Compensation
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Glass Lewis Announces Approach to COVID-19 for 2021 Proxy Season

By **Bonnie Schindler** and **Louisa Heywood**

In late January, proxy advisor Glass Lewis published guidance on its approach to executive compensation given the ongoing COVID-19 pandemic. Acknowledging the significant market-wide disruptions caused by the global pandemic in 2020, Glass Lewis remains committed to compensation plans with strong linkages between pay and performance. Glass Lewis has made no changes to the mechanics of its pay-for-performance model and continues to use three-year weighted averages to measure pay and performance, even in 2020.

NEW YORK
1133 Avenue of the Americas
New York, NY 10036
Phone: (212) 921-9350 | Fax: (212) 921-9227
www.capartners.com

CHICAGO
200 S Wacker Drive
Suite 3100
Chicago, IL 60606
Phone: (312) 462-4500

HOUSTON
840 Gessner
Suite 375
Houston, TX 77024
Phone: (713) 559-2715

LOS ANGELES
400 Continental Blvd
6th Floor
El Segundo, CA 90245
Phone: (310) 426-2340

While not changing its pay-for-performance model or long-term focus, Glass Lewis acknowledges that qualitative assessments of companies and their pay programs will be important in such an unprecedented year. Though its main concern overall is whether pay is aligned with performance, Glass Lewis will consider many additional factors during the disrupted year, including:

- Overall executive pay levels – When a pay-for-performance disconnect is identified, low pay levels can mitigate Glass Lewis's concern, while high pay levels can amplify the concern.

- Company performance – Strong company performance despite macroeconomic challenges can potentially mitigate Glass Lewis concerns about high pay levels.

- Company performance momentum – A disconnect between past pay and performance can possibly be mitigated if the company's performance has improved in recent months relative to peers.

Companies should carefully read Glass Lewis's "Approach to Executive Compensation in the Context of the COVID-19 Pandemic" when drafting their compensation discussion and analysis (CD&A) reports to ensure that investor concerns are addressed.

Comparing Glass Lewis and ISS COVID-Related Guidance

A summary of the Glass Lewis guidance and how key points compare to Institutional Shareholder Services' "U.S. Compensation Policies and the COVID-19 Pandemic: Frequently Asked Questions" follows.

Base Salary Adjustments: The most common COVID-related pay adjustment is a temporary reduction in named executive officer (NEO) base salary, an action taken by more than half of companies within Glass Lewis' coverage that have disclosed at least one COVID-related pay modification. Glass Lewis views salary reduction as a minor symbolic change given that base salaries are generally small relative to total compensation.

Alignment with ISS Voting Guidelines: ISS views temporary salary reductions as mitigating if they meaningfully reduce total compensation and will view such reductions more favorably if annual incentives are calculated with the lower base salary.

Annual Incentives: Glass Lewis cautions that it will view increases to short-term pay levels or above-target payouts with scrutiny. Companies that have removed caps or made significant adjustments to performance measures or calculations need to disclose their rationales clearly. In addition, companies that exercise upward discretion or measure performance based on qualitative or nonfinancial measures need to carefully disclose their rationales and ensure that overall payouts are reasonable relative to performance and past payouts.

Alignment with ISS Voting Guidelines: ISS views changes to annual incentive programs as reasonable in light of the COVID-19 pandemic as long as companies provide clear and compelling rationale, and the outcome is reasonable.

Long-Term Incentives: Glass Lewis will closely scrutinize amended performance-based awards, particularly mid-cycle adjustments to performance periods, metrics, and vesting conditions. It will apply additional consideration to program changes that have the potential to result in windfall benefits due to exogenous improvements in market conditions, such as if performance-based awards are replaced with time-based awards. Glass Lewis will look less favorably at companies that change metrics or performance periods for awards near the middle or end of their performance cycles. Concern may be mitigated if modifications, such as switching to solely time-based equity, are confined to a specific time period and if companies have a history of good governance and pay vs. performance alignment prior to the COVID-19 pandemic.

Alignment with ISS Voting Guidelines: ISS will generally view changes to in-process awards negatively given the intent of awards covering performance over multiple years is to control for performance volatility over the short-term.

Other Glass Lewis Guidance

One-Off Awards: Glass Lewis cautions against one-off awards granted to offset base salary reductions or below-target incentive payouts. Any one-time awards should be sized reasonably with internal alignment to past company practice and external alignment to peer pay levels. Concern may be mitigated if supplemental awards are subject to additional performance or vesting criteria, and if companies are not relying on one-time awards year after year.

Increases to Quantum and Forwards vs. Backwards: On a total compensation basis, Glass Lewis will look unfavorably on increases in total compensation unless companies have achieved strong performance on both a relative and absolute basis. Higher total compensation because of COVID-related adjustments will face extreme scrutiny. When upward discretion is applied to performance or payouts, Glass Lewis will look for meaningful rationale. Glass Lewis continues to prefer year-over-year increases to target compensation rather than high payouts for backward-looking performance.

Major Structural Changes: Glass Lewis cautions against short-sighted decision-making. It urges boards to think critically about implementing sweeping, long-term changes given ongoing market uncertainties, and will view concessions made in early 2020 negatively when the company has recovered meaningfully but the executive's windfall has not been counterbalanced.

Potential Windfalls: Glass Lewis will evaluate pay program changes, especially to equity programs, for the potential for windfalls. Examples of actions that can result in windfalls and merit additional consideration include deviation from past equity granting practices, equity grants made at stock price lows, removal of performance-based equity awards from incentive programs, and replacement of performance-based awards with time-based awards. Longer time-based vesting can be used as a potential guard against such windfalls.

Equity Plan Proposals

Glass Lewis published revised guidance on equity plan proposals, option repricing and golden parachutes for 2020.

Equity Plan Proposals: As share prices have dropped, Glass Lewis expects higher dilution and larger share requests in equity plan proposals. Glass Lewis will require meaningful justifications such as that the company urgently needs to conserve cash, or that the company has exhausted reasonable alternatives to compensate employees.

Option Repricing: For companies in industries most highly affected by COVID-19, Glass Lewis may support option repricing provisions only if the company has demonstrated that it has considered all reasonable alternatives and that eligible options are close enough to expiration that a stock price rebound is unlikely.

Golden Parachutes: Glass Lewis will continue to scrutinize golden parachute provisions, weighing them against the quantum of pay adjustments in response to COVID-19 and other merger-related payments.

Glass Lewis acknowledges the havoc wreaked by COVID-19 on many compensation programs and urges boards to proceed carefully with any pay modifications to ensure companies remain faithful to a strong pay vs. performance alignment over the long run. Throughout its guidance, Glass Lewis emphasizes the need for strong disclosure for any COVID-related pay actions. Clear and thorough disclosure can help mitigate Glass Lewis concerns about changes to compensation programs in response to COVID-19. Disclosures should address the rationale for pay program changes and the impact of the pandemic on the company.