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Day 2
The SEC All-Stars-A Frank Pay Disclosure Conversation
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Liz Dunshee: Welcome back everyone and welcome to our SEC All-Stars this morning. We have Mark Borges of Compensia and CompensationStandards.com. Mark was former Special Counsel in the Office of Rulemaking in Corp Fin. We have Meredith Cross of WilmerHale and the former director of the SEC's Division of Corporation Finance among other roles at the SEC. We have Alan Dye of Hogan Lovells and Section16.net, and Alan was a former Corp Fin staffer and special counsel to the chair of the SEC. We have Keith Higgins of Ropes & Gray and a former director of Corp Fin. And we have our very own Dave Lynn also of Morrison & Foerster and a former chief counsel of Corp Fin among other roles.

So these folks, our panelist have an agenda that will run about 50 minutes and then they're saving about 15 minutes at the end for Q and A. You can submit questions throughout the panel in the Q and A chat box to the right of the speaker view, and I would encourage you to keep that chat box up throughout the panel anyway, because the CLE codes will be popping up in there. And if you are having any technical questions, or issues, we will be addressing those in the chat box. If there are any network problems, you may want to try to refresh your browser, that could solve it. So I will turn it over to Dave now to discuss the status of SEC rulemaking. Dave.

Dave Lynn: Thanks very much Liz. I'm going to kick it off by really talking about some of the rulemaking items that I didn't get to talk to Bill about while we were discussing in the panel right before this. The rulemakings have been a focus on a **___ really big ___ for the fact (01:52)**, proxy disclosures and executive compensation disclosure and one thing I will note, as was evident in the conversation with Bill this morning, it is a very active rulemaking time at the SEC, and I think the conventional wisdom would say that the SEC rulemaking tends to slow down or shut down in the summer of a presidential election. But as was still noted with things in Washington these days, the old conventions we're throwing out the window.

And we've seen the Commission you know, really make a lot of progress on the Disclosure Effectiveness Initiative, you know, which really kicked off in earnest in its latest iteration about a decade ago. And one thing I would note is all this rulemaking is proceeding in the midst of the pandemic and I wanted to echo what Bill had said, you know I think the staff, the Commission, and certainly, in the division have done a great job of going to a work from home environment and in my experience, as I'm sure all of the panelists today can attest to, the rulemaking process is a very high touch activity. There's a lot of meetings that take place with folks from the division**,** with other divisions, with the Commission, with the staff of the offices of each of the Commissioners and the chairmen and you know, I know it's got to be difficult, and the same difficulties we face in private practice, they're facing in the Commission, in terms of making those meetings happen and be effective. So I do give them a lot of credit for that and making all this rulemaking happen in such a difficult time.

Meredith Cross: Dave, on that, to make this, to bring it home, Keith and I can both attest to the fact that regularly the division directors would be wandering the halls looking for votes. I mean we were literally walked into Commissioners' offices who hadn't committed yet, saying, "Do you have enough votes to get to a Sunshine Act notice," so saying it's high touch is the understatement. I don't know they do it if they can do it.

Speaker1: Yeah. Well also the...

Meredith Cross: ___ (04:04) discussions about things. That's got to be incredibly challenging.

Speaker1: .... the interaction of meeting with the Commissioner's offices as well as been meeting with the rulemaking staff to, Meredith, that conference room, that conference table in the director's office was always chocked full of rule writers, sitting around the table trying to figure out how to do things well. So, they are pretty active. I give them a lot of credit for that.

Dave Lynn: One convention that probably won't go out the window this year is after the presidential election, there's probably going to be some changing of the guard no matter what the outcome is at the Commission and within the division and obviously that's going to shape going forward what the rulemaking agenda is going to look like. So take all of what I said with a grain of salt because it could all be thrown out the window come November. **___ (04:56)** is that **___ (04:59-05:04)** I've seen some commentary about it that the publication in the federal register is really slow at this point and I believe there's probably a variety of reasons for it. There's a lot going on, there's the COVID pandemic and **___ (05:19)** facing the same issues **____ (05:22)** a little bit of uncertainty around the notion of when these rules go into effect.

Keith Higgins: Yeah.

Dave Lynn: So we see it get adopted back in August, the S-K changes and the Accredited Investor changes and we're still guessing as to when they go in effect because they usually go in effect 30 or 60 days **after ___ (5:41).**

Keith Higgins: Well Dave, we're all hoping that the S-K amendments don't get published in the Federal Register until about October the, I don't know, the 10th maybe or thereabouts.

Dave Lynn: Exactly.

Keith Higgins: Because you know it's right now, because having to deal with your risk factors in this Q, it would be a different kettle of fish if it's effective before you file this quarter, so.

Meredith Cross: Another point is the CRA, the Congressional Review Act, and whether rules that get adopted late in this administration are going to get essentially thrown out if there's a flip in the senate and the president because last time when Trump was elected, I think they threw out 16 rules...

Dave Lynn: Mm hmm.

Meredith Cross: SEC rules, which is like the highest number in hist...I mean they threw out 16 rules including some SEC rules...

Keith Higgins: Yeah.

Meredith Cross: ...which was the highest number in history. So it'll be interesting to see how all this rulemaking plays out as you get down to the later periods.

