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Day 3
The Top Compensation Consultants Speak
Date: 09-23-20

Liz: Hi everyone. Welcome back from your break. I am now joined here by three outstanding compensation consultants to share their views on what compensation committees should be thinking about right now. We have Bindu Culas of FW Cook, Blair Jones of Semler Brossy, Tara Tays of Deloitte Consulting and then also, Howard Dicker of Weil Gotshal is going to moderate this panel. So, I will turn things over to Howard to set the stage.

Howard Dicker: Thanks, Liz. Well, we're going to dive right into it. This is the next day of the conference; human capital is certainly top of mind. I spoke on it earlier. There were a couple of other panels earlier. Now, we're going to really hear from expertise here in thinking what the comp committees are doing in this area. As we know from my perspective as a disclosure lawyer in particular, I know that I'm going to be working on disclosures for 10Ks on human capital disclosure. But what's going on at the comp committee, Blair. Take it away.

Blair Jones: Yeah, so one of the trends that we've seen over the last couple years is comp committees adopting this broader mandate to include human capital. And that's being driven by a number of forces. Investors have been asking about these issues for quite a while. State Street asked about culture a year ago and asked companies to talk more about that. A number of investors came together as consortium, mainly public pension funds, a couple years ago with the CEO pay ratio asking for more data about the workforce. BlackRock has put together their KPIs which include board oversight of some of these human capital issues. State Street has come back with an interest in racial diversity in the last month. And the New York City Controller's office is asking for more disclosure on diversity and inclusion. So, it's coming from a lot of fronts.

The SK new disclosure on HCM and COVID and just investor's interest in the employee experience that has been happening are pushing this over the goal line. So, I think that a trend that had started is only going to pick up speed as we go forward.

So, as you think about it, the comp committee is a pretty natural place for a lot of these HCM issues to end up. As you're thinking about pay decisions for managers, it's natural to be thinking about pay decisions more broadly and how we're aligned up and down the organization. But it's also important to think about are you rewarding leaders who

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support the right types of culture and leaders who are inclusive. Are you accelerating pay through promotions for those kinds of people as well? So, there's just a natural link to these kinds of things.

What we've been doing with committees to help them through this process is to actually think about the different human capital topics. You can imagine a grid where across the top you have culture, pay equity, leadership development, succession planning and talent, broader pay considerations across the globe. Things like ESG measurement. You take those and then you say, well, where in the board should those items be discussed? And sometimes it's going to be the comp committee. Sometimes it might reside elsewhere.

So, you can imagine that for topics like culture and diversity and inclusion, particularly given the attention they're getting right now, some of those are elevating to the board level. But I think our expectation is that over time some of that may continue to reside at the board level from a what's happening standpoint. But to the extent there are issues that need to be implemented that they get carried down to the compensation committee.

So, that is a good first conversation to have because it allows you to say are we covering all of the key human capital topics that our investors, and increasingly actually our employees and our customers, are asking about? Are we including them in the right places? Do we know what the accountabilities are? What do we want the comp committee to do? Is it just monitoring, or do we need them to have other accountabilities? And then also, are they happening with the right frequency? Because some issues for some companies are going to take more importance than others.

Howard Dicker: Blair?

Blair Jones: Yes.

Howard Dicker: Just wondering, would you agree that just the events of the last 6 months, I mean COVID and diversity and racial issues that have just come up, have kind of accelerated this whole conversation with committees? I mean, it got even more focused in the last several months.

Blair Jones: There's no question, Howard, that this is accelerated. Because with COVID, it puts in full relief what is the employee experience. If you're going to have incentives and incentive relief in particular for executives, what's happening with the rest of the population? And particularly, those people who are on the frontlines having to go in and potentially be in tough environments. So, that's one thing.

The George Floyd incident and the Black Lives Matter movement has clearly put this issue front and center. You know, to the extent it wasn't already. Companies are

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coming out and making pretty strong statements and commitments about what they're going to do. And so, it's natural that then the next step is how does that relate to pay as well? So, you've got to understand and think about those activities in addition to how they relate to pay.

You've got State Street coming out with its new focus on tell us about your racial diversity, both of your executive team and the board. You've got some, actually, plaintiff's cases now with some of the tech companies, including Oracle where the plaintiffs are questioning whether companies are committed to their commitments to diversity and inclusion. And then you've got the New York City Controller's Office asking 67 of the Fortune 100 to disclose their E01 data.

It would be hard for boards to ignore this. Again, the compensation committee, because you're making decisions about the type of culture you're creating and trying to reward the right cultural leaders is a pretty natural place for some of this to happen. Although, like I said, some of this you may imagine elevating to the board level as well. So, we're seeing much enhanced interest in this.

Now, what we aren't seeing necessarily, and Bindu can comment on this a little bit and maybe you can as well, Howard, we aren't seeing a lot of changes to charters yet. We're seeing changes to names of the committees to embrace the broader mandate and we're seeing changes to agendas. So, you're seeing diversity and inclusion hit, let's say, a July agenda and you're seeing the employee engagement survey hit another agenda. And you're seeing other aspects of culture maybe hit a different agenda. Leadership development hit another agenda.

