

CORPORATE BOARD MEMBER®

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THE RULES OF HIS GAME

J.C. WATTS
DIRECTOR, DILLARD'S
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AMERICA'S TOP VALUE-CREATING DIRECTOR ON WHAT IT TAKES TO MAKE A REAL DIFFERENCE IN TODAY'S BOARDROOMS. 'IF THERE'S NO INTEGRITY, STRATEGY DOESN'T MATTER.'

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EVALUATING EQUITY PLAN FREQUENCY

How will investors react to increasing the frequency of share replenishment proposals?

By Donald Cioffi, Stephen Freyman and Etelvina Martinez

WILL ISS OR INSTITUTIONAL SHAREHOLDERS HOLD

it against my company if we add shares to our equity plan two years in a row?

Alliance Advisors receives this question often, and it was worth a deeper look.

If going back for shares two years in a row caused companies to lose support on their equity plan proposals, then surely a company that asked shareholders to approve a new share increase for six consecutive years would face a significant increase in "Against" votes over time.

Alliance found 12 members of the Russell 3000 had proposed new or amended equity incentive plans each year from 2018 to 2023. We analyzed each of those proposals and determined there is no evidence of a change in shareholder support.

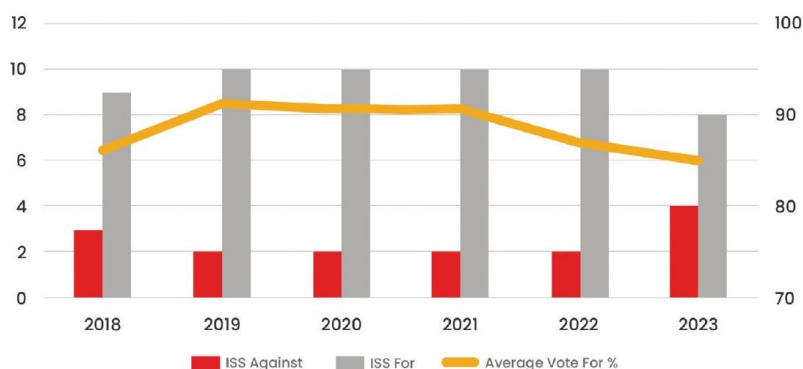
The chart at right shows that ISS recommendations "Against" did not increase over time, nor did "Average Vote For %" decrease in a meaningful way.

If your company is planning to ask for an equity plan pool replenishment multiple years in a row, the factors below are worth considering:

1. Receiving proxy advisor support on an equity plan proposal doesn't necessarily seal the deal, nor is proxy advisor support often necessary for passage. While investors often use proxy advisors ISS and Glass Lewis recommendations as inputs for their evaluations of equity plan proposals, many ultimately determine whether an equity plan proposal merits support based on dilution, burn rate and the company's business rationale. Several large institutional investors have thresholds for these factors that are more stringent than those in ISS or Glass Lewis policies—lower dilution limits, for example. As such, knowing your company's shareholders and their specific policies before your plan goes to vote is critical. Alliance Advisors can provide you with an equity plan projection to determine the likely vote outcome.

2. Commitments needed to secure ISS support when replacing an existing equity plan. When companies seek approval of a new equity plan and intend to terminate and cancel the remaining shares available in an existing equity plan, proxy disclosures need to be clear on this intention. Otherwise, ISS may include the remaining shares available under the old plan in its calculation of plan

Asking for New Equity Plan Shares Six Years in a Row



The chart above shows that ISS recommendations "Against" did not increase over time, nor did "Average Vote For %" decrease in a meaningful way.

costs [termed shareholder value transfer, or SVT, by ISS]. This would render the plan more costly and negatively impact scoring under the Equity Plan Scorecard [EPSC]—ISS' tool for analyzing employee stock incentive programs.

ISS revised its policy to require an explicit commitment that: [a] no further shares will be granted under the existing plan unless the successor plan is not approved, or [b] the number of shares available under the successor plan will be reduced by shares granted under the existing plan prior to the successor plan's approval.

3. If your company's equity awards are heavily concentrated at the NEO level, check your pay-for-performance alignment.¹ Some issuers are surprised to learn that having a pay-for-performance [PFP] misalignment could negatively impact ISS' recommendations on equity plans in situations where the majority of equity awards are concentrated in the C-Suite. This is in fact possible even when the equity plan scores favorably under ISS' EPSC evaluation if ISS considers that the equity grant practices are driving the misalignment. To avoid any surprises, it is advisable to calculate equity concentration ratios for your CEO and NEOs and run a pay-for-performance simulation to see if there will likely be an elevated PFP concern. Having a broad-based plan is also a positive feature.

While there are numerous factors that feed into the evaluations that proxy advisors and institutional investors use, the aforementioned are considerations that are sometimes overlooked. Awareness and preparation for these can go a long way in seeing an equity plan over the finish line.



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¹ While ISS and Glass Lewis methodologies for determining whether executive pay and company performance are aligned vary, these quantitative tests are an important component of both proxy firms' evaluations of Say-on-Pay proposals. Essentially, they look at the relationship between executive pay and company performance, as measured by total shareholder return [TSR], over multiple periods on both an absolute and relative basis.