Mark Borges: What's the period for that, **six months (06:54)?**

Meredith Cross: It's so complicated. It's like 60 days from, I think maybe from when they get it, but 60 days **or can't (07:07)** have breaks if they're out of session.

Keith Higgins: Right. Yeah.

Meredith Cross: And so I was trying to answer this question for a client yesterday and it's like a hard calculus problem. But it's about 60 days sort of. I don't know David, you probably know.

Dave Lynn: Yeah, you know better than I. **That one I ___ as much (07:31).** So the first **___ (07:35)** rulemaking I'm going to mention briefly is the shareholder proposal rule changes, changes to Rule 14a-8, and we had hoped that we would be discussing the adopted rule, but consideration of that rule got pushed back from last week to this week, and hopefully on tomorrow's panel, we might be able to better discuss **the rule (07:54)** if it gets adopted. **And it's (07:56)** out there about the adoption at the **time we're speaking (08:00).** You know, I think it's significant in the sense that 14a-8 hasn't been looked at since 1998, so it was important for the Commission to look at it and I would also remind anyone who hasn't had to deal with 14a-8 before that, you know, it's perhaps a good example of a role that's been swallowed by the interpretive gloss and that, you know, if you're going to deal with 14a-8 issue, you need to wade through mountains of staff legal bulletins and staff letters to understand exactly what **we're meaning (08:31)** and start from the most recent **and go back (08:34)** because the **staff (08:35)** has changed its mind as to what the rules mean over time.

But you know, I think these amendments were modest in a way. They focused on the technical requirements for submission and resubmission and rules for how many proposals and **___ (08:52)** submit or serve as a representative of. It didn't revisit the substantive **basis for exclusion (08:58),** you know, which have historically been some of the more controversial topics. And so you know, I think we'll wait and see how the rule comes out and it's probably not worth going through the proposals in detail given it's been closed to adoption**,** but you know certainly I think one of the interesting things **they said (09:20)** was yet another movement on the decades old proxy plumbing concept release. This rule will ____ **(09:39)** at the same time the regulation on proxy advisory firm recommendations **going back to September (09:35)** and that rule got adopted and so now they're **___ (09:41)** brought to fruition through this **___ (09:44)** correctly.

Another area that the Commission had outstanding that I think was an interesting area to address was, the concept release on Rule 701 and Form S-8. Back in 2018, SEC issued a concept release on this rule and I'm sure Keith could give a much better summary of it than I could. But you know, here I think basically the thought was it's been so long since Rule 701 and S-8 have been adopted or last amended, and things have changed in terms of the compensation that people are getting, the forms of compensation, the relationship between companies and employees and independent contractors in **___ (10:35-10:40)** important step to start looking at those issues. I think since that concept release, the Commission's approach has sort of been more focused on capital raising issues, the Disclosure Effectiveness Initiative and we haven't really seen **these ____ involved (10:57)** in current proposals. But obviously the Commission has a **base of comment (11:03)** that was provided on the concept release from which to **work on (11:07)** if that issue again becomes something that's deemed important.

Keith Higgins: Well Dave I wonder whether the...I don't know that we'll see a proposal before the end of this year, but I kind of wonder whether the Commission would move more boldly in this. It's always struck me as a bit anomalous that private companies can sell up to 10 million dollars of stock every year without basically providing any information to their employees, but once they become public and once there's all this information out there about the company, they got to sell everything under an S-8, and they can't use 701. And you know, it doesn't make a whole lot of sense to me, not to mention with the S-8 not having at least some main features like pay as you go. You know, how many times have we had clients come up to us and say, "Oops, I think we've exceeded our limit. What do we do?" And you tell them, "Well you count the days til your statute of limitation runs and you know, move on." So, but I don't know, does anybody think that the Commission will act on S-8 and 701 this year?

Dave Lynn: I don't think so. I don't think that's a likely…

Keith Higgins: Yeah, I'm not betting they will.

Dave Lynn: And then I'll wrap up just with the curious case of the Dodd-Frank Act compensation or **effective (12:30)** rules. I mean the most notable thing is here we are a decade away from the Dodd-Frank Act. How could 10 years have passed since that was enacted? And we got some big hits out of the Dodd-Frank Act. You got Say-on-Pay and Say-on-Golden-Parachute, you had Say-on-Pay ratios. Those were listing standards for comp committees and **compensation ___ (12:55). So ___ disclosure (12:57),** but yet we still have outstanding the proposals from back in 2015 for the compensation recovery listing standards and the pay versus performance **proposal rule (13:10)** and they really seem to have moved to the backest of back burners.

That's a terminology that in terms of the rulemaking **prompt, (13:20)**. I think in both cases, you know, we've seen just the world move on without those rules. In the compensation **recovery context (13:28)** for a long time there was a lot of fence sitters out there among public companies that were saying, "Well let's see how this comes out," but yet, you know, because of pressure from investors and the like, they just moved on and adopted some sort of compensation recovery. Typically not in accordance with the **rule (13:44)** proposal, but at least some approach to compensation recovery and then in the context of the pay-versus-performance disclosure investors and proxy advisors have shaped what people write and really most of the proxy statement is dedicated these days to explaining the relationship between pay-versus-performance. You know, sort of rendering that whole somewhat irrelevant, but I don't think we'll see these taken up anytime soon, at least, unless we see a changing of the guard in which case that might bring these back to the floor.

