UNITED STATES

U.S. Compensation Policies and the COVID-19 Pandemic – Updated for 2022 U.S. Proxy Season Frequently Asked Questions

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This FAQ is intended to provide general guidance regarding the way in which ISS' Governance Research Department will analyze certain issues in the context of preparing proxy analyses and determining vote recommendations for U.S. companies. However, these responses should not be construed as a guarantee as to how ISS' Governance Research Department will apply its benchmark policy in any particular situation.

TABLE OF CONTENTS

1. How should this FAQ document be referenced?

This FAQ document serves as general guidance as to how ISS U.S. Benchmark Research may approach COVID-related pay decisions in the context of ISS' pay-for-performance qualitative evaluation (as applicable to meetings covered under U.S. Benchmark Research policy). This FAQ document is intended to serve as an update to the prior COVID-19 Pandemic FAQ originally published in October 2020. This updated FAQ document endeavors to explain any changes in how ISS U.S. Benchmark Research may approach these issues beginning with the 2022 U.S. proxy season.

As discussed further below, ISS' qualitative evaluation will take into consideration the impact on company operations as a result of the pandemic. As in the past, an elevated concern from the quantitative screen will continue to result in a more in-depth qualitative review of the company's pay programs and practices. The guidance in this FAQ has been shaped by feedback from direct discussions with investors in various roundtables as well as the annual policy survey; updates generally reflect feedback received from the most recent 2021 roundtables and policy survey. Nothing in this document should be construed as a guarantee as to how ISS Research may recommend on a given proposal. If you have questions about this document, please contact the ISS Help Center.

2. How will ISS view temporary salary reductions for executives?

As base salaries typically make up a small portion of total pay for top executives, temporary salary reductions will be given mitigating weight to the extent they decrease total pay. The action will be considered more meaningful if targeted incentive payout opportunities are decreased to reflect the reduced salary. Many companies' temporary base salary reductions were lifted before fiscal 2021.

3. How will ISS evaluate COVID-related changes to bonus/annual incentive programs?

The 2022 U.S. Proxy Season will mark the third proxy season and second year of executive pay proxy disclosure occurring under pandemic conditions. The surprise element of the pandemic in early 2020 is generally no longer applicable. Many investors believe that in 2021 boards were in a position to return to traditional pre-pandemic annual incentive program structures – i.e., those based predominantly on objective and transparent metrics that utilize predetermined target goals. Accordingly, as in pre-pandemic years, any mid-year changes to metrics, performance targets and/or measurement periods, or programs that heavily emphasize discretionary or subjective criteria will generally be viewed negatively. This will be of particular focus for companies that exhibit a quantitative pay-for-performance misalignment.

However, in certain circumstances lower pre-set performance targets (as compared to 2020) and/or modest year-over-year increases in the weighting of subjective or discretionary factors may be viewed as reasonable for companies that continued to incur severe economic impacts and uncertainties as a result of the pandemic in 2021 (see question #5 below). As before, companies should clearly explain target setting and any changes to the program, to allow investors to evaluate the compensation committee's actions and rationale.

4. What disclosure would assist investors in their evaluation of changes to bonus/annual incentive programs?

As noted above, mid-year adjustments to annual incentive programs will generally be viewed negatively. For companies that do make such mid-year program adjustments, investors have indicated that additional disclosure should be provided to assist investors in their evaluation of the changes. Companies are encouraged to explain why such actions were necessary, including the specific pandemic-related challenges and how those challenges rendered the original program design obsolete or the original performance targets impossible to achieve. The disclosure should also address how changes are not reflective of management performance. While such additional disclosure points will be useful information for investors, their inclusion in the proxy will not necessarily mitigate concerns regarding mid-year program adjustments.

5. If COVID-related changes to a company's bonus/annual incentive programs resulted in a lowering of financial or operational targets below the prior year's performance levels, how will ISS' analysis take that into account?