Most of my clients are trying to put one HCM topic per, and it's a good education. I think we're in our infancy. The other things that are happening on this front for comp committees is these HCM dashboards. So, you see committees just like they look at your placemat for compensation, some of you would be familiar with those. That's kind of your Cliff Notes on your compensation program. People are now creating a similar dashboard for HCM metrics.

So, a number of my committees would be looking at the demographics of the workforce and how those have changed meeting to meeting. They're looking at the ability to attract and particularly to attract diverse populations. They are looking at the retention of diverse populations. They're looking at the retention of newer employees. They're looking at poll survey results. They're looking at specific questions within those poll survey results. So, the committee gets a quick read on how things are happening from an HCM standpoint. So, that's one thing.

And then the second thing for companies that have been on this journey for a little bit longer, I'm seeing them move from a place where they just reported on statistics and

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programs and practices. And now, they're moving to actually bringing outcomes and individuals. So, they might put a face to leadership development. They might bring somebody who is a diverse candidate who has been through their leadership and development programs to talk about what those programs did and meant to them. Or they might bring a business unit leader in to talk about what he or she is doing to create an inclusive environment. So, to put a little bit more texture to what's happening and to make sure that it's real movement, not just things that show up on numbers.

Howard Dicker: And Blair, to the point you were making about committees thinking about changing their names from compensation committee to something that reflects a broader mandate, that is…I think that is catching on. We've certainly had clients say tell us other names of committees that you've seen that might be good for us to embrace.

Second is on diversity and inclusion the other thing that I've been seeing more charters include is succession planning, compensation committee charters. And I think that is directly in response to COVID and concern about what if our CEO gets sick. What do we do? Which succession planning, that has been a minority practice historically that it resides as a formal charter item. But that is, I think, catching on.

And I agree with you, Blair, that on the broader mandate of we will do the sun, the moon and the stars in terms of human capital management, that is early days still. And my feeling is committees want to make sure that they can actually do the things they put in writing before having aspirational goals that might be in the charter and could expose them to a plaintiff's lawyer saying, "You said you would do A, B and C. What have you done?" So, I agree with everything you said.

Tara Tays: And Bindu, that's what I also forget. I may think in some cases where succession planning is not part of the compensation committee's responsibilities. We also see it show up in the nominating and governance charter as well. So, it really depends on whether or not organizations are going to start shifting that responsibility from the nominating and governance over to the compensation committee.

Bindu Culas: Yep. Agreed.

Blair Jones: Yeah, and the other thing you see is another variation, which is the board still owns the CEO succession, but as you get below the C-Suite the comp committee starts to look at the next level and to make sure that we're feeding…you know, particularly as diversity and inclusion becomes important and making sure we have the bench that is going to allow for a more diverse leadership, that that's something the comp committee can focus on as well.

It's interesting times and it just, I mean, it seems so natural now because all of these issues are interrelated. And you really want to reward people who are leaders in these

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areas. But, you know, it took all of these events, back to Howard's point, for people to say, "Yeah, this conversation makes sense and it's helpful to the company."

Howard Dicker: Okay. Tara, we want to segue way to you.

Tara Tays: Yeah. I mean, I think as Blair just said, definitely rewards have an impact. I think we all are observing that the effects of COVID-19 are impacting companies in different matters and magnitudes. And executive pay reductions to date have been the most common action taken, but still not a prevalent one.

I'd say about approximately 20% of the Russell 3,000 have disclosed officer base salary reductions ranging from anywhere from 20% to 100%. And these reductions lasting anywhere from three to nine months. With respect to inflight annual incentive awards, still not a prevalent practice. We have observed some Russell 3,000 companies either suspending inflight plans and offsetting with equity awards, reducing target incentive opportunities, settling annual bonuses with equity awards for those companies that might have a June year end, adopting new COVID-related performance goals in the middle of the performance period. And then also, there is modifying existing performance goals and corresponding payouts. So, that's all for annual incentive plans in terms of what we're seeing.

With respect to inflight long-term incentive awards, you know, specifically performance-based awards, we've really seen very few companies take action with respect to either stopping the plan or modifying the targets in the plan. Most companies have definitely taken a wait and see approach to see what's going to happen as the performance period comes to close. And actually, Deloitte kind of prepared and I'm going to share with the group this framework for what should be considered by both compensation committees and management when it comes to whether or not adjusting incentives should be determined. Please present the slide on that.

I definitely think it's more palatable for institutional shareholders to except changes to design of go forward annual incentive and long term incentive arrangements in order to align current economic conditions with executive compensation program. And many compensation committee members have been faced with having ongoing discussions around how much discretion should be used to settle existing inflight annual incentive arrangements.

You'll see here, as I mentioned, there's a 10-issue framework or questions, high-level questions that should be asked. The one thing I'd call out is while this does cover a number of different areas, definitely specific industry implications also should be factored into whether or not some of these areas should be observed.

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Hopefully, everyone can see this slide. But basically, I think the first thing that you want to do when determining whether or not the annual incentive award or **performulaic (15:09)** incentive reward be modified is calculate the award based on actual performance. See where actual performances and what that corresponding payout opportunity is.

