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Key Trends in the Usage of Equity Awards

SEC Reopens Comment Period for Pay Versus Performance Rules

Proxy Plumbing Progress: A Look at Vote Confirmation this Proxy Season

A Word from the Editor

In this issue, we begin on page 2 with coverage of the 2021 Equity Incentives Design Survey, cosponsored by the NASPP and Deloitte Consulting. The NASPP has conducted this survey since 1993 and collaborated with Deloitte Consulting since 2004. For 2021, a total of 368 companies participated in the survey, representing a wide range of industries and sizes of companies. The survey provides a holistic and in-depth look at how equity compensation is used by public companies. The article discusses how RSUs have become the full value award of choice, supplanting stock options which are at their lowest utilization in two decades. Further, companies are typically granting their executives a mix of equity vehicles, while at the same time more employees within the organizations are getting access to equity awards. The article addresses different approaches to equity compensation within industries, provides details regarding the use of performance-based awards and potential payout ranges, as well as the treatment of awards upon retirement. We would like to thank Barbara Baksa and the NASPP for this article!

Beginning on page 8, we dive into the SEC's recent reopening of the comment process for the Dodd-Frank Act era pay versus performance disclosure rules. Proposed back in 2015 and never adopted, the pay versus performance rules received some significant pushback during the original comment process. The SEC is now back in 2022 with some new ideas, including proposals for a few additional performance measures that would be included in the disclosure along with TSR and peer group TSR. The SEC appears to be on a mission to finally adopt the outstanding Dodd-Frank Act compensation rulemakings, so this reopening is yet another step toward that effort come to fruition.

We wrap up on page 13, with a discussion of significant proxy plumbing progress that has been a long time in coming! In an effort to improve the transparency and reliability of the proxy voting process, industry participants have collaborated to provide end-to-end vote confirmation for Fortune 500 annual meetings, as well as launch a pilot to conduct an early-stage vote entitlement reconciliation process for 20 Fortune 500 meetings. We look forward to seeing how this process unfolds, and we tip our hats to the various parties who made this effort happen in 2022.

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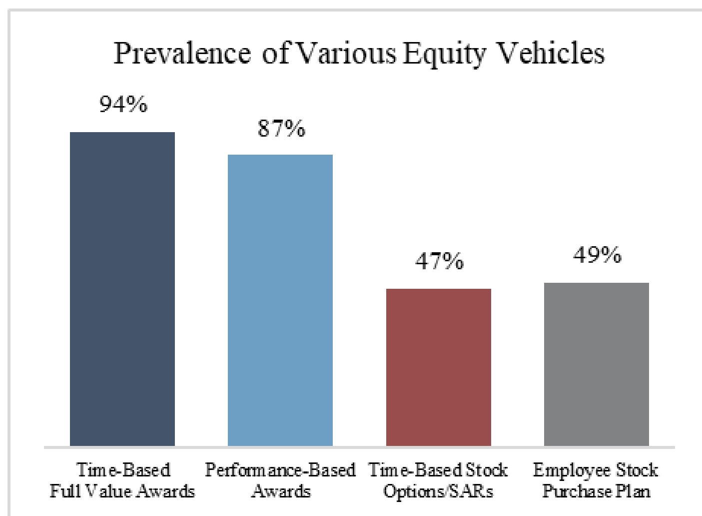
Key Trends in the Usage of Equity Awards

Companies both within and outside of the technology industry offer equity compensation at a wide range of employee ranks, and restricted stock units continue to grow in popularity. These are just two of the trends revealed by the 2021 Equity Incentives Design Survey, cosponsored by the NASPP and Deloitte Consulting.

Conducted in early 2021, the survey provides a holistic and in-depth look at how equity compensation is currently used by public companies. In this article, we highlight a number of trends that emerge from the data.

Today's Most Commonly Offered Equity Vehicles

Time and performance-based full value awards are the most common equity vehicles offered by public companies: 94% of respondents to the survey grant time-based full value awards and 87% grant performance-based awards. Only 47% of respondents grant time-based stock options and only 49% offer an employee stock purchase plan.



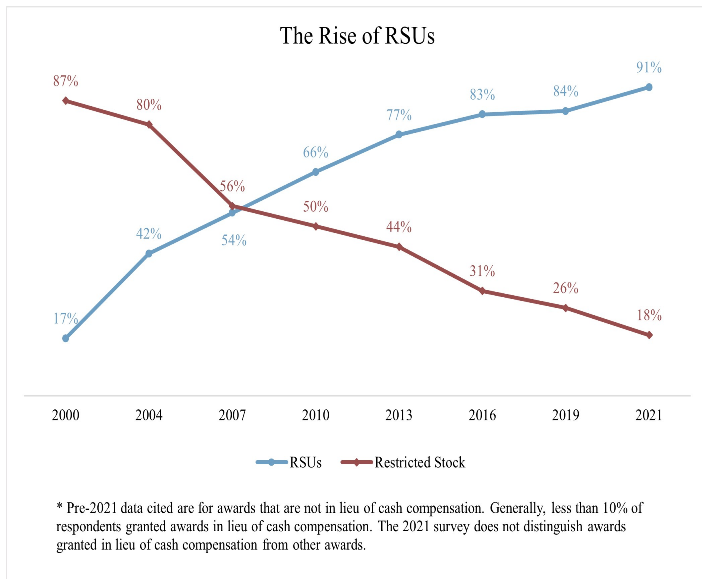
RSUs Are Overwhelmingly the Full-Value Award of Choice. Over the past two decades, as companies have shifted from stock options to full-value awards, they have also shifted from restricted stock to RSUs. In 2000, only a fifth of respondents to that year's edition of the survey granted time-based full-value awards. Among those companies, almost all (87%) granted restricted stock; only 17% granted RSUs.

Today, these statistics are reversed. Nearly all (94%) of companies grant time-based full-value awards. Among these companies, over 90% do so in the form of RSUs, while only 18% grant restricted stock.

