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Proxy Season Greetings: ISS and Glass Lewis Announce Policy Updates Ahead of the 2023 Proxy Season

Employee Benefits & Executive Compensation Blog on **December 15, 2022**

Proxy advisory firms Institutional Shareholder Services ("ISS") and Glass Lewis ("GL") each published their annual policy updates for 2023, which updates made certain changes relating to executive compensation.[1] As a general matter, the changes are incremental to the existing policies and do not significantly change the rubric by which ISS and GL review compensation programs

ISS's ANNUAL BENCHMARK POLICY UPDATE

Severance Payments. ISS will continue to consider problematic severance pay on a case-by-case basis when determining its recommendation on say-on-pay and board member votes. However, it has updated its policy on severance payments to require that companies accurately disclose the circumstances of an executive's termination (voluntary vs. involuntary) when severance is paid. Specifically, ISS's list of factors that carry significant weight and may result in a "no-vote" recommendation on the say-on-pay and board member votes now includes severance payments made when the termination is not clearly disclosed as involuntary (i.e., a termination without "cause" or resignation for "good reason"). In short, ISS objects to Form 8-K and proxy disclosures that seek to put a positive spin on an executive's involuntary departure (*e.g.*, describing an involuntary termination as a retirement). Companies should be mindful of this issue when describing any termination on Form 8-K or the proxy statement for their annual meeting**.**

Value-Adjusted Burn Rates for Equity Plan Evaluations. ISS's 2022 Benchmark Policy Update included a change to how the burn rate should be calculated for purposes of its Equity Plan Scorecard evaluations after a one-year transition period. With that period ending January 31, 2023, ISS has now updated its Benchmark Policy to remove its prior burn rate methodology and to only include the new methodology called Value-Adjusted Burn Rate ("VABR"). The VABR methodology is intended to capture an option grant's value more accurately by utilizing the Black-Scholes value for stock options (instead of the previous approach that used a volatility multiplier).

GLASS LEWIS POLICY GUIDELINES UPDATE

Long-Term Incentives. GL has modified its position on performance-based awards within a company's long-term incentive offerings. Historically, GL has set a 33% floor on performance-based awards with a minimum of a three-year performance or vesting schedule, but now, GL may recommend a "no vote" on the say-on-pay proposal when a company's long-term incentives fall below 50% performance-based.

Mega-Grants. GL clarified its approach when "mega-grants" have been granted and the awards, among other things, have excessive quantum, lack sufficient performance conditions, and/or are excessively dilutive. GL will generally recommend against the compensation committee chair when such outsized awards have been granted.

Front-Loaded Awards. Front-loaded awards are equity awards intended to provide for multiple years of equity compensation upfront. GL recognizes the value that front-loaded awards may provide to compensation committees by locking-in executive service and incentives. However, GL expanded on its concerns regarding the use of front-loaded awards due to the increased restrictions placed on boards to respond to unforeseen factors.

One-Time Awards. GL had previously required that companies describe and explain the use of one-time awards. GL expanded on this requirement by adding that the disclosure should discuss how the compensation committee determined the quantum of the award and its structure.

Compensation Committee Discretion. GL affirmed its position that it respects a compensation committee's need to be able to exercise discretion over incentive payments to account for "significant events that would otherwise be excluded from performance results of selected metrics of incentive programs." However, GL clarified that companies should provide a thorough discussion of how such events were considered in the committee's decisions to exercise discretion, and if a company is not prepared to provide this discussion, GL indicated that the company should not apply discretion over incentive pay outcomes.

Disclosure Related to Say-on-Pay. GL expanded upon what it considers robust disclosure in the event of low levels of support on a company's say-on-pay vote. Any decision for not making any changes that drove low support should be explained, as well as what the company's intentions are going forward.

New SEC Pay vs. Performance and Clawback Rules. GL will not take into account a company's newly required pay vs. performance disclosure for purposes of GL's Pay-for-Performance methodology, but the new disclosure may be considered as part of GL's qualitative analysis. To learn more about the SEC's new Pay-vs-Performance disclosure requirements, read our blog post here. Similarly, companies that make an early effort to meet the standards of the SEC's new clawback requirements may mitigate GL's concerns if the company only previously adopted a clawback policy consistent with the Sarbanes-Oxley Act. For more background on the SEC's new clawback rules, please see our earlier discussion in this blog post and this Law360 article.

LOOKING FORWARD

ISS will apply these new policies to annual meetings beginning February 1, 2023, and GL will apply its new policies beginning January 1, 2023. Compensation committees should work with their counsel and compensation consultants to determine whether these changes impact their company, and, if they do, what, if anything, should be done to address the impact.

Proskauer's Employee Benefits and Executive Compensation team regularly advises companies on best practices with respect to implementing executive compensation programs, including the potential impact of proxy advisor policies on the company. Please contact a member of the team with questions.

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[1] ISS released its Benchmark Policy Update for 2023 on November 30, 2022, and GL released its Policy Guidelines on November 17, 2022.

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