Next, you're going to want to see how is actual performance relative to other performance targets. So, specifically looking at how did the company perform relative to preestablished financial and operational goals in the incentive plan. And what might this look like for other goals that are in the strategic plan? How did the company compare relative to prior years? How does performance look like in comparison to last year? It's also important to look at whether shortfalls in the incentive plan performance are due to factors other than COVID-19, for instance. Was there an acquisition that resulted in poor shareholder return or inadequate synergies?

For companies with multiple subsidiaries, the company will also want to look at whether certain business units performed better than others, especially if enterprise-wide metrics are used at the executive level in the annual incentive plan.

The other area that's good to look at is how does the company compare with shareholder experience. So, looking at the company's stock price performance over the past year or six months and factoring in whether dividends were reduced or suspended. Looking at how the company's relative total shareholder return compared to both peers and the market in general. And then you also want to look at how a company's financial performance compared to its peers or an index if they measure against one.

And finally, what you'll see as the fourth area is how does the company compare to overall business performance. Some of the areas that can be explored include whether or not management took appropriate action to reduce costs in a timely manner? Did the company maintain proper amounts of cash on hand during COVID-19? Was the company in compliance with the terms of its bank loans or loan convenance? You also could look at did the company maintain a strong balance sheet during this time.

And then finally, another area that you might want to look at is whether or not the company was able to negotiate any lines of credit or loan terms on a favorable basis. The other area that we have here is whether or not actions, what actions specifically were taken to protect the employees' health. I think this is definitely a very important one given COVID-19. We definitely want to see what steps were ensured to make sure that the workforce maintained a health environment.

And also, what plans were put in place to protect the workforce and whether those plans were put in place in a timely manner and whether they were well planned out. This might include making changes to the existing health plans, providing additional paid time

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off or vacation benefits to help employees address COVID-19-related issues. Obviously, making sure that the companies were in a safe working environment, whether it's providing the mask, gloves, making sure that the office environment was safe for certain parts of the U.S. where it was okay to go back to work and is currently okay to go back to work.

Next up, we have the six areas of what actions were taken around employee compensation of workforce planning. I think it's definitely good to look at whether or not the company reduced employee base salaries, reduced hours worked, whether they conducted furloughs or layoffs. And determining, again, how much discretion should be applied on the existing annual incentive plan.

I'm also wanting to look at whether or not the company was able to retain talent and maintain levels of employee engagement during this time. And I also look to see whether or not appropriate steps were put in place to ensure the right talent was in place to take advantage of the economic recovery.

The other area that you'll see here on the framework is what strategic actions were taken to respond to the road for recovery. So, how did management prepare for the road recovery? What plans were put in place? How did management deal with issues uncovered by the economic crisis such as supply chain issues or cash flow? And depending on industry, it will be good to review if the company was able to ramp up quickly to take advantage of consumer demands in addition to kind of the supply chain areas.

We also want to see whether or not the company kept management apprised and well informed throughout the economic crisis and how responsive management was to input from the board.

The other area is also looking to see was the company proactive in communicating with investors and suppliers and customers during this time. And then what information was provided to employees? Was the right level of information and appropriate information provided to employees during these times?

The other area is more from an external lens, and it's really kind of looking to understand whether or not potential reactions from shareholders, institutional shareholders and proxy advisory firms. So, we definitely want to see and understand what the proxy advisory firms and the institutional guidelines are out there related to COVID specifically and how they might react with respect to an adjustment or discretion being used to determine whether or not additional payout or modification payout should be provided.

Both ISS and Glass Lewis have put out COVID-19 guidance that basically in a nutshell I would say says that every decision made to adjust the plan formula will be a case by

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case basis. Definitely other factors will be considered in determining whether or not the discretion or the adjustment to the executive incentive plan formula makes sense and was fair to shareholders and other employees alike.

The other thing I'd call out is when adjustments are made, it's also good to look to see how do these adjustments compare to historical discretion used in other annual incentive plans in previous years. So, really kind of looking to see…you might expect that COVID-19 related expenses might be excluded from the calculation to the extent that you have a metric where it impacts. But also, just make sure that management and the board won't be criticized to cherry picking in its approach in terms of what level of discretion was used and why it was used.

And then in the end, I think once management and board members take full measure of everything that has happened and carefully evaluate all factors in, the appropriate amount of judgement should be applied to determine how much discretion or adjustment to the incentive should be utilized in determining the executive's incentive pay outcomes. And, you know, given COVID-19, I think it definitely has shifted the way executives and employees have worked. And definitely, I think, in some cases created a lot more hours that are needed to make sure that the wellbeing of employees and management are required.

The last thing you want to do is have an incentive plan that does not reward the appropriate contributions. So, taking a really good look to see, okay, you might have had financial metrics in the incentive plan, but maybe some of the softer contributions that happened in light of COVID-19 also should be factored in with respect to any decisions on whether discretion should be applied or the formula being adjusted.

Howard Dicker: Okay. Well, I know that my clients and myself are going to be keenly aware of working on CDNA trying to explain the adjustments in a transparent way, of course. When the rubber hits the road though, it will be difficult to, I'm sure, do the disclosure that we want. And I think it will be important, one of the things on your slides about having the rationale explained carefully.

