Compensation
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ISS Policy Updates for 2021 and Frequently Asked Questions for COVID-Related Pay Decisions

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Institutional Shareholder Services (ISS) recently issued policy updates for 2021. Additionally, in October ISS issued Frequently Asked Questions (FAQs) related to COVID-19 pay decisions. This article summarizes both the compensation-related policy updates and the FAQs related to COVID-19, and highlights other key changes to ISS's policies. ISS will publish all updated proxy voting guidelines for 2021 by late November/early December.

2021 Policy Updates

The two compensation-related policy updates cover ISS voting recommendations on shareholder proposals relating to Gender, Race/Ethnicity Pay Gaps and Board Independence – Classification of Directors.

Gender, Race/Ethnicity Pay Gaps: ISS will vote case-by-case on requests for reports on a company's pay data by gender or race/ethnicity, or a report on a company's policies and goals to reduce any gender or race/ethnicity pay gaps, taking into account:

- The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy on fair and equitable compensation practices;
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender, race, or ethnicity pay gap issues;
- The company's disclosure regarding gender, race, or ethnicity pay gap policies or initiatives compared to its industry peers; and
- Local laws regarding categorization of race and/or ethnicity and definitions of ethnic and/or racial minorities.

ISS updated the policy language to clarify how it evaluates a company's policies and practices compared to its peers. ISS also highlights that some legal jurisdictions do not allow companies to categorize employees by race and/or ethnicity and that definitions of ethnic and/or racial minorities differ from country to country, so a global racial and/or ethnicity statistic would not necessarily be meaningful or possible to provide.

Board Independence – Classification of Directors: ISS will not consider a non-employee director as independent if the individual's pay is comparable to Named Executive Officers' (NEOs') pay for multiple years. While ISS has reviewed non-employee director pay vs. NEO pay as a historical practice, this factor is now being made explicit with this policy update.

Other notable ISS updates are summarized below:

Director Elections: Racial/Ethnic Board Diversity (applies to Russell 3000 and S&P 1500 Indexes): Beginning in 2022, ISS will adopt a new voting policy with respect to U.S. boards that lack racial and ethnic diversity. During a one-year transition period beginning in 2021, ISS will highlight in a company's proxy research report the lack of racial and ethnic diversity (or lack of disclosure of such) on its board. The purpose is to help investors identify companies they may wish to engage and foster dialogue with on this topic.

In 2022, for companies in the Russell 3000 or S&P 1500 indexes where the board has no racially or ethnically diverse members, ISS will recommend voting against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis). Companies that provide aggregated diversity statistics for board members will only be considered if the breakout is specific to racial and/or ethnic diversity. ISS will allow an exception if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racial and/or ethnically diverse member within a year.

ISS Discontinues S&P 500 Proxy Report Draft Review Process: Effective for shareholder meetings held on or after January 1, 2021, ISS will no longer provide U.S.-based S&P 500 companies the opportunity to review draft proxy research reports prior to publication. ISS does not believe the additional review process is necessary as ISS supports the accuracy of its data and the quality-control process. With the elimination of the review process, ISS states that institutional clients will be able to engage with companies sooner, as reports will be filed earlier.

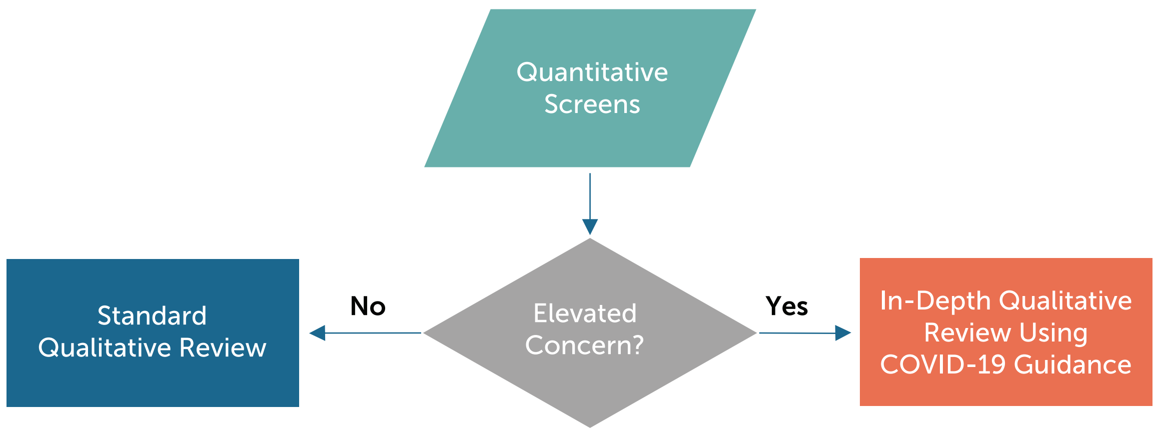
In order to comply with the Securities and Exchange Commission (SEC) regulations passed in July regarding proxy advisor recommendations, ISS notes that companies will receive a complimentary copy of the ISS report upon publication and be able to respond with comments and corrections.

FAQs for COVID-Related Pay Decisions

ISS released the October FAQs to help public companies think through incentive plan changes related to COVID-19. Consistent with its April 2020 policy guidance, ISS's October FAQs emphasize the importance of clear and adequate disclosures.

ISS will continue to use quantitative screens as a first look at incentive plans at publicly traded companies. The quantitative screens will not be modified to address the impact of the pandemic. Instead, ISS notes that it will continue to use the quantitative screens to identify elevated concerns that warrant more in-depth qualitative reviews of compensation programs and practices. The qualitative evaluation is where ISS considers the impact of COVID-19.