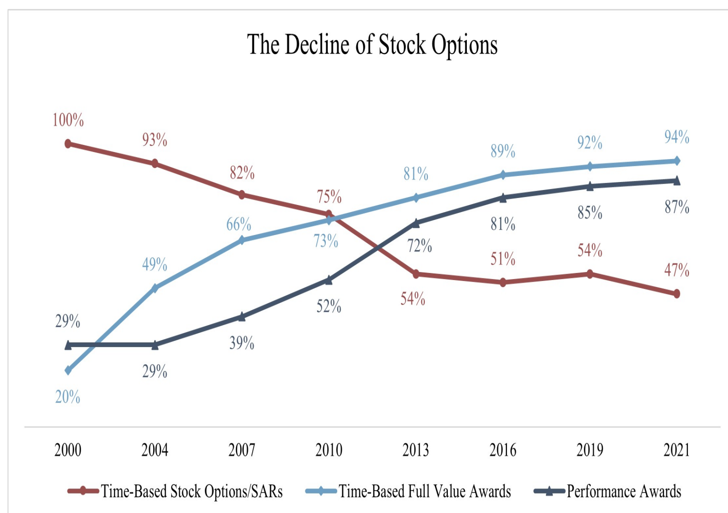
Units are also the most common form of performance vehicle granted. Among companies that use full value awards for their performance-based equity vehicle, nearly 90% issue the awards in the form of units. Only 4% of respondents grant performance-based stock options (down from 6% in 2019).

Although restricted stock and RSUs deliver similar economic benefits to employees, RSUs offer several advantages to the granting corporations that have driven this shift in practice (see the November–December 2003 issue of *The Corporate Executive* at page 1):

- Generally, RSUs are a more flexible form of award, and allow the granting corporation control over the point of taxation and the payment of dividends.
- Often, RSUs are taxed more favorably than restricted stock outside the United States.
- Because restricted stock involves issuance of the underlying shares at grant, administration of these awards can be more cumbersome than that of RSUs.

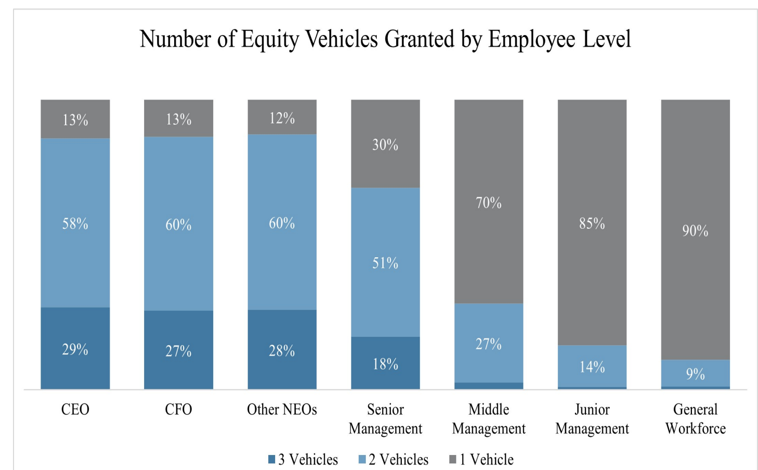


Use of Stock Options at Lowest Point in Two Decades. Although we continue to hear rumors of a resurgence of stock options, this trend has not yet materialized. The use of stock options has declined considerably since 2000, when 100% of survey respondents granted them. Although usage of options ticked up slightly in the 2019 survey and seemed possibly poised for recovery, this revival did not materialize. In the 2021 survey, only 47% of respondents currently grant stock options, reflecting the lowest usage level among public companies in the past two decades.



Executives Typically Receive a Mix of Equity Vehicles. A significant shift in grant practices can be observed between the middle-management and senior-management employee ranks. For senior managers and above, companies overwhelmingly offer a mix of equity vehicles. However, for middle managers and below, the predominant approach is to offer only one type of award (excluding ESPPs).

When a mix of equity vehicles is offered, it most often is a combination of time-based full-value awards and performance-based awards. For employee ranks where only one vehicle is typically offered, that vehicle most commonly is time-based full-value awards.



Prevalence of Equity Plans for Lower-Ranking Employees

Among public companies, access to company equity is universal for employees at and above the senior-management level. This is hardly surprising. A more interesting question to consider is whether equity awards are offered to employees below the senior management level. We frequently encounter the assumption that this practice is rare.

The NASPP and Deloitte find, however, that it is common for employees below the senior-management level to have access to equity

plans, most often in the form of RSUs or an ESPP. Over 90% of companies extend equity plans to middle management, over 70% extend equity to junior management, and nearly 60% offer equity to employees in their general workforces.

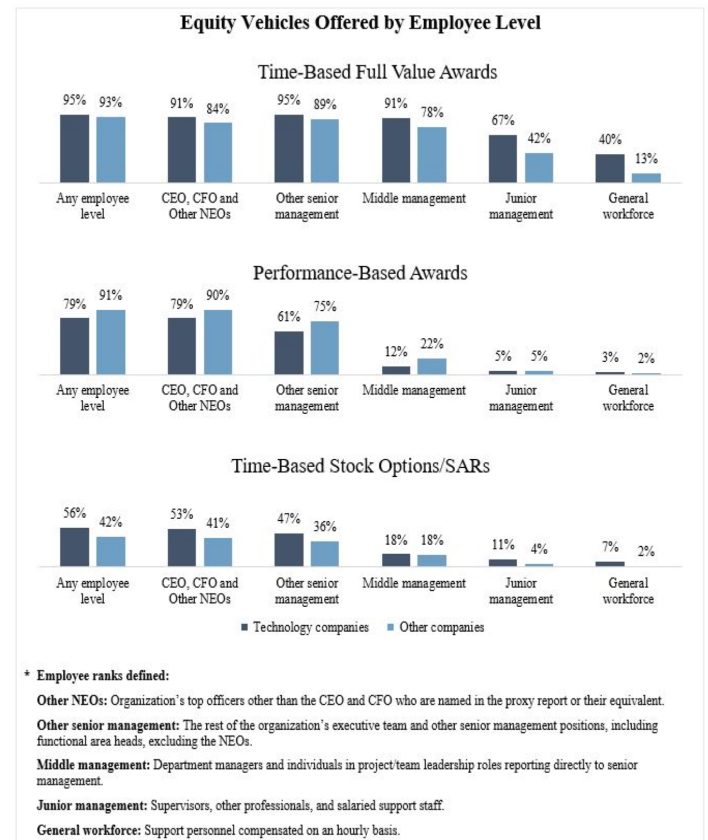
When middle-management employees have access to company equity, it is most often in the form of time-based full-value awards, usually RSUs. At the junior-management level, equity is about as likely to be offered in the form of time-based full-value awards as in the form of an ESPP. Half of all respondents offer time-based full-value awards to junior managers, and half of the respondents offer an employee stock-purchase plan (junior managers have access to both vehicles at 28% of companies).