Tara Tays: Right. And I mean, definitely an important point telling the story as to why and going outside of just the decisions that were made. Well, going outside of specifically the plan formula but really kind of telling the whole story in terms of the impact of how maybe the incentive plan is also used for other employees within the organization. So, it's not just an executive incentive plan, but really, the calculation is used to reward employees below the executive level. So, I think that paints a nice picture too. Usually you'll see that the executive plan will kind of start the framework in terms of how other employees in the organization get rewarded. So, adding flavor in terms of the non-employee population will be important.

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Howard Dicker: Well, speaking of plans, in this case equity plans and structuring, I'll turn it over to you, Bindu.

Bindu Culas: Thank you, Howard. So, equity plans is like my absolute favorite thing to talk about. And what better place than the NASPP to talk about it. The reason we as a panel thought this was worthy of discussion at the 2020 conference is because we, and Blair and Tara should jump in, but envision that a lot more companies will go back next year to replenish the share pool than they may have been expecting to do pre-COVID and all that has followed since March.

So, in the expectation that companies may be going back sooner than they were hoping for, I'm going to take a little bit of time just to talk through what are the things to keep in mind as companies go back to seek a replenishment of the share plan.

So, the first thing I would say is as a general rule of thumb, I personally like to go back for shareholder approval of a new equity plan at least a year in advance. I don't like waiting until the final year and then being out of shares. Then it's very tricky and you're in this limbo of do I have enough shares to make a grant the next year. There will be companies who will be in a position where they may not have enough shares at next year's grant. In which case, we may say conditional grants. They'll make the grant conditional on shareholder approval of the equity plan. But hopefully those will be limited circumstances.

But to the extent that next year you have shares but the year after, so 2022, it's looking uncertain, I would encourage that company to go back next year so that there's not brinksmanship come 2022. And before deciding whether you need to go back--and this is such a practical point, but I'll make it anyway--make sure that the share reserve has been tallied accurately. You would be surprised at how often the way the shares were accounted for in the plan are not consistent with the permission in the plan.

So, for example, virtually all plans will permit forfeitures to be added back to the share pool. So, if you have a PSU that didn't pay out, those forfeited shares should be added back to the share pool. And it gets tricky when you've got awards under different plans. A well written plan should recapture all forfeitures regardless of which specific plan it's coming out of. So, make sure that all the shares that are available for use are being properly accounted for and no shares are left on the table. And this gets tricky when there is recycling of tax shares and option shares. So, the overall point, do a good calculation to know exactly where you stand in terms of the share count.

The next question for someone going back next year is whether the plan should be amended and restated or whether a new plan should be adopted. And this is kind of form over substance, but it actually has implications in the ISS world. If you amend and restate a plan, ISS will actually review the plan for line by line changes. So, what were

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the modifications that were made. And they will assess those modifications as whether it's accretive to shareholders or detrimental to shareholders. You have to defend every change.

For example, if you did not permit liberal share recycling and you decided to add liberal share recycling, that would be viewed as a negative change. Or if it was a legacy plan that had participant limits and you wanted to clean up the plan to eliminate legacy provisions that were 162-M related, those would be viewed as negative to shareholders. So, that becomes a little trickier. And the proxy writing becomes a little bit more cumbersome because you have to itemize all of the changes. So, on balance, we prefer, I prefer, a new plan even if it means just renaming the plan to the 2021 equity incentive plan but you're keeping everything else exactly the same. Because then the plan is reviewed holistically and there isn't this line by line comparison.

That said, if a company is doing a brand-new plan and it is international, like virtually all big companies are, it is worth checking local law requirements. Because if you are in jurisdictions that are complicated, like China for example or Australia where there are filing requirements for changes to equity plans, it may make a difference whether it's a new plan or an amended plan. So, that has to be factored into the mix because it shouldn't just be what's convenient for ISS. It should also be what's convenient for the company and not having to go reregister plans around the world just to make it easier on the U.S. approval end. So, that is a takeaway for local counsel to be thinking about.

And then you get into what is the share reserve going to be. So, this goes to plan cost. What is the need of the company versus what the company can bear from a shareholder dilution perspective? In an ideal world, you would go back to shareholders and say give us…I love five years, but it may be three to five years. But if there's a lot of overhang because there are options that are under water that's outstanding and it's creating overhang in the request, the company may only be able to ask for fewer shares. And so, that needs to be balanced.

The investors have bright lines about what is a tolerable level of dilution. So, a general rule of thumb, and this goes back to the fidelity days, was 15%. But many of the big institutional investors have higher levels of dilution, so 20%, I believe, is what Vanguard will support. There is flexibility there. That's going to be essentially the key consideration for what is going to be in the new plan. How many shares can you get? Once you've decided how many shares you can get—and we'll come to this in the second part of what I talk about, like do you subscribe to the ISS model, do you pick your own number, we'll come to that in a little bit—but once you know how many shares you're going to be asking for, the next question is what is the design of your plan? Is your plan going to be a full value design? Meaning every award counts as one share. An option counts as one share, an RSU counts as one share, a PSU counts as one share. Or is it going to be a fungible design so that you're matching the economic value

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of the award to the plan cost. Again, as a general rule of thumb, an option is worth about a third of a share. So, in a fungible design you would set it so that an option counts as one share but a full value counts as three times that. So, it's a 3x.

