Pearl Meyer

CLIENT ALERT | JAN 2024

Updates on Proxy Advisor Voting Policies for 2024



Deb Lifshey

MANAGING DIRECTOR

Institutional Shareholder Services (ISS) and Glass Lewis (GL) have recently released updates to their voting policies for the 2024 proxy season. The following provides a high level summary of the most significant compensation-related policy updates for the United States. As compared to prior years, the US updates were relatively light and included more clarifications rather than major policy shifts.

Institutional Shareholder Services

The new policies for ISS[1] apply to shareholder meetings on or after February 1, 2024. ISS had only one new US policy, which was related to shareholder proposals concerning both executive severance agreements and golden parachutes. The update codifies the case-by-case approach ISS uses when analyzing such shareholder proposals, including consideration of the following factors:

- The company's severance or change-in-control agreements in place, and the presence of problematic features (such as excessive severance entitlements, single triggers, excise tax gross-ups, etc.);
- Any existing limits on cash severance payouts or policies which require shareholder ratification of severance payments exceeding a certain level;
- Any recent severance-related controversies; and

- Whether the proposal is overly prescriptive, such as requiring shareholder approval of severance that does not exceed market norms.

In addition to this update, ISS issued changes in some of its supplementary compensation-related guidance, as follows:

US Compensation Policies: Frequently Asked Questions

Changing Vote Recommendation: ISS will consider company actions taken in response to pay-related concerns in the ISS research paper only if they are disclosed in a public filing. However, ISS is unlikely to change the vote recommendation if the additional filing is made fewer than five business days before the meeting date. Additionally, vote recommendations would only be changed where a company has specifically remedied the concerns (i.e., disclosed specific plan design changes, rather than simply broad commitment to increase focus on performance-based pay) in the report or modifies existing awards to strengthen the performance linkage.

Impact of Adjustments (including non-GAAP metrics): If adjustments materially increase incentive payouts, companies should provide clear disclosure in the proxy explaining the nature of the adjustment, its impact (dollar or percentage) on payouts, and the board's rationale. Disclosure in the proxy of line-item reconciliation to GAAP results, when possible, is considered a best practice. ISS views the absence of these disclosures negatively, particularly for companies that exhibit a quantitative pay-for-performance misalignment.

Single-Trigger Change in Control (CIC) vs. CIC Incentives: ISS has clarified that while CIC severance without a qualifying termination remains a problematic pay practice, bona fide incentive awards payable upon a CIC transaction would not be viewed as problematic so long as they are not excessive and are accompanied by sufficient disclosure about rationale for the incentive.

US Equity Compensation Plans: Frequently Asked Questions

ISS provided certain clarifying adjustments to their Equity Plan Scorecard Model which addresses factors according to five different company models (S&P 500, Russell 3000, Non-Russell 3000, and two categories of Special Cases) and three different pillars (Plan Cost, Plan Features and Grant Practices). Among these adjustments, weighting of the Plan Cost factor decreased for both the S&P 500 and Russell 3000 models. Weighting of the Grant Practices pillar for the S&P 500, Russell 3000, and Non-Russell 3000 models decreased, while the weighting of the Plan Features pillar for the same models increased. There are no factor score adjustments for the Special Cases – Non-Russell 3000 model. There were no factor definition changes nor threshold passing score changes for any

model. ISS also provided 2024 updates to their Value-Adjusted Burn Rate Benchmarks. Further thresholds and details are contained within the FAQ.

Glass Lewis

The new policies for GL will apply for shareholder meetings on or after January 1, 2024. The following highlights compensation-related updates and select board-related clarifications.

Clawback Trigger Expanded

In addition to meeting Dodd-Frank Act (DFA) requirements, clawback policies should provide companies with the ability to recoup both time-based and performance-based incentive payments when there is evidence of problematic decisions or actions (e.g., material misconduct, a material reputational failure, a material risk management failure, or a material operational failure), and regardless of whether employment was terminated with or without cause. This would considerably expand the requirements of a DFA policy which requires clawback of incentive-based compensation triggered by a financial restatement. Where a company ultimately determines not to follow through with recovery, if the company does not provide a thorough, detailed discussion of its decision to not pursue recoupment, this lack of disclosure may play a role in GL's say-on-pay (SOP) vote recommendation.

Executive Ownership Guidelines

Executive ownership requirements should be clearly disclosed in the compensation discussion and analysis (CD&A), including a thorough discussion of how various equity awards are counted or excluded from the ownership level calculation. GL has also indicated that counting unearned performance-based full value awards or unexercised stock options without a cogent rationale may be viewed as problematic.

Proposals for Equity Awards for Shareholders

With respect to proposals for shareholders to approve individual equity award grants, where the recipient of the proposed grant also is a large shareholder of the company whose vote can materially affect the passage of the proposal, GL believes provisions that require a non-vote, or vote of abstention, from the recipient may help address potential conflicts of interest and will be viewed as a favorable feature.

Pay-Versus-Performance (PVP) Disclosure Impact

GL may use PVP disclosures mandated by the SEC as part of its supplemental quantitative assessments supporting its primary pay-for-performance grade. Specifically,

the “compensation actually paid” data, along with other quantitative and qualitative factors, may support GL’s recommendation in favor of an SOP proposal, even when there is a disconnect between pay and performance using GL’s pay-for-performance model (e.g., where the company would ordinarily receive a “D” or “F”).

Non-GAAP Reconciliation Disclosure

For companies that use non-GAAP metrics in incentive programs, clear reconciliations to GAAP results should be provided. Where significant adjustments were applied to performance results to determine incentive payouts, the absence of a thorough, detailed discussion within the proxy statement of the adjustments and their impact on payouts will impact assessment of the quality of disclosure and could impact the SOP recommendation.

Conclusions

While ISS and Glass Lewis recommendations may be closely followed by many institutional shareholders and these advisors are sometimes viewed as standard-setters for governance, they should not be the sole driver of compensation strategy and design. It is important that companies take a holistic approach in designing their plans rather than trying to strictly meet all advisor parameters. At the forefront, companies should focus on tying compensation to business and leadership strategy and stakeholder interests, while secondarily considering the impact of ISS and GL on voting recommendations.

---

[1] Note as of the date of this Client Alert, ISS has not yet released its officiation 2024 Proxy Voting Guideline document, and there were no changes to Peer Group Selection Methodology or Pay-For-Performance Mechanics.

About the Author

Deb advises on executive compensation from a legal and regulatory perspective, including securities disclosure, tax and governance matters, contract negotiation, and reasonableness opinion letters.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.