When company equity is offered to the general workforce, it is most often in the form of an ESPP. Overall, nearly 50% of companies offer an ESPP, but only a quarter of companies offer discretionary equity awards (*i.e.,* full value awards, stock options, or stock appreciation rights) at this employee rank.

Broad-based Equity Is Most Prevalent at Technology Companies. At all organizational levels, a majority of technology companies provide employees with access to equity programs (either discretionary equity awards or an ESPP). Even for employees in the general workforce, 75% of technology companies provide access to equity programs, compared to just under half (47%) of non-technology companies.

Therefore, it is not surprising that technology companies are both more likely to offer an ESPP (64%) than non-technology companies (41%) and more likely to offer discretionary equity awards to lower ranking employees. Nearly all technology companies (94%) offer discretionary equity awards to middle-management employees, almost 70% offer these types of awards to junior-management employees, and 43% of technology companies offer them to employees in their general workforce.

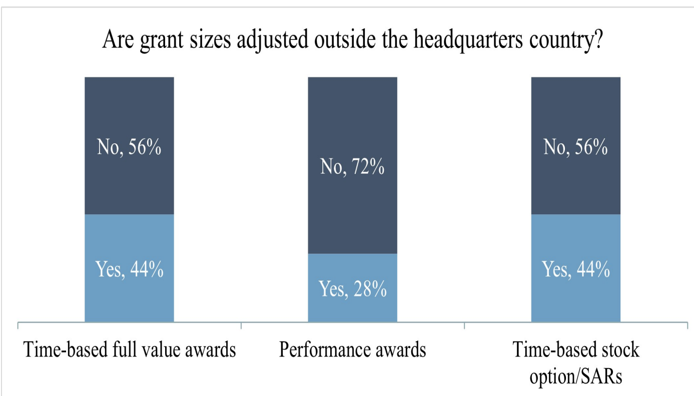
Non-technology companies still come in high for middle-management employees, with 84% offering discretionary equity awards at this level. But grants of equity sharply drop off below this level, with only 44% offering awards to junior management and only 15% offering awards to employees in their general workforce.



Multinational Equity Programs

Over 90% of respondents extend their equity programs to employees located outside of their headquarters country (92% of survey respondents are headquartered in the United States). Where equity is offered outside of the HQ country, most companies utilize their HQ equity plan to do so, with approximately 5% using a sub-plan or separate international plan, or a mix of plans. The survey also found that companies typically offer the same types of awards worldwide and rarely change the terms (*e.g.*, vesting and forfeiture conditions) of equity awards offered outside their HQ country.

Nearly half (44% of respondents) adjust grant sizes outside their HQ country for time-based full value awards and stock options, while only 28% adjust grant sizes for performance-based awards. The top three criteria for adjusting grant sizes outside the HQ country are: pay practices for employees by jurisdiction (52% of respondents), relative wage levels (47%), and job descriptions/levels (41%).



Tax-Qualified Arrangements

Section 423 ESPPs are the most common type of locally-tax qualified equity arrangement that public companies offer. Nearly half of companies offer an ESPP and, among those that do, approximately 80% offer a tax-qualified plan in the United States. By contrast, less than 10% of the survey respondents grant incentive stock options to their US employees.

Tax qualified plans are equally as uncommon outside the United States. The countries where companies are most likely to offer locally tax-qualified arrangements are Belgium, Canada, France, Israel, and the United Kingdom. Even in these countries, however, only a third of respondents or fewer offer tax-qualified plans (Israel is an exception—over 70% of companies that offer equity to Israeli employees do so under the framework of Section 102 of the Israeli Tax Ordinance). Generally, companies are more likely to offer qualified plans in countries where they have a larger population of employees.

Performance Awards

The use of performance-based awards remained almost flat from 2019 to 2021. As noted, 87% of companies responding to the survey currently offer performance-based equity awards, but this is up just one percentage point, from 86% in the 2019 survey.

The Technology Industry Lags Other Industries. The technology industry has been slower to adopt the practice of granting performance-based equity awards and continues to lag behind other industries in this area. Only 80% of both computer-related and other technology companies currently grant performance-based LTI awards, compared to 98% of manufacturing companies, 95% of financial/insurance companies, 84% of entertainment/shopping companies, and 90% of other non-technology companies.

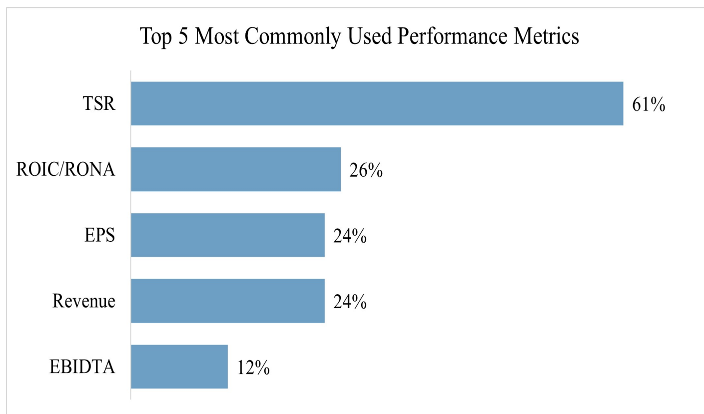
Three-Year Performance Periods Are Standard. Three years is the most common performance period among respondents for all types of performance-based awards: this is the performance period utilized by 84% of respondents that grant performance shares, 78% of respondents that grant performance cash/units, and 54% of respondents that grant performance-based options/SARs. We suspect this practice is attributable to the fact that three years is the minimum performance period considered acceptable by ISS combined with the difficulty of establishing appropriate targets for longer time periods.