Keith Higgins: Yeah.

Dave Lynn: And I think that with that, I'm going to turn it over to Meredith because that was everything I had to say about rulemaking**.**

Meredith Cross: That was good to hear, David. Keith and I both lived **___ (14:42)** world, many of them...

Keith Higgins: Yeah.

Meredith Cross: ...and he got a lot more done in the compensation area than I did. I got to do like conflict minerals and stuff.

Keith Higgins: You got some tough ones done.

Meredith Cross: Yeah, yeah. Very exciting. Anyway, it's good to see everyone today and I'm going to talk briefly about using non-GAAP measures in compensation plans**,** and what you should be thinking about on that. As everyone knows, going to the basics, I think recognizing realistically that in setting pay, compensation committees and those who advise them recommend that measures be used that will incentivize management and often those include non-GAAP measures and those non-GAAP measures in fact may be measures that are different from the measures that are used for public reporting. For example, they will have a further adjusted non-GAAP measure for compensation purposes. So that will mean non-GAAP measures are important in setting pay. There's no question about that. The SEC has the strong desire to have a proxy disclosure line up with what **was done in setting pay (16:04).** And so to have those work together, there had to be a way to get the non-GAAP measure rules to work with the requirement to disclose how you set pay.

So they included in Item 402 an instruction, I think it's Instruction 5, that allows non-GAAP measures that are used to set targets to be disclosed and you get a pass from Reg G and Item 10(e), but you have to provide disclosure about how the measure is calculated from the audited financial statement. So it's basically a narrative about that. So of course everybody jumped right through that and decided that the questions really needed to be what else could you put in the proxy statement about your non-GAAP measures that wasn't in connection with setting pay, and that is complicated. You know, if you use non-GAAP measures just generally in your proxy statement, then you have to comply with the non-GAAP measure rules.

If you use them in connection with setting pay, for example explaining your pay in a summary at the beginning of CD&A, then you get to use a **CDI (17:32)** that talks about having reconciliation in an appendix or in a 10-K that you link to. And right now it's a lot of discussion around is it being used in connection with compensation or how is it being used. I tend to think that as long as you're talking about how the company performed and how that was relevant to pay, that you get to use at least the cross-reference approach. So that's the basics.

From there, you get to the complexities. So the first complexity has been this topic has attracted a lot of criticism from some circles. For example, Commissioner Jackson, former Commissioner Jackson, wanted the Instruction 5 eliminated. CII filed a rulemaking petition to get the instruction eliminated and there's been Wall Street Journal articles about this and the like. So there's criticism for sure, and it's likely that there will be more criticism depending on what happens in the election. This is a topic that, you know, executive pay will always be a hot button issue and so it'll be a bigger hot button issue to the extent that if the party changes that's in control of the SEC. So that is something to keep in mind as you're thinking about the future. I wouldn't be surprised if they try to address complaints and do something about that if the SEC leadership changes hands to the other **___ (19:35).**

I think that the...You know if they get rid of Instruction 5, it would just make it harder to write down your CD&A because they can't determine how people pay their people. That's not an SEC job. SEC doesn't have the authority to determine how companies pay their people, so somehow or another you have to describe it. They want the targets disclosed. If those targets are non-GAAP that are not permissible under the non-GAAP rules, that's not going to mean you can't pay your people that way. It's just going to mean your disclosure is extremely complicated.

And so, I doubt that this will change in the way that some circles might hope that it would. You know, companies are going to continue to pay people how they think is appropriate as a way to incentivize folks. They're going to exclude items that they don't exclude from their **public (20:38)** non-GAAP measures. They're going to exclude items that are not permissible to be excluded under Item 10 of S-K. So I don't see this as, while there's a lot of criticism, I don't see this as something that will actually change how people pay their people. I'll stop for a second and see if others agree with me on that, so I'm just not yammering on.

Keith Higgins: Yeah, Meredith, I didn't understand what the problem that they're trying to solve really is. As long as something's explained, I don't know why there's a problem in using non-GAAP for compensation information.

Meredith Cross: Yeah, so I think it's a number of reasons. It's people don't like executives to be paid a lot, it's people don't like non-GAAP measures. So when you combine paying executives a lot and using non-GAAP measures to determine that, some will find that to be extremely offensive. Others will say, "Well you need to have good practices to set pay and those practices should incentivize good performance," and that can be based on non-GAAP measures and that's...

I think what it really comes down to is you need good disclosure. You need to explain why are you using the measures you use, because you gotta win over your stockholders. They do Say-on-Pay votes. If they think that you're using measures that are irresponsible, have nothing to do with what should incentivize people, eventually they're going to vote no on Say-on-Pay if they think your pay practices are bad.

So, it is an area that really turns on how well you can explain yourself, is what I think is probably the best answer to it. It's also, essentially I look at it in terms of are you going to enrage investors with what you're doing, because if you are, it's like the investors are the the best regulator here. And so, we now know this has not been a significant area of staff comment as far as I have experienced personally. It's just you know, you look at the rules, you do your best and explain what you did and then the SEC staff as far as I know has not been weighing in on it.