Again, to equalize it you could use a lot more options before coming up with equal length number of full value shares. And that fungible ratio is going to key off of the Black-Scholes evaluation of each company and their variety of inputs. An option of a third of a share is very rough justice, but that's the analysis.

Now, there's a natural inclination to say oh, let's just do fungible because that is the economically sensible thing to do. The problem is if you do a fungible reserve, you're going to get a much bigger share request. Because remember everything is nominated and option equivalent. So, instead of a plan reserve of say, 300,000 full value shares, you might be requesting a plan reserve of a million shares because those are all option equivalent that translates into about 300,000 full value shares. And that can trip up dilution limits because just of the quantum of the number.

If the company is not a company that is granting options, then it is just not worth doing. As the option usage has declined, and this is more industry by industry, but for companies and industries that are not using options, fungible designs are not prevalent anymore. And Blair and Tara should jump in. For companies like technology companies that are still in the option granting sphere, fungible designs could make a lot of sense to be prudent about share usage.

Then you're going to share recycling features. What do you want to add back to the share reserve? On share recycling it's important to draw a distinction because when you think of share recycling you think oh, it's bad from an ISS perspective. Don't do it. But there are three categories of share recycling. There is recycling of forfeited awards or terminated awards. Basically, awards that never come to life. And that is not problematic from anyone's perspective. Those shares should always be added back to the reserve.

The share reserve, it should operate on a closed loop basis. Every shareholder approved share is sacred and to the extent you can save it, my believe is you should. So, forfeited shared, terminated award shares always return to the pool.

Then you go into shares withheld for taxes or shares withheld to satisfy the option exercise price. And this is a key…two key areas. Shares withheld to satisfy the option exercise price or taxes withheld on options, that is considered a negative from an ISS perspective. It is considered liberal share recycling and it is considered negative. Shares withheld for taxes on full value awards is also considered negative. It's also considered liberal share recycling and scored negatively on the ISS scorecard. But it is

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scored less negatively on the ISS scorecard. And when you look at the quality score rating, it only considers the option recycling.

In my practice, what I have seen is that companies will give up recycling of option shares but retain recycling of full value awards. And this matches up nicely to the fact that people are not really using options very much anymore. And the benefit of getting those shares back even though it's upfront a slight hit from a scoring perspective, can add a couple of years to the reserve. My default is give up the option recycling, but retain the full value recycling of shares.

Howard Dicker: Bindu, do you want to pick up with approval or any other things? We'll move it over to Blair now.

Bindu Culas: I'll come back to it. I'll let Blair take over.

Howard Dicker: Okay.

Blair Jones: Sure. And so, where we thought we might go next is the use of ESG metrics or non-financial metrics in incentive plans. Interestingly, as Tara was talking, it's clear that this year is going to be a year for many companies which involves a lot of discretion. And I think as we talk about this issue in the profession, we think this is one of the changes that might stick. We've found that those companies who already have discretion or non-financial metrics built into their program have an easier path getting into this discretionary decision that those who don't. If we make predictions going forward, one thing coming out of the COVID crisis is probably having some non-financial component of your program. Whether it's a 20-30% carved out block or some modifier and specifying what that is, is probably something that's worthwhile so you don't have to create things from whole cloth.

Particularly in today's environment, ESG metrics are part of that whole equation of non-financials. I want to make sure as we talk about non-financials that we don't just isolate it to ESG because there are other strategic metrics and operational metrics that may have great importance. And particularly, if you're a company in transformation or you're a company that has set out aggressive growth goals, that real estate can be valuable for that as well.

But be that as it may, ESG metrics have taken a lot of interest. State Street and BlackRock entered the year putting a heavy emphasis on climate, so companies started down the path thinking about that. The Black Lives Matter movement and the continued discussion around diversity has started to elevate those metrics, which were already in discussion as well. But it has only elevated them.

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And then actually, beyond that for companies in the consumer products or the retail industries, there's also a high interest in responsible sourcing and responsible packaging. And that is coming to the fore as well. As these discussions come to the fore with investors, then the natural extension is where they fit in the compensation real estate. And I think that's where the trick is, right? As I was talking about earlier, you've probably got 20-30% to play with. Because you've got other metrics that are really important; the outcomes metrics of your financials or in the long-term incentive the stock price or TSR metrics as well. So, we need to find something that compliments and allows us to capture the how things are achieved in addition to the outcomes but that does it in a way that makes sense and weaves together nicely.

The best way to start to think about this is what are the metrics that make a difference for your company's mission or strategy. It's easy, and I think one of the risks in this environment is for people just to take a metric and say this is really important right now. Let's just put it in. You see this, for instance, with DNI. And it's really important that we're signaling a commitment to DNI, so I don't want to diminish that at all. But there probably are better and worse ways to measure it and there are better and worse ways to move it forward. You want to make sure that you're thoughtful in that regard.