Multiple Metrics and Value Metrics Are Most Common. Overwhelmingly, companies measure performance only at the corporate level (90% of respondents). At over 70% of companies, vesting in LTI awards is tied to different metrics than those used in the company's annual incentive plan. This approach provides for more well-rounded incentives and can prevent executives from focusing too narrowly on just a single metric.

Vesting in performance-based awards is typically contingent on two or more metrics (74% of

respondents), most commonly just two metrics (48% of respondents).

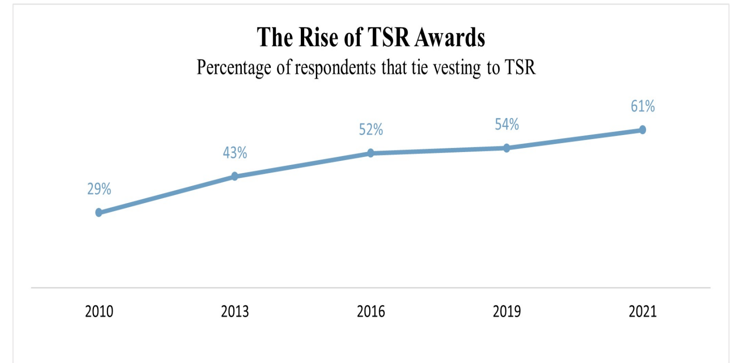
Over 70% of companies tie vesting in performance-based awards to value metrics and, by far, the most commonly used value metric is total shareholder return, at 61% of overall respondents, up from 54% in 2019 and 29% in 2010 (the first year the NASPP and Deloitte began tracking the specific metrics tied to vesting in performance awards).



In over half of companies, vesting is contingent on revenue/profit metrics. The most common metrics utilized in this category are earnings per share and revenue, each representing 24% of overall respondents. Just over 10% of respondents utilize earnings before income, taxes, depreciation, and amortization (EBITDA).

Although less than half of companies (41%) tie vesting to return/margin metrics, return on invested capital (ROIC)/return on net assets (RONA) is the second most commonly used metric at 26% of overall respondents.

Strategic metrics (*e.g.*, milestone goals, market share, customer satisfaction) are utilized by only 10% of respondents. Similarly, ESG metrics have not yet gained even a modest level of adoption, with less than 5% of respondents using them.



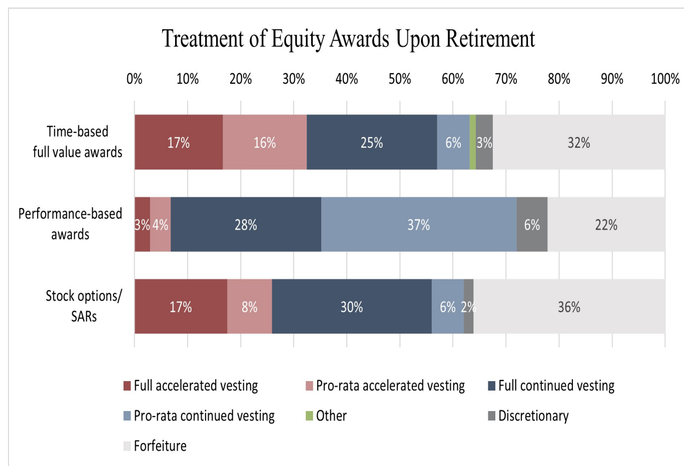
Among companies that tie vesting to TSR, performance is overwhelmingly measured on a relative basis (86% of respondents). In addition, when companies outperform their peers, 81% of respondents pay out awards even when TSR is negative, notwithstanding that this practice is often viewed unfavorably by proxy advisors and investors.

Award Payouts Can Typically Range from 41% to 200% of Target. The most typical payout for minimum performance is between 41% to 60% of target (51% of respondents). For another 25% of respondents, the minimum payout is between 21% to 40% of target.

At 66% of companies, the maximum payout is within 151% to 200% of target. For another 17% of respondents, the maximum payout is between 101% to 150% of target.

Treatment of Equity Awards Upon Retirement

It is common for companies to provide payouts to retirees for all types of equity awards. Two-thirds of respondents pay out time-based full value awards and over 60% pay out time-based stock options to retirees. At nearly 80% of respondents, retirees are eligible to receive a payout under their performance-based awards (but typically only to the extent that the performance conditions are achieved). The higher prevalence of payouts to retirees for performance awards is likely attributable to the fact that these awards are typically offered only to very senior level employees.



For time-based full value awards, practices are split between continuing vesting after retirement and accelerating vesting upon retirement.

Respondents are twice as likely to pay out awards in full to retirees as they are to provide a pro rata payout.

Continued vesting after retirement is more common for stock options, with 36% of respondents employing this approach vs. only a quarter that accelerate vesting of options upon retirement. Nearly half of respondents pay out options in full; only 14% provide for a pro rata payout.

Practices vary considerably with respect to the length of time retirees have to exercise options: 31% of respondents allow retirees the full remaining term, 21% allow retirees only three months, 16% allow five years, 8% allow three years, and 7% allow retirees only one year to exercise their options.

When it comes to performance awards, companies are much more likely to pay out awards to retirees at the end of the performance period (65% of respondents) vs. at the time of retirement (only 7% of respondents).

This practice may, in part, be a holdover from the period when performance awards were exempt from the Section 162(m) limit on corporate tax deductions for compensation paid to executive officers; during that time, paying out performance awards immediately upon retirement caused the awards to become subject to Section 162(m) (see the January-February 2012 issue at pg 10).