That leads me to my last point, which is how do we think investors are going to react to pay metrics that are adjusted for the impact of COVID, because that could be a hot button issue. You know, you have people who have suffered, communities have suffered, companies have done furloughs or layoffs. You know what do you then do with if you want to adjust for some COVID metrics. I suspect that the reaction may not be...May be relatively muted if it's for typical things to exclude, you know, Goodwill impairments, things of that nature. Now I think if you try to normalize revenues for if you had, you know, if stores were open or something like that, that you'll likely...Just like you would with investors and regular disclosure, you'd likely get some blowback there. I think that would be a very interesting thing to see. You know, are people going to, at the end, adjust to pay executives a higher amount than what happened under other plans because of what happened because of COVID and that's going to be a very hot topic this year. That's it.

Alan Dye: Okay. I think the hand-off is to me now Meredith. Am I...Okay.

Meredith Cross: Yeah. If Dave says yes, it is.

Alan Dye: Okay. I see him nodding his head. Thank you. I'll kick off the panel's discussion of factors that companies should consider if it's thinking about integrating ESG factors into its incentive compensation plans. This isn't exactly a brand new idea, but it's an issue that has been gaining increasing attention. You know, for several years now, companies have been receiving shareholder proposals asking companies to integrate in one form or another, ESG factors into executive's incentive compensation plans. I think in the last few years, there have been at least a dozen or so, sometimes more shareholder proposals asking for integration in some form or another of ESG metrics. Sometimes it's a proposal that asks the company to consider sustainability measures in the incentive comp plan, sometimes it may be a particular measure relating to climate change or something unique to the company's industry.

The shareholders have been putting a little bit of momentum behind the issue for several years now and companies might also expect that some of the large institutional investors might be supportive of that kind of program, and might even be headed in that direction. State Street, Vanguard and BlackRock have been increasingly vocal and very vocal in recent years, particularly in their most recent annual reports about the need for companies to have sustainability programs with objective measures and to disclose those sustainability programs and the extent to which the company is making progress on sustainability. And then in just the last few weeks, Vanguard and BlackRock, at least, have made announcements that they expect companies to be focused on diversity, racial justice issues and employee health and well-being, particularly in light of the COVID pandemic.

So it's not a huge leap to think that because BlackRock and Vanguard also say that companies should have sustainability drive executive compensation, that some companies might think that maybe sustainability measures should be incorporated into the equity or the incentive compensation plans for executives. And I'm not suggesting that integrating ESG measures is something that companies have to be dragged into or that's company versus shareholders. CEOs, at least in my experience, are all very concerned about certain sustainability measures. They do a lot of analysis of sustainability and so their interests often are aligned with those of shareholders and trying to achieve sustainability goals.

So the issue, I think, for companies who are thinking about integrating ESG measures into their incentive compensation plans is just how to go about doing that. And so I'll suggest a couple of things based on my own observations that I think companies might want to take into account, and then I'll turn the discussion over to other panel members to see what their thoughts are or what their experience has been.

And we can learn to some extent from companies that have already integrated ESG measures into their compensation plans. Just to make a few general observations about what those programs have done. Most use ESG metrics only for the annual incentive compensation plan, and not for the long-term incentive compensation plan. Presumably it's easier to establish your goals and objectives on an annual basis than to project out for three years what you'd like to achieve on your sustainability goals.

Also the ESG goals that have been built into incentive plans have tended to relate primarily to climate change, also employee well-being and again, some companies have particular issues in their industry where they may have a measure that's important to the company's goals that they will build in. But for the most part, the ESG metrics that have been built in to incentive compensation plans have involved environmental and, to some extent, social issues.

So things to think about if you're thinking about having ESG metrics built into your equity compensation plan. First I think incentive metrics in general tend to be designed to implement the company's business plan and so if the company's planning to build ESG metrics into the incentive plans, first those metrics need to be a part of the company's business plan. And so the company just needs to identify what those measures are, that strategically are important to the company so that they can be built into the incentive plan and incent the executives to try to achieve those goals. If the company hasn't yet, in its sustainability planning, developed measurable objective goals, maybe it's premature to think about implementing or incorporating the ESG measures into the equity compensation plan.

Second, I'd say companies should choose issues that hold promise for delivering long-term value. The reason for adding any metric to an incentive compensation plan is to drive executive behavior and focus them on achievement of particular goals, and so the metrics that are built into the compensation plan should be designed to achieve long-term value. In addition, sort of what you were suggesting earlier about non-GAAP financial measures, Meredith, remember that whatever metrics are selected, whatever goals are defined, it's going to have to be defined and defended in the CD&A as why those measures were chosen and how they helped push the company's progress along. So defining those goals can be fairly important.

Then third, and I'll finish here, is consider how the executive performance is going to be measured against those ESG metrics. Will they be quantitative measures, achievement of a certain reduction in energy consumption or in a carbon footprint so that executives have an identifiable goal that they're trying to chase and the compensation committee knows at the end of the year that those have been achieved. Or, as I think is more common at least in my experience, would be a subjective measure making increased diversity in the workforce or an achievement of safety records on factory floors or that sort of thing, be a subjective assessment by the compensation committee. And in that context, executives then need to be sure that they know what their goals are and what they're expected to achieve.

So I'll stop there and turn the discussion over to others to see if other panelists have thoughts.