Starting with your strategy is really important. Perhaps if you're in the food industry, thinking about your supply chain and the sustainability of that supply chain is a really important strategic metric central to your mission. So, are there things from a strategic sourcing standpoint that perhaps fit into that real estate. Or if you're a retail company, these younger consumers really care about the working conditions and the types of places where you're sourcing your materials. So, are you doing that, and is that central to who your mission is? We see a lot of these newer and trendier retail outlets appealing to that, so should we be measuring that component?

And then across industries. Of course, DNI and talent applies particularly as we become a more knowledge and talent driven company. So, figuring out which metric is going to make a difference to your strategy and figuring out that it will really make a difference in your financial outcomes is your first step.

Then you've got to get to how do we measure it and what are the right measures. And you want a measure that one, is easy to understand how it connects to your financials. You want a measure that you can measure over time. And you want a measure that you're not embarrassed if the outcome is poor. Those are kind of three pretty good gates as you start to think about these particular metrics.

So, tied to mission, think about what to measure and then set goals that you can communication and again, aren't embarrassed if they are poor.

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Tara Tays: And I can't echo enough on what Blair is saying. It's all about the mission, the strategic plan that the company has in place. Because often times anytime there are thoughts around whether or not…changing the metrics or changing the performance curve, you might do a market assessment in terms of what your peers are doing. And sometimes what your peers are doing may not be what you need to be doing in terms of how those metrics should be established. And I think we'll see a lot of that specifically for those companies that continue to adopt DNI metrics.

What might make sense for one company may not be an issue for another company. So, definitely really good to kind of go back to the strategy, go back to the analysis on the company around these various metrics to determine what's the right way to set these goals if you're going to include them in the annual incentive plan or even performance based long-term incentive plan.

Blair Jones: That's a really important point, Tara. The last point I would make is that while I think that we're on this path and there is room to have non-financial metrics that include ESG metrics, right now if you don't have the right metric the best thing is to be on the journey and to be communicating with your investors how you're on the journey.

Again, we shouldn't do a knee jerk and just put something in to put it in. It's too precious real estate to do it wrong. Definitely be on the journey, definitely start the measurement, but put it into the incentive plan when you know it can make a difference.

Howard Dicker: Blair, do you want to turn it over to Tara? You ready?

Blair Jones: Yes, Tara are you ready?

Howard Dicker: Okay, go ahead.

Tara Tays: I think another topic we wanted to discuss is whether or not boards should consider modifying prior equity awards that are under water or adopt an option exchange program. I definitely do think it's important to remember that unexpected U.S. or world events which have sudden material impacts on financial markets are nothing new. And by no means do I mean to undermine the impact of COVID-19, that it's had on employees and people and families and companies. But if we look back at the S & P 500 stock price performance during and after disruptive past events, we will observe that after the 1987 stock market crash that the S & P 500 experienced a 39% gain three years later and an 85% gain five years later.

And after September 11th, the S & P 500 experienced a 3% gain three years later and a 19% gain five years later. And after the 2008 financial crisis, the S & P 500 experienced 2% gain three years later, so not as much, but a 41% gain five years later. So, even when you look at the review of impact of stock prices after the last five epidemics that

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have occurred, the overall average of S & P 500 returned one year later was 24%. Therefore, the history alone might suggest that a wait and see approach regarding significant loss and equity value might be best.

For the 2020 proxy season to date, there have only been nine companies that have taken forth the stock option repricing or exchange proposal from the Russell 3,000. None of the S & P 500 companies have taken this type of proposal. And again, this is for this year. Seven out of those nine proposals received an against vote from ISS. And four received an against from Glass Lewis. And despite the proxy advisor's recommendations, only two issuers really received a no vote or against vote on the stock options repricing proposal.

Some of the red flags that were observed in the repricing proposals included—that did not pass—included executive officers being eligible to participate in the repricing, which in some eyes might undermine a company's promotion of pay for performance philosophy. Recent grants being eligible to participate in that stock option repricing program were included. And then also, exchange of awards. Not being neutral. So, basically, the exercise price of new option awards were lower than the recent closing price which effectively provides for discounted stock options. Those are some of the things to not do perhaps if you are considering adopting a stock option exchange program or repricing awards.

As board and management consider whether stock options should be canceled and exchanged, it's also important to evaluate the value of money, the value of out of money stock options by the remaining term of the option awards and by employee groups, separating both the executives and the non-executives. It's good to run this analysis by looking at what the Black-Scholes is using current assumptions. And also, looking at how out of the money the awards are by remaining term of one year, three years and five years. And this analysis should also provide information on potential expense of the repricing proposal.

Under ASC 718, an option exchange is considered a modification of outstanding options participating in that program if incremental compensation expense will have to be recognized to the extent that the fair value of the replacement awards exceeds the fair value of the canceled options. So, definitely good to understand the accounting impact associated with any option exchange program.

The types of stock option exchange should also be reviewed. For the past five years companies have canceled options and granted new options typically designed the award exchange ratios to be neutral in value. There have been very few companies that have offered discounted options or premium options in exchange or by the exercise prices they had to lower or higher than the current stock price on their pricing tape.