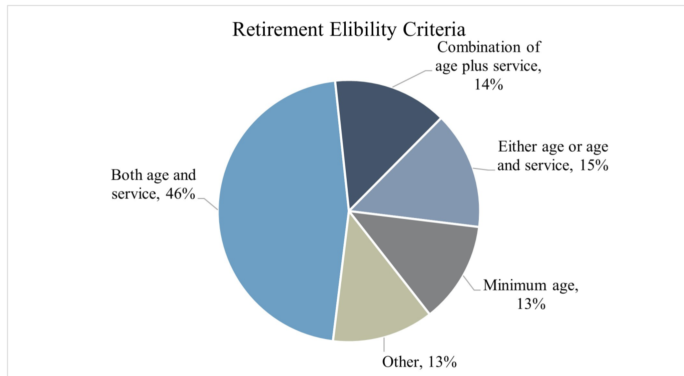
Now, of course, this concern is moot. Under the Tax Cuts and Jobs Act of 2017, all performance awards are subject to Section 162(m), whether or not they provide for automatic payouts to retirees. Moreover, because most performance awards have a three-year performance period, any grandfathered awards have likely already been settled. (See the July-August 2018 issue of *The Corporate Executive* at page 10.)

In light of the fact that the Section 162(m) concerns are no longer relevant, readers might expect practices to shift towards automatic payouts to retirees. This isn't indicated in the survey, however, and we don't expect this trend to materialize. By deferring payout until the end of the performance period, companies can ensure that retirees receive a payout only to the extent that the performance conditions are achieved. Where performance awards are paid out to retirees irrespective of achievement of the performance goals, executives would be incented to retire during periods of poor performance to lock in payout of their performance awards. This could be detrimental to the company's success and would likely be viewed unfavorably by investors.

Approaches to Determining Retirement Eligibility Vary. For termination of service events to be treated as retirement, 46% of respondents require employees to meet both minimum age and years of service requirements (*e.g.,* the award holder must be age 55 and have completed 10 years of service).

There is little agreement as to the retirement eligibility requirements among the remaining respondents. Fifteen percent of respondents require award holders to achieve a number that is a combination of their age and years of service (*e.g.,* age plus service must equal 70) and another 15% require award holders to achieve either a minimum age or an age and service requirement (*e.g.,* award holders are eligible to

retire if they are 65 or if they are 55 and have completed 10 years of service).



For those respondents that specify a minimum age, 50-55 years is the most common requirement (51% of respondents). For those that specify a minimum service requirement, 10 years is most common (54% of respondents).

About the Survey

The 2021 Equity Incentives Design Survey was jointly developed by the NASPP and Deloitte Consulting and administered by Deloitte Consulting from January to May 2021. Members of the NASPP and clients of Deloitte Consulting were invited to participate.

A total of 368 companies responded to the survey, representing a wide range of industries and sizes. All respondents are public companies, and 92% of the companies are headquartered in the United States. Just over a third of respondents are technology companies.

The survey is one of the most comprehensive of its kind, providing an in-depth look at global equity compensation design practices of companies that offer stock-based compensation to employees. The survey includes more than 100 questions covering the design of time-based full-value awards, performance-based awards and time-based stock options and stock appreciation rights.

The NASPP has conducted this survey since 1993 and has collaborated with Deloitte Consulting on it since 2004.

SEC Reopens Comment Period for Pay Versus Performance Rules

Consistent with an apparent emphasis on seeing the Dodd-Frank Act era compensation rulemakings to completion (see the November-December 2021 issue of *The Corporate Executive* at page 2), the SEC recently reopened the comment period on the still outstanding proposed pay versus performance disclosure rules (see Release No. 34-94074, *Reopening of Comment Period for Pay Versus Performance* (Jan. 27, 2022)). The rulemaking, which turned out to be fairly controversial when the disclosure requirements were initially proposed back in 2015, now appears to be back on the SEC's front burner with a focus on resolving some of the knottier issues raised in implementing the Dodd-Frank Act's statutory directive.

The Original Proposal

On April 29, 2015, the Commission proposed rule changes to implement Section 953(a) of the Dodd-Frank Act, which were subject to a 60-day comment period that ended on July 6, 2015 (see Release No. 34-74834, *Pay Versus Performance* (Apr. 29, 2015)). The proposed rules would add new Item 402(v) of Regulation S-K, which would require a company to provide a clear description of: (i) the relationship between executive compensation actually paid to the company's named executive officers and the cumulative total shareholder return ("TSR") of the company stock; and (2) the relationship between the company's TSR and the TSR of a peer group chosen by the company, over each of the company's five most recently completed fiscal years. The proposed disclosure would be required in proxy or information statements for annual meetings of shareholders in which executive compensation disclosure is required.

More specifically, the proposed disclosure would require companies to add a new table to their proxy materials with the following information:

- Executive compensation actually paid for the principal executive officer and the average compensation actually paid to the remaining named executive officers;
- The total executive compensation reported in the Summary Compensation Table included under Item 402(c) of Regulation S-K for the principal executive officer and the average of the reported amounts for the remaining executive officers;
- The company's TSR on an annual basis, using the definition of TSR in Item 201(e) of Regulation S-K, which sets forth an existing requirement for a stock performance graph; and
- The TSR on an annual basis of the companies in a peer group.

This new table prescribed by the proposed rules would include executive compensation "actually paid" to named executive officers, as defined in Item 402(a)(3) of Regulation S-K. While the proposed rules would require companies to disclose the executive compensation actually paid to the principal executive officer, the compensation amounts disclosed for the remaining named executive officers would be the average compensation actually paid to those executives. Under the proposed rules, executive compensation "actually paid" would be calculated using compensation that companies already report in the proxy statement as a starting point. Specifically, compensation "actually paid" pursuant to the proposed rules would equal total compensation, as reported in the Summary Compensation Table, with certain adjustments relating to pension amounts and equity awards.

The proposed rules would require that companies use TSR as the measure of financial performance of the company for purposes of pay-versus-performance disclosure. To supplement the required disclosure, the proposed rules would permit companies to provide supplemental measures of financial performance, provided that any such additional disclosure is clearly identified, not misleading and not presented with greater prominence than the required disclosure.

Pursuant to the proposed rules, companies would be required to disclose the relationship between issuer TSR and peer group TSR, in each case over the company's five most recently completed fiscal years, using the peer group identified by the company in its stock performance graph or in its CD&A. Companies would be required to provide the disclosure contemplated by the proposed rules for the last five fiscal years, except that smaller reporting companies would be required to provide disclosure for only the last three fiscal years.

