



# UNITED STATES

## U.S. Compensation Policies and the COVID-19 Pandemic Frequently Asked Questions

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*This FAQ is intended to provide general guidance regarding the way in which ISS' Global Research Department will analyze certain issues in the context of preparing proxy analyses and determining vote recommendations for U.S. companies. However, these responses should not be construed as a guarantee as to how ISS' Global Research Department will apply its benchmark policy in any particular situation.*

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## TABLE OF CONTENTS

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1.	How should this FAQ document be referenced?.....	3
2.	How will ISS view temporary salary reductions for executives? .....	3
3.	How will ISS evaluate COVID-related changes to bonus/annual incentive programs? .....	3
4.	For companies making COVID-related changes to bonus/annual incentive programs, what disclosure would be needed for investors to fully evaluate these decisions? .....	3
5.	If COVID-related changes to a company's bonus/annual incentive programs resulted in a lowering of financial or operational targets below the prior year's performance levels, how will ISS' analysis take that into account? .....	4
6.	How will ISS evaluate COVID-related changes to equity/long-term incentive cycles that are currently in-progress (e.g., FY2018-20 or FY2019-21)?.....	4
7.	Will the approach differ for long-term incentives that were awarded in the most recent year (e.g., the go-forward cycle beginning in 2020)? .....	4
8.	How will ISS evaluate COVID-related retention or other one-time awards? .....	4
9.	How will ISS evaluate retention or other one-time awards granted in the context of a forfeited incentive? .....	5
10.	Are there any changes to ISS' responsiveness policy in light of COVID-19? .....	5
11.	Are there any changes to ISS' Equity Plan Scorecard (EPSC), Problematic Pay Practices (PPP), or option repricing policies in light of COVID-19? .....	5

### 1. How should this FAQ document be referenced?

This FAQ document serves as general guidance as to how ISS U.S. Benchmark Research may approach COVID-related pay decisions in the context of ISS' pay-for-performance qualitative evaluation (as applicable to meetings covered under U.S. Benchmark Research policy). As discussed further below, ISS' qualitative evaluation will take into consideration the impact on company operations as a result of the pandemic. As in the past, an elevated concern from the quantitative screen will continue to result in a more in-depth qualitative review of the company's pay programs and practices.

ISS endeavored to provide this preliminary FAQ ahead of the regular annual FAQ update expected to be published in December, in order to sooner inform investors, companies, and their advisors on these issues. The guidance laid out in this FAQ has been shaped by feedback from direct discussions with investors in various roundtables as well as the annual policy survey. However, nothing in this document should be construed as a guarantee as to how ISS Research may recommend on a given proposal. If you have questions about this document, please contact the [ISS Help Center](#).

### 2. How will ISS view temporary salary reductions for executives?

As base salaries typically make up a small portion of total pay for top executives, temporary salary reductions will be given mitigating weight to the extent they decrease total pay. The action will be considered more meaningful if targeted incentive payout opportunities are decreased to reflect the reduced salary.

### 3. How will ISS evaluate COVID-related changes to bonus/annual incentive programs?

It is expected that many companies will be making adjustments to annual incentive programs, which may include changes to metrics, performance targets, and measurement periods. Some companies, particularly those most severely impacted by the pandemic, may suspend their programs entirely and instead make one-time discretionary payments. Other companies may take a combination of these approaches. Such actions would be considered problematic under normal circumstances; however, in the extraordinary circumstances of the current economic downturn, ISS may view such actions to be a reasonable response so long as the justifications and rationale are clearly disclosed, and the resulting outcomes appear reasonable.

### 4. For companies making COVID-related changes to bonus/annual incentive programs, what disclosure would be needed for investors to fully evaluate these decisions?

ISS' qualitative review will continue to evaluate incentive programs at companies on a case-by-case basis. However, given specific concerns related to the pandemic, investors have indicated that additional disclosure is necessary for them to evaluate annual incentive program changes or discretionary awards. While the below list is not intended to be exhaustive, it represents key disclosure items that would help investors evaluate COVID-related changes to the annual incentive program:

- (i) The specific challenges that were incurred as a result of the pandemic and how those challenges rendered the original program design obsolete or the original performance targets impossible to achieve. The disclosure should address how changes are not reflective of poor management performance.
- (ii) For companies making mid-year changes vs. one-time discretionary awards, the company should explain why that approach was taken (as opposed to the alternative approach) and how such actions further investors' interests.
- (iii) One-time discretionary awards should still carry performance-based considerations and companies should disclose the underlying criteria, even if not based on the original metrics or targets. Investors

- are likely to find generic descriptions (i.e. "strong leadership during challenging times") to be insufficient.
- (iv) The company should discuss how the resulting payouts appropriately reflect both executive and company annual performance. The disclosure should clarify (or estimate) how the resulting payouts compare with what would have been paid under the original program design. Above-target payouts under changed programs will be closely scrutinized.
  - (v) Companies that have designed the following year's (2021) annual incentive program are encouraged to disclose information about positive changes, which may carry mitigating weight in ISS' qualitative evaluation.