Mark Borges: Well I've certainly seen a number of tech companies begin to introduce ESG measures into their plans along the lines of what you've described Alan. They tend to be more subjective. They tend to be just a small portion of the overall set of goals that the company is looking for almost exclusively in their annual incentive plans. But it's a way for sort of establishing a stake in the ground, particularly given the focus on ESG now that we're seeing in proxy statements generally with companies kind of promoting what they're doing in all of the areas that are relevant to them. So it almost feels like incorporating them, at least on a minor basis, into their incentive compensation plans is the next step in the process that's evolving.

Dave Lynn: Alright. I think a point that you made Alan that is a really good one is, it should be integrated into the overall strategy discussion adopting them as sort of window dressing. Because your peers adopted them or something along those lines is probably not going to cut it from an investor's standpoint, you know, disclosure standpoint. So you really do have to do the hard work of trying to figure out what is the right way to approach and measure this and, you know, how does it fit into our overall strategy as opposed to we're just going to tack this on to the comp process.

Alan Dye: Yep, and my experience has been the same as Mark's. Companies tend to take baby steps in integrating these metrics into their compensation plans. The metrics, or the achievement of the metrics is a small part of you know, what goes into the calculation of what the incentive pay out is going to be.

Keith Higgins: Yeah I think...

Meredith Cross: I was going to say, I think that there's going to be tremendous sensitivity, we're really chasing such a moving target at this point, about what would be considered to be good goals. And so, I think that it's a great idea in theory. If you put in goals that look too modest, then I think that there will be blow back for that and if you pay people well even though they didn't achieve whatever these goals were in the minds of others, then that also won't be successful. So I think that I agree with the overall sense of the group, which is, this shouldn't be window dressing. You should do it if you have things that you think would be good business, and good business could be enhanced community relations that come from things that you do. It could be, you know, make your customers happier because you have...You know, if you look at the Amazon ads now about going to zero carbon by whatever year, 2025 or something, it's pretty soon. You know, they're not doing it...I mean, I'm sure they're doing that because they want to do that for the environment, but they're also doing that presumably because it's good business. So each one of these things, I think, needs to be carefully crafted so that it actually incentivizes performance and benefits overall, company performance.

Alan Dye: Great. Dave, that's all I had. I think I turn the mic to Keith now?

Dave Lynn: I think we'll go to Mark next.

Alan Dye: Okay.

Dave Lynn: In fact ___ (36:12).

Alan Dye: Okay.

Mark Borges: Let me step in for a minute and talk a little bit about disclosure. I had to chuckle when Bill Hinman said that, "This year compensation committees are going to earn their keep." I think the same is true for consultants and attorneys as well. With the possible exception of 2018 when the CEO pay ratio rule was adopted, I think this proxy season is going to prove to be, coming proxy season is going to prove to be one of the more interesting years for executive compensation disclosure, given the impact of COVID-19 on so many different compensation programs of different companies. And to this point we've really only gotten a glimpse into what companies have done, as I'll mention in a moment.

ISS encouraged companies to file 8-Ks if they were making changes to their incentive compensation plans to give an indication of what the changes were. I haven't seen that many. I think most companies are waiting until they file their proxy statement and some of those, of course, have started to come out now for June 30 companies but I think the bulk of the changes that we're going to see are going to based on the proxy statements that come out in the spring.

The other thing that I note here, which is kind of interesting, is that the pandemic hasn't had the same effect on every company. Certainly companies in the travel, hospitality and related industries have been the hardest hit and they continue to suffer greatly and have had real challenges in taking actions that are intended to bolster the business, kind of keep people motivated and incentivized and move towards the future. But it seems like a lot of other businesses were impacted differently.

Some were immediately affected but have bounced back. Others, particularly some in the tech sector, weren't affected quite at all so this is really kind of a company-by-company determination and I think we're going to see quite of variety of disclosures as each company looks at its own situation and figures our or describes what it figured out to do in order to deal with the pandemic at the point where it was most acute for its particular business. And for some of those companies, it's going to continue to be an ongoing challenge.

Back in March when this first started to come out, we didn't see much change in the disclosure of proxy statements right away, in fact there were generally three categories of disclosure that we saw in the proxy statements filed in early March. For some companies they simply issued cautionary statements on the timing of the information included in their proxy materials indicating that all they were discussing was 2019 information and that pandemic really hadn't hit them yet, and so didn't have an impact on any of their compensation results. A greater number of companies though, recognizing the severe challenges that lied ahead, began to report on the immediate impacts of the pandemic on their compensation programs, and we began to see companies that indicated that they were cutting salaries, reducing director fees, taking other steps to conserve cash or even changing aspects of their overall compensation program so that they were paying awards such as bonuses in shares of stock rather than in cash. The bulk of the companies however, in those initial disclosures, really indicated that they had not made their compensation decisions for fiscal '20 or were in the process of studying what the impact of the pandemic was going to be on them before they made any final decisions and that they would disclose what those modifications were if and when they occurred.