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And some companies have actually canceled options and granted restricted stock awards or cash instead of another stock option which is also known as a buyout. So, definitely there are some options to consider with respect to what type of stock option program should be established.

I think it's also really important to always include what the institutional shareholder's guidelines might be or proxy advisor guidelines might be. ISS actually put out COVID-19 updated guidance that basically notes that it will review stock option repricing or exchange proposals on a case by case basis. And what they'll look at is the historical stock trading patterns of the organization. So, basically, they're going to review how volatile the company's stock price has been and whether out of the money stock options are likely to be in the money in the near term given the stock price volatility of the company.

They'll also look to see what the rationale for the repricing or exchange will be disclosed in the proxy statement and whether the company's stock price decline was beyond management's control. They'll also look to see whether or not the program will provide for a value for value exchange and making sure that there's no really egregious upside that's being provided to employees.

The timing of repricing is also another area that they'll look at. They'll look to see whether or not repricing occurred at least one year out from the significant drop in the company's stock price awards. So, looking at the different awards that might be included in the repricing is definitely an important consideration.

They'll also look to see the vesting period. You know, whether or not the new awards will be immediately vested or will they kind of continue on with the outstanding vesting period as seen in the exchange. And then the term of option will also be reviewed. ISS will expect that the term remains the same as the replace option. And finally, there's the exercise price. They'll expect that the exercise price will be set at or above the current fair market value.

On the other hand, Glass Lewis's COVID-19 guidance noted that stock option repricing proposals are only acceptable if macroeconomic or industry trends rather than specific company issues cause the company's stock price to decline dramatically. And really, that pricing is truly needed to motivate and retain employees. So, their guidelines are not as detailed, but again, I think that both proxy advisors and other institutional shareholders will definitely take a very close look to see whether or not the option exchange makes sense to continue to motivate and retain employees and whether there are just dips in the stock price that were truly outside of management's control and really kind of unfortunately, in lieu of COVID-19 or due to COVID-19.

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The other considerations to also keep in mind are perhaps participants that are overseas, outside of the U.S., what are the local country regulation requirements on award and what that might look like. For companies that grant instead of stock options, you still want to look at the tax implications as well. As repricing does trigger a new grant date, so with ISOS shares must be held for two years from the grant date and one year from the date of exercise to receive that favorable tax treatment under ISOS. So, you definitely want to look at that.

Other tax implications include 409a. So, when an option is modified, such as in connection with an exchange program or repricing, the option must have a new exercise price that's at or above the fair market value at the time of modification or to remain exempt under section 409a. And it's also important to note that multiple price adjustments could cause the option to be characterized as having a floating exercising price which could put the option at risk for losing its section 409a exemption and exposing option holders who are U.S. tax payers to an additional 20% given the way the 409a rules work.

So, those are some of the other considerations that should be included. A lot of analysis should go into it. As I mentioned, ISS and Glass Lewis kind of have their guidelines. Other institutional shareholders have guidelines as well but not as detailed as or prescribe as what ISS might have. So, definitely just good to kind of do a robust analysis to understand the implications of the repricing program or the option exchange program and what approach makes best sense for the organization for its employees.

Howard Dicker: And of course, these things typically involve, in addition to shareholder approval in the stock exchange, they'll involve all sorts of SCC things, meaning tender offers, registration statements, file disclosure. And I think it goes without question, you were just talking about external issues to consider, it's a big messaging and explanation thing. It's not like you create a document and you throw it out. There will be town hall meetings and all sorts of explanation sessions. They'll be a lot of time and effort given internally with the employees explaining how this works and what makes sense for you. Iv'e seen all sorts of different ways of handling it. In particularly, with people working remotely it's probably even more of a challenge I suspect.

Tara Tays: And that's a great point Howard. Change management is so important with any type of event that impacts the outstanding award. Very instrumental to make sure you have a robust change management program and com strategy as well.

Blair Jones: It will be interesting to see if we see many repricings. I think there was a lot of interest when the market dropped so deeply. And then one, it has recovered, but I think as people looked into the requirements that Tara went through between senior executives not being able to participate and needing to be at least two years beyond the

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drop, the interest seems to have subsided some. So, it will be interesting to see how it plays out.

Tara Tays: Right. I mean, more so for the awards that are going to be expiring this year or maybe next year. Because those are the two awards that potentially are impacted the most. So, really doing that analysis over the remaining term I think is really important to kind of see if this makes sense for the organization in order to make sure that employees are not penalized at the end of the day given the current situation that we're in.

Howard Dicker: Okay. Bindu?

Bindu Culas: So, back to equity plans and I'll close this out very quickly because, Howard, we don't have very much time, do we?

Howard Dicker: We can go over a little bit.

Bindu Culas: We've looked at the plan and now let's talk briefly about how do we get the plan approved. The good news is unlike Say on Pay where you want a nice high vote in the 90's, for an equity plan approval you only need 50.1%. It is a binding vote, but you only need 50.1% to have it approved and have a good plan. So, what does that mean?

That means that you can be strategic about how you go about seeking shareholder approval. And there are three routes. One is if you are a company that has been conservative in equity usage, you may know internally what an appropriate share request is going to be and then match that with plan features and provisions that are aligned with market practice. And you can get comfortable that you know what is a fair request that meets the needs of the business and will be supported by shareholders, and you can go forward that way.