With respect to ISS' analysis of incentive plan rigor, investors have indicated that lower performance expectations that reflect external factors (such as operational impacts due to the pandemic) may be a reasonable explanation for lower goal setting. This consideration has not changed for the 2022 proxy season. Nonetheless, a lower performance target should be accompanied by disclosure that addresses the board's rationale for the lower target and how the board considered corresponding payout opportunities, particularly if such payout opportunities are not commensurately reduced.

6. How will ISS evaluate COVID-related changes to equity/long-term incentive cycles?

As before, changes to *in-progress* long-term incentive cycles will generally be viewed negatively, particularly for companies that exhibit a quantitative pay-for-performance misalignment. Modest alterations to *go-forward* cycles (i.e., awards granted for the cycle beginning in 2021) may be viewed as reasonable, particularly for companies that continue to incur severe negative impacts over a long-term period. For example, some movement from quantitative to qualitative metrics or modest increases in the proportion of time-vesting awards. More drastic changes, such as shifts to predominantly time-vesting incentives or short-term measurement periods, would continue to be viewed negatively. Companies should clearly explain any changes to the program, to allow investors to evaluate the compensation committee's actions and rationale.

7. How will ISS consider forward-looking disclosure of pay program changes beyond the year in review?

Many investors believe that boards are in a better position to return to the traditional incentive program structures which had been in place prior to the pandemic. For companies that made changes to pay programs that normally would be viewed as concerning from a pay-for-performance standpoint, clear and detailed disclosure of the company's intention to return to a strongly performance-based incentive program going forward may be viewed as a mitigating factor. The significance given to such forward-looking disclosure will generally be dependent on the level of detail provided in the proxy statement and the extent to which the disclosed changes are meaningfully positive.

8. How will ISS evaluate COVID-related retention or other one-time awards?

As with one-time awards granted outside the context of the pandemic, companies that grant one-time awards should clearly disclose the rationale for the award (including magnitude and structure), as well as describe how the award furthers investors' interests. As in prior years, boilerplate language regarding "retention concerns" will not be viewed as sufficient rationale. Awards should be reasonable in magnitude and an isolated practice; a company's repeated use of one-time awards in consecutive years will be viewed as especially problematic. Additionally, the vesting conditions attached to the award should be strongly performance-based and the vesting period should be long-term. Finally, the award should contain shareholder-friendly guardrails to avoid windfall scenarios, including limitations on termination-related vesting.

9. How will ISS evaluate retention or other one-time awards granted in the context of a forfeited incentive?

While many investors recognize that well-structured retention or other one-time awards may be appropriate in limited circumstances, investors do not expect companies to grant such awards merely as a replacement for forfeited performance-based awards. To the extent one-time awards are granted in the year (or following year) in which incentives are forfeited, companies will be expected to explain the specific issues driving the decision to grant the awards and how the awards further investors' interests. Granting one-time awards to replace forfeited incentives and/or to insulate executives from lower pay outcomes will be viewed as a problematic action.

10. How will ISS' responsiveness policy evaluate shareholder opposition to COVID-related pay decisions?

When a company receives less than 70 percent support on the say-on-pay proposal, ISS' responsiveness policy reviews three factors: (1) the disclosure of the board's shareholder engagement efforts; (2) the disclosure of the specific feedback received from dissenting investors; and (3) any actions or changes made to pay programs and practices to address investors' concerns.

As before, the expectations regarding the first two factors will remain consistent with prior years. Going forward, with respect to the third factor, the responsiveness policy will return to its pre-pandemic application. Under the policy, companies must demonstrate actions that address investors' feedback. This includes negative feedback stemming from one-time COVID-related pay decisions. In such a case, a responsive board could make a commitment not to repeat the action that shareholders viewed as problematic.

11. Are there any changes to ISS' Equity Plan Scorecard (EPSC), Problematic Pay Practices (PPP), or option repricing policies in light of COVID-19?

As before, there are no changes to these policies specifically related to the pandemic.

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