In addition to providing the tabular and narrative disclosure contemplated by the proposed rules, issuers would also be required to tag the disclosure in an interactive data format using XBRL.

The Reopening Release

In January 2022, the SEC reopened the comment period for the pay versus performance rule proposal. In the reopening release, the Commission acknowledges "[s]ince the Proposed Rules were published, executive compensation practices related to company performance have continued to develop and evolve, to the point that we believe interested persons should be given a further opportunity to analyze and comment upon the Proposed Rules." This is certainly an understatement — even at the time when the rules were originally proposed back in 2015, companies had already "moved on" by disclosing comprehensive information in response to the focus of institutional investors and proxy advisory firms on seeking a clear articulation of the relationship between pay and performance. In any event, the Commission has determined to plow forward, and indicates that it is considering whether additional requirements would "better implement the Section 953(a) mandate by providing investors with additional decision-relevant data."

Additional Performance Measures. Section 953(a) of the Dodd-Frank Act did not specify how to measure a company's "financial performance," but it did require that "financial performance … [take] into account any change in the value of the shares of stock and dividends of the issuer and any distributions." With this statutory language in mind, the SEC went exclusively with TSR as the measure of financial performance in the original rule proposal. The Commission notes in the reopening release that the rationale for TSR as the measure of financial performance made sense, given that (i) TSR is consistently calculated and should increase comparability across companies; (ii) TSR is objectively determinable and not open to subjective determinations of performance; and (iii) TSR is a measure for which disclosure is already required in the context of the stock performance graph, so it did not represent some entirely new approach to measuring performance for the purpose of SEC disclosure requirements.

The SEC is requesting comment on whether three measures of performance should be required to be disclosed, in addition to TSR. In particular, the SEC is considering requiring disclosure of: (i) pre-tax net income; (ii) net income; and (iii) a measure specific to the company, chosen by the company (the "Company-Selected Measure"). Companies would be required to provide a clear description of the relationship among the measures provided in the tabular form (including these three measures), but the company would be allowed to choose the format used to present the relationship, such by using as a graph or narrative description.

In the reopening release, the Commission notes that pre-tax net income and net income are provided for under U.S. GAAP and are therefore familiar to companies and investors. The SEC notes that "[b]ecause these measures reflect a registrant's overall profits and are net of costs and expenses, we believe they are additional important measures of company financial performance that may be relevant to investors in evaluating executive compensation." The SEC also notes that these measures could complement TSR by providing accounting-based measures of financial performance.

With respect to the Company-Selected Measure, the SEC contemplates that companies would select a measure that, in the company's assessment, "represents the most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure." The SEC believes requiring that companies select their own measure rather than mandating a further specific measure may elicit additional useful disclosure while reducing the risk that required disclosure focused on TSR could misrepresent or provide an incomplete picture of how pay relates to performance.

In addition to potentially requiring that the Company-Selected Measure be included in the proposed table, the SEC is considering whether to separately require that companies provide a list of their five most important performance measures used to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure, in order of importance. If a company considers fewer than five performance measures when it links compensation actually paid during the fiscal year to company performance, the company would be required to disclose only the number of measures it actually considers. The SEC is considering whether to require that this list be presented in a tabular format.

The Commission notes that while the CD&A requirement elicits specific disclosure about measures of performance, the discussion of these topics in the CD&A "tends to be prospective in nature and focused on the design of the registrant's compensation program." The SEC acknowledges that there is no existing rule that specifically mandates disclosure of the performance measures that actually determined the level of recent NEO compensation actually

paid. Given that such information is not currently required, the Commission believes that tabular disclosure of a list of the five most important performance measures that drove compensation actually paid "may be useful to investors in addition to the more detailed disclosure related to the consideration of the registrant's corporate performance and individual performance in the design of NEO compensation required in the CD&A."

The Commission indicates in the reopening release that the tabular disclosure of the five most important measures in order of importance could enable investors to assess which performance metrics have the most impact on compensation actually paid, and therefore "make their own judgments as to whether compensation appropriately incentivizes management." In the SEC's view, the disclosure of the five most important performance measures that drove compensation actually paid may also provide investors with context that could be useful in interpreting the remainder of the pay versus performance disclosure.

Applicability to Smaller Reporting Companies. The SEC is considering not requiring smaller reporting companies to disclose a Company-Selected Measure and a list of their five most important performance measures, because smaller reporting companies would not be able to satisfy the new disclosure requirement by drawing upon or cross-referencing to existing disclosures such as CD&A (which is not required for smaller reporting companies). With respect to the potential disclosure of additional measures, pre-tax net income and net income, the SEC is considering requiring smaller reporting companies to disclose such measures.

Request for Comment. Taking into consideration the additional potential rule changes discussed in the reopening release, the Commission solicits comment on the overall proposals in a wide range of areas. For example, the SEC's raises questions about:

- Whether disclosure of additional financial performance measures beyond TSR should be required, such as pre-tax net income and net income presented in tabular format alongside the other metrics that would be required, and whether these two additional metrics would help investors to evaluate the relationship between executive compensation actually paid and the financial performance while alleviating concerns about focusing only on TSR measures.
- Whether the SEC should also require that these measures be discussed in the required description (which may be, *e.g.,* narrative or graphical) that accompanies the tabular disclosure.
- Whether pre-tax net income and net income should be included only as examples of additional measures, leaving it to companies to elect to disclose them if they believed such disclosure would be beneficial.
- Whether other measures of company performance should be considered in addition to, or in lieu of, pre-tax net income and/or net income.
- The appropriate approach for defining the Company-Selected Measure and whether the SEC should require companies to disclose the methodology used to calculate the Company-Selected Measure.
- Whether the Company-Selected Measure should be required to be the most important measure used by the company in a performance or market condition in the context of an incentive plan.
- Whether the Company-Selected Measure would allow investors to better evaluate the extent to which the total compensation reported as actually paid reflects the performance the company explicitly chose to incentivize.