That began to change quite dramatically in May and June and almost every proxy statement that we saw during the summer did, to some degree, address COVID, whether it was only in the introductory letter from the chairman or the CEO, whether it was in their ESG disclosure or whether it was something to the effect of what was going on with their compensation program. A lot of companies, because their bonus plan metrics all of a sudden became unobtainable as a result of the volatility in the stock market, abandoned their bonus plans or either decided to put a new plan in place for the second half of the year, or to wait until the end of the year and see what happened, and decide to exercise discretion at that time as to whether or not they had achieved goals that warranted paying bonuses, or whether there were some other basis to pay some portion of the bonus to their executives. And we saw a number of 8-Ks that were filed in June and July that indicated that that was the approach that those companies were taking.

At the same time, we also saw the proxy advisory firms sort of get involved in the mix by issuing statements on how they expected their policies to be applied to pandemic impacted compensation. Both ISS and Glass Lewis said that they weren't going to be changing their policies as a result of the dramatic changes that were happening in executive compensation, but instead would look at things on a case by case basis in order to evaluate the particular facts and circumstances and decide whether or not how they would react to whatever a company had done in response to the pandemic. ISS was the one, as I said, that indicated that they encouraged companies to file 8-Ks of any changes that were being made to their short-term incentive plans and we saw a few of those, but I haven't seen much recently in terms of companies filing 8-Ks on changes, so I'm assuming that most of them are waiting until their proxy statement, when they can give a more complete picture of how things worked for them or how the pandemic affected them, and what impacts that had on the decision making around their executive compensation program.

Glass Lewis I thought, took a more strident position focusing both on the quality of the disclosure for the specific changes that were being made as well as on the rationale, sort of reminding companies that it wasn't enough to just say we made a change because we could no longer attain the goals that we'd originally set at the beginning of the year, but explaining what the rationale behind those changes were and how they were consistent and proportionate in respect to how shareholders and employees were also being impacted by the crisis.

So I think we're going to see a lot of criticism from them if not from ISS on some of the changes that were made if they don't' believe that the rationale that the companies have provided for the reasons for making the changes are sufficient. Now that we're into the fall, we've begun to see some proxy statements for the second half of the year with June 30 fiscal year ends reporting on their results which is sort of a valuable window for calendar year companies as to what they're going to be looking to disclose around their incentive pay plans for this and next year.

I've been surprised at the number of companies that have reported that they simply did not pay bonuses for 2020, fiscal 2020 in their proxy statement, either because the goals were not met or because they decided not to exercise discretion in order to provide some amount to the executives for the efforts that they expended. I think some companies may be a little leery on what they pay based on the criticism that Nike received a few weeks ago when they issued their proxy statement and indicated that they had not met the goals for their incentive plan or their long-term incentive plans, but yet paid fairly significant bonuses to their senior executives. I note that they only received about 60% support on Say-on-Pay which may be an indication that shareholders were not pleased as to how they decided to exercise discretion with respect to the treatment of their executives.

Right now, most companies have either changed their annual bonus plans as I indicated, perhaps making them six-month plans for the second half of the year with revised performance metrics or they left the plans in place and are going to decide what to do at the end of the year. This is a situation where I think the ability or the willingness of the proxy advisory firms to tolerate the exercise of discretion is really going to come into sharp focus. As I've said, their judgment's going to be influenced by how executive pay correlates to the treatment of shareholder's employees.

So it's going to important for companies to keep in mind when they are describing the justifications for their changes, these particular stakeholders, because it's going to be within that context that I think their compensation decisions are going to be evaluated.

Another area that companies are beginning to look at now as they get closer to the end of the year, is what they're going to do with equity awards and there are sort of three buckets that these awards fall into. There are the awards for which the performance period is ending at the end of fiscal ’20, there are the awards that were granted in 2020 for which the first year now has gone awry but still have two more years to run and then there are new awards to be granted in fiscal ’21. Each of these situations is going to demand special attention to be sure that the company has a persuasive rationale for the decision that it ultimately makes on how it’s going to handle those particular awards. I’ve seen some companies that have decided for awards that are just getting started to extend the performance period for an additional year. I’ve seen some that have decided to change the metrics and make them two year programs instead of three year programs in order to wipe out the year that’s been affected by the pandemic, although it’s not clear how shareholders are going to react to that particular decision.

I think the other thing that they’re going to have to do is going to have to look closely at how they describe their exercise of discretion in their proxy statement. I think there are a couple of things that are going to different this year in terms of the proxy disclosure that we haven’t’ seen in the past as a result of the pandemic. One is that I think executive summaries to the proxy statement are going to be very different. You’re going to company highlights which often times the performance isn’t going to be very good and I think it’s going to be important for companies to be able to explain how they’ve changed their program in response to their performance and the impact of COVID-19 in a way that’s going to make sense to shareholders and that’s going to be proportionate and reasonable given the company’s stock price, the impact on shareholders and the amounts that they’re looking to pay to their executives.

The other place where it’s probably going to have an impact is in the disclosure around Say-on-Pay. I don’t think Say-on-Pay votes are going to be straightforward the way they have been in the past few years particularly if the explanations behind the reasons for the changes that are being made aren’t persuasive. So what we’re starting to see is companies, even now as they’re looking at different alternatives for how they want to handle their incentive plans, whether it’s changing the bonus plan metrics to something that’s a little bit more attainable or whether it’s changing the design or mix of their long-term incentive compensation plans.

