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EXEQUITY

Independent Board and Management Advisors

Client Alert

Glass Lewis's Approach to Executive Pay Responses to COVID-19

In late January 2021, Glass Lewis provided additional guidance with respect to how it may approach executive pay responses to the COVID-19 pandemic.[1] Previously, Glass Lewis had provided some guidance, but it has now launched a dedicated web page to COVID-19 and issued additional guidance concerning how COVID-19 may impact its analyses under its various policies.[2] This *Client Alert* summarizes the key guidance that Glass Lewis recently provided, which companies should review as they prepare their 2021 proxy statements.

Say-on-Pay Proposals

Regarding the analysis of say-on-pay proposals, Glass Lewis indicates that with respect to actions taken in response to COVID-19, it will view selected companies' responses with caution. For example, the lowering of executives' base salaries may be viewed as a token of solidarity, but Glass Lewis will consider such action in the context of total executive compensation. Furthermore, Glass Lewis indicated that it prefers to see more than merely token gestures and provided a more granular synopsis of its approach in such evaluations.

Increases to Quantum

Glass Lewis indicates that unless companies have performed very well on a relative and absolute basis, it will view increases in short-term pay levels or above-target payouts with great scrutiny. Furthermore, if a company adjusts its programs to provide enhanced outcomes, it will have a high bar to prove the appropriateness of such actions.

Forwards vs. Backwards

Glass Lewis generally views year-over-year increases to target incentive payout opportunities as being more tolerable than high payouts for backward-looking performance. But this presupposes that the incentive plan incorporates robust performance requirements that are reflective of executive efforts.

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[1] Glass Lewis' Approach to Executive Compensation in the Context of the COVID-19 Pandemic, United States & Canada, available at: https://www.glasslewis.com/wp-content/uploads/2020/09/*US-Canada-Comp-Approach-to-COVID.pdf*.

[2] Glass Lewis' web page is https://www.glasslewis.com/coronavirus-COVID-19-pandemic-governance-resources.

One-Off Awards

Generally, Glass Lewis is wary of one-off awards granted outside a company's regular incentive plans. Glass Lewis will review the following factors in evaluating one-off awards:

- Whether the quantum of the award is reasonably sized relative to peers' and the company's past pay levels;
- Whether the awards are subject to additional performance or vesting criteria;
- The company's history of one-off grants; and
- Whether the company adhered to predetermined agreements regarding severance-based, one-off award payments.

Major Structural Changes

Glass Lewis views any major structural changes with caution. In reviewing committee discretion with respect to short-term matters, Glass Lewis will be mindful of the need for flexibility during this time—along with the corresponding burden to thoroughly disclose and provide convincing rationale for any such use of discretion.

Glass Lewis may still view certain program changes as potentially problematic, including any decisions to replace performance-based awards with guaranteed or time-based awards, and any changes made to performance-based awards near the middle or end of their performance cycle, such as switching metrics or retroactively shortening the length of a performance period.

Factors Glass Lewis will consider in evaluating such major structural changes include:

- The strength of the company's disclosure and rationale, and whether the changes continue to align pay and performance; and
- In the case of any performance-based awards replaced with guaranteed or time-based awards, Glass Lewis will evaluate the rationale for the grants and quantum.

Potential Windfalls

Glass Lewis will evaluate the potential for any program changes to result in windfall benefits to executives. Specific circumstances that warrant additional consideration include:

- If a company deviates from historic equity granting practices, or priced equity awards at the lowest stock price in recent history; and
- If a company removed performance-based equity awards from its incentive programs or replaced them with time-based equity awards.

No Penalty for Late Bloomers

Glass Lewis will not penalize companies that did not provide extensive discussion of their board response to the pandemic in their 2020 proxy season filings, but it will give credit to companies that did so.

Glass Lewis Will Take Past History Into Account

Glass Lewis will take into account a company's past history. Companies that exhibited a healthy track record of good governance, pay-for-performance alignment, and appropriate use of board discretion prior to the COVID-19 pandemic will likely be viewed through a more accommodating lens than companies that did not.

Equity Plan Proposals

Glass Lewis indicates that its general approach to evaluating equity plan proposals using a quantitative and qualitative assessment remains the same, though in the context of the COVID-19 pandemic certain features may be flagged more frequently by its quantitative analysis. While Glass Lewis' analysis does look to relative historic information, Glass Lewis does not expect to see dramatic swings for individual companies but does expect higher levels of dilution as stock prices drop, and that most companies will need a bit more equity than they requested last year.

To address the challenges in using historic data, Glass Lewis will consider the following factors:

- The justification for large share requests that result in significant dilution, with the threshold set higher for companies that have made multiple, large share requests within the past two years. Circumstances that Glass Lewis would consider sufficient justification may include:
  - An urgent need to conserve cash; or
  - The exhaustion of reasonable alternatives to compensate employees.
- Whether the equity is being awarded to executives or other employees. Where the majority of equity awards are granted to executives, Glass Lewis' say-on-pay proposal analysis may inform its vote recommendation on the equity plan proposal.

Repricing and Option Exchange Proposals

Glass Lewis remains firmly opposed to the repricing of executive and director options. However, Glass Lewis recognizes that there are certain circumstances in which repricing may be acceptable. Glass Lewis believes repricing may be justified by companies in highly affected industries, assuming that appropriate justifications are provided and the options repriced are late enough in their term that a meaningful stock price recovery would be unlikely. Glass Lewis will continue to evaluate repricing proposals in accordance with its guidelines.

Golden Parachute Proposals

When reviewing golden parachute proposals, Glass Lewis will consider the background of merger-related payments, along with the impact and treatment of earlier pay adjustments made in response to COVID-19.

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