ISS Process to Analyze Pay Decisions Related to COVID-19



Temporary Salary Reductions: In spring 2020, many companies impacted by COVID-19 reduced executive and employee salaries. The recent ISS FAQs note that salaries are a small portion of total pay for executives. As a result, the impact of salary cuts will be given mitigating weight to the extent they decrease total executive pay. Accordingly, salary reductions will be considered more meaningful if they flow through to targeted incentive opportunities.

COVID-Related Changes to Incentives: Most of the FAQs address the impact of COVID-19 on executive incentives. Overall, the FAQs emphasize the need for clear disclosures that provide the justification and rationale for each decision, and that demonstrate the reasonableness of the resulting incentive outcomes. The following table summarizes the FAQs addressing incentives:

Bonus / Annual Incentives	
What Companies Should Disclose:	• Disclose the specific challenges caused by the pandemic, and how they make the original performance goals impossible to achieve. The disclosure needs to address how the plan changes are not paying for poor management performance. • Companies making mid-year changes: Explain the rationale for this approach (vs. one-time discretionary awards) and its benefits to investors. • Companies making one-time discretionary awards: Describe how the decision was made and the performance rationale for the award. Avoid generic descriptions, such as "strong leadership during challenging times." • Discuss how the resulting payouts appropriately reflect both executive and company annual performance, and what would have been paid under the original program design. Above-target payouts under changed programs will be closely scrutinized. • Describe the 2021 annual incentive program, if it has been designed. Positive changes may carry mitigating weight in ISS's qualitative evaluation.
If Financial or Operational Targets are Lowered Below Prior-Year Performance Levels:	• Lower performance expectations that reflect external factors may be a reasonable explanation for lower goal-setting. • A lower performance target should be accompanied by disclosure as to how the board considered corresponding payout opportunities, particularly if payout opportunities are not commensurately reduced.
Long-Term Incentives	
In-Progress Cycles:	• Should not be altered after the beginning of the cycle based on a short-term market shock. • Changes will be viewed negatively, particularly with a quantitative pay-for-performance misalignment.
Go-Forward Cycles (awards granted in most recent year):	• Drastic changes to the long-term incentive programs are not expected unless the underlying business has changed. • More modest alterations could be viewed as reasonable, such as movement to relative or qualitative metrics to address difficult long-term forecasting. • More drastic changes, such as shifts to predominantly time-vesting equity or short-term measurement periods, continue to be viewed negatively. • Clearly explain any changes to the program to convey the compensation committee's actions and rationale.

Retention or Other One-Time Awards	
What Companies Should Disclose:	• Clearly disclose the rationale for the award (including magnitude and structure) and how it furthers investors' interests. • Avoid boilerplate language regarding "retention concerns." • Awards should be reasonable in magnitude and an isolated practice. • Vesting should be: ▪ Strongly performance-based and clearly linked to the underlying concerns the award aims to address. ▪ Long-term. • The award should have guardrails, such as limitations on termination-related vesting, to avoid windfall scenarios.
Awards in the Context of Forfeited Incentives:	• Well-structured retention or other one-time awards may be appropriate in limited circumstances. • Investors do not expect companies to grant such awards 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 are expected to explain the specific issues driving the decision to grant the awards and how the awards further investors' interests. • Companies that indicate that one-time awards were granted in consideration of forfeited incentives, for fairness considerations, lowered realizable pay, etc., also need to explain how such awards do not merely insulate executives from lower pay.

Responsiveness Policy: In addition to the guidance on incentives, ISS released information about its responsiveness policy in light of COVID-19. When a company receives less than 70 percent support on a say-on-pay proposal, ISS's responsiveness policy reviews three factors:

- The disclosure of the board's shareholder engagement efforts;
- The disclosure of the specific feedback received from dissenting investors; and
- Any actions or changes made to pay programs and practices to address investors' concerns.

The guidance notes that the expectations regarding the first two factors will remain consistent with prior years. With respect to the third factor, if a company is unable to implement changes due to the pandemic, the proxy statement should disclose specifically how the pandemic has impeded the company's ability to address shareholders' concerns. If pay program changes are delayed, or do not fully address shareholder feedback, the company should disclose a longer-term plan on how it intends to address investors' concerns.

Equity Plan Scorecard (EPSC), Problematic Pay Practices (PPP), or Option Repricing: Lastly, the FAQs address ISS's EPSC, PPP, and option-repricing policies in light of COVID-19. No changes were made to these policies specifically because of the pandemic. However, ISS noted 2021 passing scores for EPSC:

- S&P 500 Model: 57 points (from 55)
- Russell 3000 Model: 55 points (from 53)
- All Other Models: 53 points (unchanged)

The PPP policies flag problematic contractual provisions in executive agreements. ISS policies on option repricing programs take a case-by-case approach but generally oppose repricings that occur within one year of a significant stock price drop. Companies that reprice options without seeking shareholder approval are reminded in the FAQs that they may receive unfavorable recommendations under ISS's U.S. policies on board accountability.

Key Upcoming Dates

Late November 2020: Publication of all updated ISS benchmark policies (proxy voting guidelines) for 2021.

December 2020: Publication of updated FAQ documents.

January 2021: ISS will evaluate new U.S. shareholder proposals anticipated for 2021 and update its Proxy Voting Guidelines as needed.

February 1, 2021: Updated 2021 ISS benchmark policies will take effect for meetings occurring on or after this date.

This article highlights changes to ISS policies and is not intended to be exhaustive. For information related to ISS's voting policies, please visit:

ISS Benchmark Policy Updates

Proxy Voting Guidelines Updates for 2021

COVID-19 Pandemic FAQs