Not only looking at the ramifications from an accounting standpoint, because that’s one of the big considerations here, is if we have an existing plan and we’re going to change it, what’s the impact going to be, not only from an accounting standpoint, or from a disclosure standpoint. If we incur additional compensation expense, are we going to have to report that in the summary compensation table? But also, what impact that’s going to have on the reaction that shareholders have to our program overall? And so I expect that we are going to see much longer disclosures around incentive compensation plan changes, probably a bit more detail in terms of the correlation between how the plan changes, facilitate the business strategy going forward, and a lot of the things that perhaps should've been in the CD&A in the past showing the connection between the plan, and the company's business objectives are something that are going to be more emphasized on, I think this year, as a result of the changes to the programs because of the pandemic, as companies look to be able to explain to their shareholders that there was a justifiable and reasonable reason for the changes that they made and that the amounts that are being paid are reasonable within the context of their business performance.

Dave Lynn: Okay, I guess we'll turn to Keith to talk about share repurchases.

Keith Higgins: Share repurchases, right. Thank you, David. We've moved into our Q & A time and so I'm going to go on and on about share repurchasing until we start getting some questions from the audience. So if that's not incentive enough, then I don't know what is. Anyway, share repurchases were a big deal through 2019 and they engendered a lot of controversy, got a lot of attention from Congress. There were bills introduced in Congress that would've prohibited companies from making open market stock purchases, would've repealed Rule 10b-18, would've required additional disclosures around stock repurchases, would've given the SEC authority if they could, to reject buyback plans and would have made CEOs certify that buybacks were in the best interest of the long-term interest of the company.

That's died down a little bit, although those bills still are sitting in Congress. They haven't moved anywhere, but then comes the pandemic and buyback **buy-in (52:46)** dropped like a stone. Through August, the buyback buy-in was less than half than what it was in the comparable period in 2019. There was still some interest in Congress. The CARES Act prohibited anybody participating in the Main Street Lending Program from doing a share buyback during the term of the loan and for 12 months thereafter. But it still remains a controversial topic. You know that controversy, as most people will remember, goes back at least, well as least as far as then Commissioner Jackson's speech a couple of years ago in which he purported to demonstrate that share buybacks were effectively being used by executives to cash out their compensation, and many people, including me, have some question about whether that's really the case.

But in any event, there was certainly a perception among some that that was one of the effects of buybacks and there was a piece in December in the FT actually complaining about share buybacks but really complaining that share buybacks were a huge transfer of wealth from shareholders to executives and that's where buybacks are basically used to replenish shares that are used in equity compensation plans. I'm not exactly sure what the point was about buybacks because if there weren't buybacks the same transfer of wealth would have taken place notwithstanding, that it's just the shareholders wouldn't have been able to participate in cashing out their interest. In any event, buybacks have been in the area of some shareholder proposals although actually the several companies received a proposal that was entitled share buybacks and share retention, which was a lot more about retention and a lot less about buybacks. It basically asked the company to put together a policy that required executives to retain a certain amount of stock that they received as equity compensation through a certain period of time. But in the supporting statement, it noted that in addition when company's senior executives sell their shares during a share buyback, it sends a mixed message to shareholders. On the one hand, the board is saying the company's stock is undervalued enough to make the buyback worthwhile, while management is saying it's valued highly enough to be worth selling, which that strikes me as just the lamest argument that I've ever heard. I mean, it doesn't make any sense. It's like apples and oranges, but in any event, that was there.

But how did these proposals do? Certainly on the retention point, the three companies that I looked at were Chipotle, TJX and Boeing and it got 21% at Chipotle, got 29% at TJX, and 26% at Boeing, so they're real proposals so stay tuned on that.

Most compensation committees, if they're doing their job are looking at share buybacks in connection with setting metrics for long-term plans where EPS, in particular, is a factor. Buybacks obviously can have an impact on earnings per share and compensation committees want to thoughtfully go through what the impact might be. You see some evidence of disclosure around that in CD&As. Just a couple examples that I pulled, in Proctor & Gamble's 2020 proxy statement, they talk about their core EPS target is specifically includes the expected impact of stock buybacks, although it doesn't go into a lot of detail about that. In the 2020 FedEx proxy statement, they went on to say, I thought this was sort of interesting, but during fiscal 2018, the company stock repurchases approximately offset dilution arising from the grant of equity awards throughout the year.

And their way of dealing with it was to take any stock buybacks in excess of what was necessary to offset equity dilution and take those off of the table for purposes of the metric. So, I don't think there's any one way to really deal with **stock share (57:23)** buybacks. The important thing is to think about it and have a philosophy that you're going to approach it and go forward with it. And to the extent whether you include that disclosure in your CD&A, I think in large extent depends on how big your buyback program is, because if it's a substantial buyback program, you'd probably want to. If it's not going to be very much, it probably is immaterial and you might not need to do that.

One question that comes up is, what should companies be doing about buyback programs, and should there be more policing of the way buyback programs are run, to make sure that executives aren't using them as ways to unload stock. I personally haven't seen, you know, clients do that. I mean the buyback programs I think are pretty mechanically done. You got somebody in the treasury's office as the parameters that the board has set and said grace over and that the treasurer doesn't opportunistically goes out and buys shares or has a buying program that does it. And you know, the likelihood that some executive selling program is going to get into that is probably not terribly far off of, on the radar screen.

