Compensation Advisory Partners

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Early Read on ISS' View on COVID-Related Compensation Changes

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With the 2021 proxy season already underway, our understanding of ISS' tolerance for COVID-related compensation changes is becoming clearer, as ISS has begun to release their proxy research reports ahead of the annual meetings for companies with fall fiscal year-ends. For calendar year-end filers, these reports will serve as weathervanes for ISS' reaction to incentive plan changes made in response to the pandemic.

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To provide insight into the proxy advisor's disposition this year, CAP reviewed select broad market COVID-19 executive compensation actions and the corresponding ISS report commentary. Our analysis highlights six companies that made various changes to their annual and long-term incentive plans and awarded one-time special grants.

CAP's preliminary findings indicate that if a company made COVID-related compensation changes and received an elevated level of concern on the ISS pay for performance evaluation, the proxy advisor will likely recommend Against the Say on Pay proposal, thereby significantly impacting the Say on Pay vote. To date, we have observed four companies that experienced sharp declines in their Say on Pay results, with two failing to receive majority support.

Impact of ISS' Quantitative Pay for Performance Evaluation on Say on Pay Recommendations

Based on our early read, it appears that ISS' assessment of pay decisions related to COVID-19 is highly correlated to the concern level on their quantitative CEO pay for performance screens, which inform Say on Pay recommendations. When there is a low concern level, a company's COVID-related changes seem to be more palatable for ISS; however, when there is an elevated level of concern, ISS seems likely to delve more deeply into a compensation program and view any COVID-related changes more critically.

True to the sentiments expressed in their October 2020 Frequently Asked Questions (FAQs), ISS seems highly skeptical of one-time special awards and discretionary upward adjustments to annual and long-term incentive payouts (especially if payouts were tracking well below target). Four of the companies we analyzed were chided for making discretionary incentive plan changes, such as altering performance periods to exclude the months most heavily affected by the pandemic and trigger payouts despite COVID impacts. ISS also found special grants problematic, particularly when used to replace underperforming performance-based awards.

Conversely, two companies made COVID-related compensation changes that seemed more acceptable from ISS' perspective and in-line with their FAQs. These changes included adjustments to the threshold and target performance goals for in-flight long-term incentives, bifurcated performance periods with payouts well below target for annual incentive awards, and modest special one-time grants.

Supplemental Filings

Supplemental filings from two companies, Aramark and Becton, Dickinson, indicate their frustration with the proxy advisor's inflexibility considering the unprecedented events of the past year. One company urged that its actions be viewed within the "broader context of executive compensation," while the other went so far as to suggest that ISS did not have the "resources or business experience to understand" the complexities of its business.

Summary of Executive Compensation Actions and Say on Pay Results

The table below summarizes the actions of six companies that made changes to their incentive plans and provides results from their votes on Say on Pay. Thus far, four companies passed and two failed to receive majority support on their Say on Pay votes.

Company	Total Shareholder Return (TSR) *as of FYE*	Actions	Say on Pay Results (% Support)
Walgreens Boots Alliance, Inc. Industry Group: Food and Staples Retailing FY Ended: 8/31/2020	1-Yr: -23% 3-Yr CAGR: -20%	**Adjusted AI Payout / Performance Period:** • Considered an average of the pre-COVID results for the first 6 months of FY 2020 and the results of the balanced scorecard for the final 6 months of FY 2020, resulting in payout at 84% • Performance for full FY 2020 would have resulted in no payout **Changed Go-Forward AI Metrics:** • Changed metrics for 2021 to 65% Adjusted Operating Income, 25% Free Cash Flow, and 10% Diversity **LTI Award Modification (2018-2020):** • Reviewed performance through the pre-COVID period (the first 30 months of the 36-month performance period) as well as the performance in the last 6 months of the performance period that was impacted by COVID • Projections based on the Company's performance pre-COVID would have resulted in a payout at 101.7%, while Company performance for the full performance period would have yielded no payout. Committee used discretion to adjust payout to 101.7% of target **Changed Go-Forward LTI Plan:** • Changed metrics for 2021 to 70% EPS growth based on 3 1-year growth targets with a simple average of the 3 years and 30% Revenue Growth based on 3 1-year growth targets with a simple average of the 3 years	2021: 47% 2020: 83%
Becton, Dickinson and Company Industry Group: Health Care Equip. and Svcs. FY Ended: 9/30/2020 *Issued a supplemental filing providing additional context regarding the special, one-time grant*	1-Yr: -7% 3-Yr CAGR: 7%	**Adjusted AI Payout / Performance Period:** • Discretionarily adjusted awards to 75% of payout for four of the six NEOs from the 18% funding level **Special LTI Grant:** • Committee considered the lost value of the 2018-2020 Performance Units (PUs), which paid out at 45% of target, and in-flight performance of the 2019-2021 PUs and on November 26, 2020 granted a special, one-time award of SARs to 233 associates who received the 2018 or 2019 PUs, including three NEOs • **Award Value:** Aggregate value of the PUs for the NEOs was less than $1M (CEO declined the award) • To avoid fully protecting associates from the impact of the pandemic, the value of SARs was limited to 50% of the decline in the value of the 2018 and 2019 PUs	2021: 67% 2020: 89%