- The appropriate approach for defining the “most important” for the purpose of the selection of the Company-Selected Measure, as well as for the ranking of any other measures, if required, and what additional disclosure may be necessary to explain these measures.
- Ways of approaching more technical considerations, such as when different measures are important in different years or if different measures determine compensation actually paid for the different NEOs.
- Whether a company would be permitted to designate TSR, peer group TSR, pre-tax net income or net income as the Company-Selected Measure, or the approach if a company did not use any measures other than those already included in the table, as well as the appropriate approach for indicating that fact in its disclosure.
- The potential benefits and challenges associated with mandating disclosure of the Company-Selected Measure and potential alternatives to requiring this disclosure.
- Whether the Company-Selected Measure should be limited to those measures that relate to the financial performance of the company, or whether the Company-Selected Measure could be any measure that could be disclosed under the existing CD&A requirements, including financial performance measures; environmental, social and governance related measures; or any other measures used by the company to link compensation actually paid during the fiscal year to company performance.
- Whether a tabular list of a company’s five most important performance measures used to determine compensation actually paid would be useful to investors in addition to existing disclosures, how the SEC should define “importance” for this purpose and how performance measures should be ranked for this purpose, particularly if multiple performance targets apply to the same elements of compensation.
- The costs and burdens associated with identifying and ranking the five most important performance measures, and whether there should be an exemption for disclosure of sensitive or competitive information.
- Ways of approaching more technical considerations, such as when a company’s five most important performance measures include measures that are included in the rules and whether companies should be permitted to disclose fewer than five measures if they deem fewer than five to be important.
- Whether Item 402 of Regulation S-K should be revised to explicitly require disclosure of all of the performance measures that actually determine NEO compensation, and whether voluntary disclosure should supplement the required disclosures.
- Whether the Commission should reconsider the scaled requirements for smaller reporting companies in the proposed rules and the additional measures being considered, whether the additional measures are appropriate for smaller reporting companies, and the potential burdens on smaller reporting companies arising from the additional disclosure.
- Whether Inline XBRL should be required, whether additional tagging of disclosures is appropriate and potential costs and burdens arising from XBRL requirements.
- Whether there are alternative approaches that would reduce the risk of misalignment

of compensation actually paid with the associated financial performance while providing for appropriate comparability across companies, including the additional measures of financial performance that the SEC discusses in the reopening release.

- Considerations arising from using the pension service cost as defined in FASB ASC Topic 715 to determine the amount attributable to pension plans to be included in compensation actually paid, as well as potential challenges associated with computing the fair value of options at the vesting date as opposed to the grant date.
- Considerations as to the appropriate time periods that should be disclosed in the TSR portions of the table.
- Whether there have been any other developments (including with respect to executive compensation practices) since the proposing release that should affect the SEC's consideration of the proposed rules, including, for example, how environmental, social and governance related metrics have changed and/or developed since the proposing release.

Next Steps

Similar to the SEC's approach of reopening the comment period for compensation recovery rulemaking last October, the reopening of the comment period for the pay versus performance rulemaking involves an expansion of the proposed requirements beyond the original 2015 proposal. Whether in response to issues raised by commenters or for other reasons, the additional requirements that the Commission is considering would substantially increase the information that companies would need to provide to demonstrate the relationship between compensation and company performance. Practically speaking, it is likely impossible for the Commission to come up with a "one-size-fits-all" approach for this disclosure, so inevitably we are likely to see a continuation of the approaches that companies have come up with to "voluntarily" demonstrate their pay for performance alignment, which would be juxtaposed with the mandatory disclosures if the proposed rules are adopted.

In terms of timing, it is likely that the SEC would be comfortable going straight to adoption of final rules after the Commission and the Staff have had an opportunity to consider the additional comments, so it is possible that the new disclosure requirements could be adopted and effective in time for the 2023 proxy season. In the meantime, we do not think that either the original proposals or the additional requirements discussed in the reopening release will have much of an impact on the pay-for-performance disclosures that companies will provide during the 2022 proxy season.

Proxy Plumbing Progress: A Look at Vote Confirmation this Proxy Season

In what is now going on a dozen years since the SEC highlighted many of the issues arising from "proxy plumbing" in a 2010 concept release (see Release No. 34-62495, *Concept Release on the U.S. Proxy System* (Jul. 14, 2010)), progress toward addressing some of those thornier issues has seemed glacial at times. Even when progress has been made, it has come in the form of one step forward and two steps back – *e.g.,* the SEC's rules on proxy advisory firms, which were adopted in 2019 and are now subject to a proposal to roll those amendments back.

That is why we thought it was significant when, earlier this year, the Operations Subcommittee of the End-to-End Vote Confirmation Working Group announced that it agreed to provide end-to-end vote confirmation this proxy season for Fortune 500 annual meetings that are tabulated by members of the Operations Subcommittee, and to pilot an early-stage vote entitlement reconciliation process for 20 Fortune 500 meetings. End-to-end vote confirmation is the affirmation to a nominee from the tabulator (and

to the nominee's beneficial owner by the bank or broker) that the vote made was counted as cast. Vote entitlement refers to bank's or broker's voting entitlement on behalf of their clients.

The End-to-End Vote Confirmation Working Group came together following the SEC's November 2018 Roundtable on the Proxy Process, and the Operations Subcommittee consists of virtual shareholder meeting providers, proxy service providers, tabulators and representatives from issuers, investors, brokers and banks. The efforts this proxy season are important because they help to minimize last minute rejections/corrections of shareholder votes and thereby improve the transparency and accuracy of the voting process.

Background

The SEC's proxy plumbing concept release noted that some market participants, including both individual and institutional investors, had raised concerns that they were unable to confirm whether an investor's shares have been voted in accordance with the investor's instructions. This is because beneficial owners cast their votes through a securities intermediary, which then uses a proxy service provider to collect and send the votes to the vote tabulator.