**5. If COVID-related changes to a company's bonus/annual incentive programs resulted in a lowering of financial or operational targets below the prior year's performance levels, how will ISS' analysis take that into account?**

With respect to ISS' analysis of incentive plan goal rigor, investors have indicated that lower performance expectations that reflect external factors (such as operational impacts due to the pandemic) may be a reasonable explanation for lower goal setting. Nonetheless, a lower performance target should be accompanied by disclosure as to how the board considered corresponding payout opportunities, particularly if such payout opportunities are not commensurately reduced.

**6. How will ISS evaluate COVID-related changes to equity/long-term incentive cycles that are currently in-progress (e.g., FY2018-20 or FY2019-21)?**

Long-term incentives are meant to cover performance over multiple years. Investor feedback indicates that these programs should be designed to smooth performance over a long-term period and not be altered after the beginning of the cycle based on a short-term market shock. Accordingly, changes to these in-progress cycles will generally be viewed negatively, particularly for companies that exhibit a quantitative pay-for-performance misalignment.

**7. Will the approach differ for long-term incentives that were awarded in the most recent year (e.g., the go-forward cycle beginning in 2020)?**

For award cycles beginning in 2020, investors generally do not expect to see drastic changes to the long-term incentive program unless the underlying business strategy has fundamentally changed. However, more modest alterations to the incentive program could be viewed as reasonable. For example, movement to relative or qualitative metrics may be viewed as reasonable in the event of unclear long-term financial forecasting. More drastic changes, such as shifts to predominantly time-vesting equity or short-term measurement periods, would continue to be viewed negatively. Lastly, companies should clearly explain any changes to the program, to allow investors to evaluate the compensation committee's actions and rationale.

**8. How will ISS evaluate COVID-related retention or other one-time awards?**

Given the unprecedented challenges faced by certain public companies and industries in the wake of the pandemic, some companies may grant one-time awards to address concerns resulting from the pandemic, which may include executive retention. As with one-time awards granted outside the context of the pandemic, companies that grant one-time awards should clearly disclose the rationale for the award (including magnitude and structure), as well as describe how the award furthers investors' interests. As in prior years, boilerplate language regarding "retention concerns" will not be viewed as sufficient rationale. Awards should be reasonable in magnitude and an isolated practice. Additionally, the vesting conditions attached to the award should be strongly performance-based and clearly linked to the underlying concerns the award aims to address. In any event, the

award vesting schedule should be long-term. Finally, the award should contain shareholder-friendly guardrails to avoid windfall scenarios, including limitations on termination-related vesting.

### **9. How will ISS evaluate retention or other one-time awards granted in the context of a forfeited incentive?**

While many investors recognize that well-structured retention or other one-time awards may be appropriate in limited circumstances, investors do not expect companies to grant such awards merely 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 will be 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., will also need to explain how such awards do not merely insulate executives from lower pay.

### **10. Are there any changes to ISS' responsiveness policy in light of COVID-19?**

When a company receives less than 70 percent support on the say-on-pay proposal, ISS' responsiveness policy reviews three factors: (1) the disclosure of the board's shareholder engagement efforts; (2) the disclosure of the specific feedback received from dissenting investors; and (3) any actions or changes made to pay programs and practices to address investors' concerns. 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 necessarily fully address shareholder feedback, the company should disclose a longer-term plan on how it intends to address investors' concerns.

### **11. Are there any changes to ISS' Equity Plan Scorecard (EPSC), Problematic Pay Practices (PPP), or option repricing policies in light of COVID-19?**

There are no changes to these policies specifically related to the pandemic. However, for the 2021 policy year, the passing score for the S&P 500 EPSC model will increase to 57 points. The passing score for the Russell 3000 EPSC model will increase to 55 points. For all other EPSC models, the passing score will remain 53 points.

ISS' PPP policies, which generally flag problematic contractual provisions in executive agreements, will be consistent with prior years.

There are no changes for U.S. policies on option repricing programs, which case-by-case approach generally opposes repricings that occur within one year of a precipitous drop in the company's stock price. If boards undertake repricing actions without seeking prior shareholder approval, the directors' actions will remain subject to scrutiny under the U.S. policies on board accountability.

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