But in any event, it's something as a governance matter, I think one ought to think about, how's the program being executed, should there be any guardrails put on to make sure that executives aren't opportunistically using a program, but quite frankly, you know look, executives selling during a share buyback time is probably the best time to be selling.

By definition, the company is in the market, which means that any MNPI that might exist has been factored in and taken care of, so why shouldn't executives find that fine to be in? In any event, stay tuned. You know, as they say, elections have consequences and if the election changes the party in control of the White House and the SEC and the like, I'm sure buybacks could once again be a top issue and could be something we're contending with in years to come. So, that's kind of it on buybacks. Other questions? I mean, do you guys see any governance issues around buybacks? You get questions from companies about how they ought to be thinking about how to execute their programs?

Meredith Cross: I get lots and lots of questions around timing of buyback programs...

Keith Higgins: Sure.

Meredith Cross: ...**I think, in their trading window (1:00:13),** and basically is it the same? There aren't really cases against companies for buying back when they claim they had MNPI, and so there's a lot of discussion around what, you know, should the **window ___ (1:00:36)** be the same and that sort of thing.

Keith Higgins: Yeah.

Meredith Cross: A while back there was a lot of discussion around using buyback programs to **goose (1:00:46)** EPS, which is obviously, you know...It does **goose (1:00:53)** EPS.

Keith Higgins: Right.

Meredith Cross: There are less **S (1:00:58)**.

Keith Higgins: Right. It's math.

Meredith Cross: It's math. If you do it in a way that causes you to make your targets, and you don't have a lot of cash sitting around, then I think you know, I can see some controversy around that. So I think...At least this continues to be an area where there's a lot of counseling work done. I'm sure we all talk to clients regularly about buyback plans. I'd be very surprised. One interesting topic right now is, what if you said you're pausing buybacks to conserve cash for COVID issues and you want to restart. What do you got to do? And that's been a very complicated issue.

Keith Higgins: Yeah.

Meredith Cross: For them, saying I'm restarting, what, you know, what do you do to tell people you're going to be doing it again.

Keith Higgins: Yeah.

Meredith Cross: So that's a different issue from compensation, but it is a governance and...

Keith Higgins: Sure.

Meredith Cross: ...And the pandemic's not over, so is it wise to restart those sorts of things. Those are all big topics for discussion that aren't really pay or proxy related, I guess.

Keith Higgins: Right. Yep. Indeed.

Alan Dye: Keith, my experience is similar to yours. I mean, most of the questions that I get having to do with stock repurchase programs or stock repurchase plans are the same as Meredith was just eluding to and that Bill Hinman eluded to this morning in his discussion sessions. It is more of a governance issue or an insider trading issue than anything else. From a compensation standpoint, the issues that I end up dealing with most often, maybe just based on the companies that I work with, has to do with the EPS issues.

Keith Higgins: Yeah.

Alan Dye: Because the incentive compensation is based largely on EPS and to the extent that you reduce the number of shares outstanding that can have an impact. So you're balancing that business purpose against possible self-interest on the part of management and buying in the stock. Just making sure the compensation committee is aware of the issues and takes into account.

Keith Higgins: Yeah, my certain experience has been that compensation committees are aware of it and where they're sending an EPS target, that there's always factoring in the buyback program and whether you, you know, exclude the impact of buybacks over the equity dilution or there's probably different ways to do it. What do you see, Mark, as a comp consultant out in the valley? What **___ (1:03:30)?**

Mark Borges: They are including that in the determination of the programs and I'm starting to see more disclosure about it as well. So there's sensitivity to the fact that that's something that people are looking at and the response has been to indicate that yes, we have considered that and taken it into account for purposes of determining what our performance goal's going to be.

Keith Higgins: Yeah. Looks like there was an audience question asking, "What are your expectations, the panel's expectations for the SEC's reproposal of the clawback rule?" And first of all, I guess I'd observe that since the item is on the short-term agenda I think, my guess is that someone must've concluded that they didn't need to repropose as **___ (1:04:24)**, that I believe on the agenda, it's not in a reproposal state, it's on a final rule stage. But it would not expect it to happen this year to be honest with you and I think whether it happens when things change will depend on who the chair of the SEC is. But if I had my druthers since I do believe that the Dodd-Frank law says that the SEC should adopt it, I think that they should take the proposal that was put out. I think they should strip out of it the provision that said that incentive plans that are based on achieving a stock price are incentive based compensation for purposes of the rule. I think that was not a very...I think that had a lot of bad implications and could have added a lot of controversy and uncertainty around the rule, and then I think they should've added, they should give the boards and directors or the independent compensation committees more discretion to either decide to clawback or not to clawback as long as they disclose it. I think if they made those two changes, the rule would still comply with the statute and would be one that most companies could probably administer relatively easily. What do you guys think?

Dave Lynn: It just depends on the politics. It's not a very satisfying answer, but that's really how this issue will play out.

Keith Higgins: Yeah.

Dave Lynn: I think that's all the time we have for today's panel.

Liz Dunshee: Alright. Thank you all of our SEC All-Stars. Thank you Mark, Meredith, Alan, Keith and Dave. We appreciate that. It was a great discussion.

Markeys/pti:mt