If you're a larger company with a history of grant practices and you've got lots of overhang, it's more murky about what is an appropriate share request that will be supported. The common practice is to subscribe to the ISS equity plan scorecard. That is a tool that enables the company to know what at least the consulting side of ISS determines is a level of request that the research side of ISS will support. So, that is an avenue that is available.

The third avenue is shareholder outreach. And we've seen this in a number of cases where you know that your request, even if you ran it through the equity plan scorecard, will not be supported because it has exceeded certain benchmark limits that have been put out by ISS. And in that case, shareholder engagement is the way to do it. But if that is the avenue that is going to be pursued, that needs to be planned and done well in

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advance. It has to be a very coordinated, very targeted outreach. We've had great success…I mean, investors are supportive of a company's equity needs if there's a clear rationale for why the request is at the level that it is.

Just as a practice pointer, ISS has something called equity plan data verification which is provided by the research side of ISS. Just as a diligence matter, it's probably a good idea if you're putting an equity plan on the ballot to register for that data verification. Because it enables you to cross check what the inputs are that ISS will be using regardless of whether or not you've subscribed to their scorecard tool. I like to do it because I like to know that what's in the proxy report is going to be accurate whether or not I am relying on the ISS support.

So, those are the avenues to get approval. I'll just talk about three features because this will come up too. Which are the three features in equity plans that are the most high-profile if you will. Should the plan prohibit acceleration of awards, and I would say no. Do not sign on for a no acceleration commitment because that just ties the hands of the committee. You don't know when they might need to accelerate an award. It's not worth it, in my opinion, to try to get the positive governance score for agreeing to that.

Contrast that with two other provisions that have become more mainstreamed, which is adding a one-year minimum vesting requirement, which people have generally come to believe that we can live with that. There are exceptions which can be built in, again, to build in flexibility. As well as a provision on dividends on unvested awards. Again, that's been mainstreamed as well because most companies will not pay dividends until the award is vested.

Those are three governance features. Director limits…Howard, can I say one word on director limits? Which is in my experience even though the law is not fully supportive and settled on this, plans that I work on, my firm works on, we continue to put in director limits in Delaware Company Plans because it's just perceived as something is better than nothing. We like to add an exception for extraordinary circumstances or a non-executive chair. Because again, you don't know when you might need to go above the limit.

And finally, on change of control, because that's also a standard provision, the market has evolved where the change of control provision in equity plans is now more generic. It used to be a couple of years ago that people were trying to fit squarely within the ISS standards, but not so anymore. It's written flexibly so that the award agreements can contain the actual terms by which the awards will be handled in a change of control.

Okay, that's it for me Howard.

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Howard Dicker: Okay. Blair, I'm going to just connect up. We're going to take one more minute to connect up something you said earlier with something that Bindu said earlier. We're talking about comp committees, diversity inclusion and discretionary adjustments and the like or using metrics that either had diversity inclusion or ESG. Bindu, you had mentioned some litigation, I believe, that has recently been around. I think that's a concern for folks. I mentioned this briefly on an earlier panel. As people start thinking about their 10K disclosure, this new rule about putting in human capital and potentially disclosing metrics or using ESG metrics elsewhere in sustainability reports or other things. So, the concern…the cases here…what we're really talking about is making these commitments to do things and not attaining them. Saying we're on track to do something and we're not. I think, Blair, when you're talking to your comp committees and management that that's probably something they need to be worried about in how they communicate things to the public about that.

Blair Jones: Yeah, no question. No question. Particularly if it goes into any file documents. You have to be even more careful.

Howard Dicker: Okay.

Liz: Excellent points. Good point to end on and thank you all. That was a very interesting discussion. I was glad that Tara included the discussion of underwater options. Not just because it's a very timely topic and interesting and practical to hear about right now, but also because it gave me some fodder for the promo video that I did for this conference where I was splashed with water in a kiddie pool. So, if you all haven't seen that and you want a laugh, you can take a look at that. The video also has a very cute baby in it. Not that I'm biased.

Howard Dicker: Very good.

Liz: One housekeeping note, for the conference archives, I think I mentioned this earlier, but to access those, they will be available on this platform that you're currently using to watch the conference just until the end of this week. And then after that, all of the archives will be over on the corporatecounsel.net and compensationstandards.com. And if you are a member of those sites, either individually or through your firm, you will use your regular login to access those archives. If you're not a member of the sites, you will get an email with login information that you can use to access those archives. And we do have an FAQ about that as well under the 'More' tab, so make sure to check that out. Or you can contact our customer service folks if you have any questions.

We now have a break until 2:45 PM Eastern Time. At which point we will reconvene to talk about navigating ISS and Glass Lewis. So, that will be a nice follow up to some of the things that we heard about in this panel as well. To get to that one, remember you need to go back to the agenda tab and then enter that room separately for that session.

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Thank you again, Howard, Blair, Bindu, and Tara. That was a great discussion.

Blair Jones: Thank you.

Liz: Bye everyone.

Tara Tays: Thank you.

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