Company	Total Shareholder Return (TSR) *as of FYE*	Actions	Say on Pay Results (% Support)
Aramark Industry Group: Consumer Services FY Ended: 10/2/2020 *Issued a supplemental filing on 1/22/2021 providing additional context regarding the LTI award modification and adjusted AI payout*	1-Yr: -34% 3-Yr CAGR: -11%	Adjusted AI Payout / Performance Period: • For FY 2020, used discretion to increase payout from 10% of target to 40% Changed Go-Forward AI Metrics: • Removed individual component, amended two financial metrics, and broadened the performance leverage for two new metrics LTI Award Modification (2018-2020): • Adjusted to measure performance for the first 30 months of the 36-month performance period, removing both the performance results and the portion of the performance targets attributable to the period when their business was hit by COVID (payout of 29.2% of target) Changed Go-Forward LTI Plan: • For FY 2021, removed Performance Share Units (PSUs) entirely from the FY 2021 awards to have a mix of 50% options and 50% RSUs Special LTI Grant: • On September 4, 2020, all NEOs received a special grant of premium-priced stock options • **Award Value:** The value of the options ranged from $1.5M-$6M ($6M granted to CEO) Changed Grant Schedule for 2021 LTI: • Granted FY 2021 LTI awards in September 2020 rather than November 2020. Stated retention as the reason for the earlier than usual grants (CEO, CFO, and COO are all new)	2021: 57% 2020: 93%
Meritor, Inc. Industry Group: Capital Goods FY Ended: 9/30/2020	1-Yr: 13% 3-Yr CAGR: -7%	Adjusted AI Payout / Performance Period: • Approved a Special Incentive Plan in June 2020 based on two equally-weighted performance measures, Liquidity and Cost Reduction • Target awards under the plan were 28% for the CEO (representing lost salary recoupment opportunity of 16.67% and incentive opportunity of 11.33%). The Compensation Committee approved incentive payouts of 100% LTI Award Modification (2019-2021): • On December 1, 2020, lowered the targets for EBITDA and EPS for payouts between threshold and 100% of target, but did not adjust the targets for these performance metrics for payments at or above 100% of target	2021: 99% 2020: 99%

Company	Total Shareholder Return (TSR) *as of FYE*	Actions	Say on Pay Results (% Support)
PTC Inc. Industry Group: Software and Services FY Ended: 9/30/2020	1-Yr: 21% 3-Yr CAGR: 14%	**Adjusted AI Payout / Performance Period:** • Split performance period, five months pre-pandemic and seven months post pandemic and determined on a weighted average basis **LTI Award Modification (2018-2020, 2019-2021, 2020-2022):** *Performance Share Units (PSUs) are measured on an annual basis over three years* • FY 2018 PSUs: › FY 2020 tranche: used discretion to determine achievement of 58% of target based on five-month period in FY 2020 preceding the pandemic • FY 2019 PSUs: › FY 2020 tranche: used discretion to determine achievement of 50% of target (i.e., threshold) › FY 2021 tranche: lowered goals and lowered threshold achievement to 25% (from 50%) • FY 2020 PSUs: › FY 2020 Annual Run Rate (ARR) Metric tranche: modified performance period from full year to (i) pre-pandemic months (150% achievement) and (ii) post-pandemic months (0% achievement) – 62.5% overall achievement › FY 2021 & 2022 ARR Metric tranches: lowered goals and changed to annual growth rate measurement	2021: 49% 2020: 67%
Digi International Industry Group: Technology Hardware and Equipment FY Ended: 9/30/2020	1-Yr: 15% 3-Yr CAGR: 14%	**Adjusted AI Payout / Performance Period:** • Implemented a revised incentive plan for the second half of FY 2020 that incorporated performance targets reflecting revised aggressive, yet achievable, levels of performance of the same financial metrics used in the original annual incentive plan • Target award amounts equaled each executive's actual base salary for the second half of the year, resulting in targets of slightly less than 50% of the original AI targets • No payout would be earned unless the threshold level of performance on both metrics was achieved. • Payment capped at 100% of the revised target • The company approved payouts of 85.6% of target (41% of original target under the initial plan) for the President of IoT Products and Services and 100% for the other NEOs (48% under the initial plan) **Special LTI Grant:** • On May 12, 2020, the Company granted incremental RSU awards to the NEOs to compensate executives for the reductions in base salary payments to conserve cash in response to the onset of the COVID-19 pandemic • **Award Value:** The RSUs had a fair market value approximating 10% of each executive's base salary for the second half of FY 2020 and ranged from $12K to $20K ($20K granted to CEO)	2021: 97% 2020: 99%

CAGR = Compound Annual Growth Rate

As calendar year-end companies confirm 2020 payouts, design 2021 incentive plans, and finalize their Compensation Discussion and Analysis (CD&A) in the proxy statement, beware that ISS is highly critical of special one-time awards, upward (discretionary) adjustments to payouts, front loading annual equity awards, and reductions in performance-based long-term incentives. It will be imperative that companies have compelling rationales as to why these decisions were made and how they are aligned with long-term shareholder value creation. As proxies continue to be filed and companies disclose more COVID-related changes, we should have a better sense of proxy advisory firms' receptiveness to such alterations.

If an early read is any indication, numerous COVID-related compensation changes and negative one-year TSR can affect a company's Say on Pay vote. As evidenced by the adjustments at Aramark, Becton, Dickinson, PTC and Walgreens Boots Alliance, there was a significant drop in their Say on Pay votes in 2021, with shareholders objecting to compensation changes. Since Say on Pay went into effect in 2011, median support was 95 percent plus, but 10 years later, we may expect to see that median level of support decrease.

This article highlights ISS' commentary on broad market COVID-19 executive compensation actions. For more detail regarding companies' COVID-related changes, please visit our COVID-19 Resource Center.