The SEC observed that institutional investors often want or need to confirm that their votes on proxy proposals have been timely received by the vote tabulator and accurately recorded. At the same time, securities intermediaries, such as banks and brokers, want to be in position to confirm to their customers that their votes have been timely received and accurately recorded. For their part, companies have wanted to confirm that the votes that they receive from the securities intermediaries on behalf of beneficial owners do in fact properly reflect the votes of the beneficial owners. Given the complexity of the proxy plumbing/share ownership system, errors inevitably occur, although we understand that the actual error rate is not as high as one might think.

As the SEC highlighted in the proxy plumbing concept release, one of the reasons for the inability to confirm voting information is because there is really no one entity that is "in charge" of the process and therefore has all of the information that is necessary to provide end-to-end vote confirmation. There are many parties involved in casting a vote on a proposal, including the transfer agents, vote tabulators, securities intermediaries and third party proxy service providers who all have a hand in the process. For a variety of reasons, they have not historically worked together in a manner that would facilitate end-to-end vote confirmation. One of the persistent challenges has been that there is no legal or regulatory requirement that forces these entities to share information with each other in a manner that would facilitate vote confirmations. The lack of any SEC action on this issue over the years and the fact that there is no proxy voting "quarterback" that can ensure that end-to-end vote confirmation occurs has created a persistent uncertainty as to whether votes cast at shareholder meetings are accurate.

In the proxy plumbing concept release, the Commission expressed the view that "both record owners and beneficial owners should be able to confirm that the votes they cast have been timely received and accurately recorded and included in the tabulation of votes, and issuers should be able to confirm that the votes that they receive from securities intermediaries/ proxy advisory firms/proxy service providers on behalf of beneficial owners properly reflect the votes of those beneficial owners." Recognizing that there were a number of operational and legal complexities with any approach to rectifying the problem, the Commission proposed a possible solution, whereby all participants in the voting chain grant to companies, or their transfer agents or vote tabulators, access to specific information relating to voting records, for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder's shares were voted. The Commission envisioned that this process could be fully automated, such that a vote confirmation

could be provided by the company (or its agent) to the record owner or, in the case of beneficial owners, to the securities intermediary or proxy service provider and sent by email to the beneficial owner. One wrinkle with this approach would be the need to implement procedures to protect the identities of objecting beneficial owners from companies, such as through some sort of system where a unique identifying code could be assigned each beneficial owner.

A Solution Emerges (Slowly)

The Commission's suggested solution did not immediately see the light of day after the publication of the proxy plumbing concept release. In August 2011, the Weinberg Center for Corporate Governance convened a roundtable to make recommendations, and the relevant parties reached a preliminary agreement on a path forward at that time. The roundtable gave four recommendations for providing end-to-end vote confirmation in its August 2011 report:

- *Early-Stage Entitlement Confirmation*. Early-stage entitlement confirmation by all parties that anticipate submitting votes for a shareholders' meeting could minimize difficulties for tabulators in reconciling voting entitlements. In order to implement this change, there would need to be a process for parties to confirm their voting entitlements with the meeting tabulator within a specified period, suggested to be six business days.
- *Encouraging Early Voting*. All shareholders, including both institutional and retail shareholders, should be encouraged to cast their votes early in the solicitation period and no later than three business days before a shareholder meeting. This would address the problems that can arise from late-stage voting, which causes difficulties for tabulators and nominees and is a major cause of potential voter exclusion.
- *Enhancements to Exception Processing*. Prompt communication from tabulators to vote-reporting entities about the reasons why vote reports have been rejected would facilitate the timely processing of exception items. A standardized rejection slip was also recommended to facilitate the reconciliation process.
- *Vote Confirmation*. The parties would work together to enable an investor to confirm whether their shares have been voted as instructed as a means to improve confidence in the voting system, particularly with contested matters.

The recommendations were validated in subsequent years through pilot efforts, and industry participants continued to voice support for a solution, including at the 2018 SEC roundtable that revisited the proxy plumbing concerns. With encouragement from the Commission, the End-to-End Vote Confirmation Working Group was formed, and is co-chaired by representatives of the Society for Corporate Governance and the Council of Institutional Investors.

The efforts of the Working Group were aided to some extent by the onset of the COVID-19 pandemic and the rapid pivot to virtual shareholder meetings in 2020. In a very short period of time, the industry had to collaborate to create electronic validation mechanisms that would allow beneficial owners to participate in a virtual shareholder meeting. The level of collaboration helped bring the Working Group together to finally conduct end-to-end vote confirmation on a larger scale.

What to Expect this Proxy Season

In early January 2022, the Working Group announced that it had agreed to provide end-to-end vote confirmation this proxy season for Fortune 500 annual meetings that are tabulated by members of the Operations Subcommittee.

Shortly after that announcement, Broadridge Financial Solutions announced that it will provide end-to-end vote confirmation this year to all shareholders in the annual meetings of the more than 2,000 U.S. public companies whose votes it tabulates. As a result of these efforts, all shareholders – including institutional and individual investors, whether the shares are held of record or beneficially owned – will effectively receive a "receipt" confirming that that their votes were received, tallied and included in the final tabulation. These efforts are a first phase in a broader effort toward providing end-to-end vote confirmation for all investors.

As part of the process, the members of the Operations Subcommittee will pilot an early-stage vote entitlement reconciliation process for 20 Fortune 500 shareholder meetings. Early-stage vote entitlement reconciliation will ensure that any discrepancies between the records held by tabulators and the records of banks and brokers will be addressed well in advance of a shareholder meeting, so that every share that is duly held and cast will be included in the final vote tally. This entitlement reconciliation process is an important development, given the overall complexity in the many ways in which investors hold shares throughout the system and thereby obtain their entitlement to vote those shares on proposals at a subject shareholder meeting. Under this pilot, beginning five days after the record date for a particular meeting, the parties will analyze the entitlements to vote at the meeting so that no issues as to entitlement to vote would arise later in the process.

While only an extremely small number of votes ultimately get rejected in the voting process today, the combination of end-to-end vote confirmation and early-stage vote entitlement reconciliation would improve the transparency and reliability of the voting process. In terms of what to expect this proxy season, individual investors will receive a confirmation communicating that their voting instructions have been received and included in the final tally (institutional investors already receive this information). For companies, they can expect to receive a communication from the tabulator that the confirmations have been sent to the shareholders.

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