	**94%**	*94%*	***94%***	*94%*
Average level of support with ISS "against" recommendations	**79%**	*82%*	***75%***	*77%*
Number of failed proposals (<50% support)	**2**	*4*	***0***	*0*

U.S.-listed companies generally are required under stock exchange rules to obtain shareholder approval for the plans under which they award executive compensation to employees, directors or other service providers.[21] 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%.

[20] This portion of the memo compares data on proposals for shareholder meetings held during full year 2021 against 2022 through June 30.

[21] *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:[22]

- ***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 approximately 27% of equity plan proposals in the case of Russell 3000 companies in 2022 (down from 33% in 2021), but recommended against only 8% in the case of S&P 500 companies (up from 6% in 2021). For many of these companies, ISS cited broad discretionary accelerated vesting authority among the reasons for its negative recommendation. Other common reasons included excessive plan cost, excessive burn rate and inadequate disclosure of change-in-control vesting provisions. Despite the negative recommendations, all of the proposals at S&P 500 companies (and all but two proposals at Russell 3000 companies) received majority support.[23]

Even though ISS recommendations did not seem to impact passing rates, they continued to have a fairly significant impact on voting results: in 2022, the average support level for equity plan proposals at S&P 500 companies was 94% when ISS recommended "for" approval and 75% when ISS recommended "against" (compared to 94% and 77% in 2021).

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22 ISS's current equity plan scorecard approach is described in its United States Equity Compensation Plans Frequently Asked Questions, *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."

23 According to ISS, proposals to adopt or amend omnibus stock plans failed to receive greater than 50% shareholder support at two Russell 3000 issuers: Concept Therapeutics, Inc. (46.8%) and TransMedics Group, Inc. (41%). ISS recommended against both proposals.

E. LOOKING FORWARD TO 2023

In 2022, many companies moved away from the discretionary adjustments to compensation that had become more frequent at the height of the COVID-19 pandemic, and which ISS had routinely criticized. Still, ISS continued to fault companies for a different form of discretionary action—namely, above-target payouts. Although this did not appear to be the sole cause of a negative say-on-pay recommendation, ISS did take note of many companies' decisions to provide excessive perquisites to their officers. ISS is likely to remain focused on these elements in light of the recent economic downturn. Further, if the SEC approves its current proposal to increase pay-for-performance disclosure, then this will likely result in increased scrutiny by ISS.

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