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Anatomy of ISS: A Current Compensatory Perspective

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- Questions during this presentation
  - We encourage questions (even though your audio lines are muted)
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  - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

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About Anthony “Tony” Eppert

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- Tony practices in the areas of executive compensation and employee benefits
- Before entering private practice, Tony:
  - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
  - Obtained his LL.M. (Taxation) from New York University
  - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
    - Editor-in-Chief, Journal of Medicine and Law
    - President, Tax and Estate Planning Society

Upcoming 2025 Webinars

- 2025 webinars:
  - Preparing for Proxy Season: Start Now (Annual Program) (9/11/25)
  - Non-Employee Director Compensation (10/9/25)
  - Pros, Cons and Contrasting Secular Trusts and Rabbi Trusts (11/13/25)
  - Year-End Review of Any Missed Executive Compensation Items (12/11/25)

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Our Compensation Practice – What Sets Us Apart

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- Compensation issues are complex, especially for publicly-traded companies, and involve substantive areas of:
  - Tax,
  - Securities,
  - Accounting,
  - Governance,
  - Surveys, and
  - Human resources

- Historically, compensation issues were addressed using multiple service providers, including:
  - Tax lawyers,
  - Securities/corporate lawyers,
  - Labor & employment lawyers,
  - Accountants, and
  - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

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- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation

Our Compensation Practice – What Sets Us Apart (cont.)

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- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement "best practices"
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

ISS Five Global Compensation Principles

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- From the compensatory perspective, the framework of ISS is built around the following 5 global principles:
  - Maintain appropriate pay-for-performance alignment, with an emphasis on long-term shareholder value;
  - Avoid pay-for-failure arrangements or risk of such arrangements;
  - Maintain an independent Compensation Committee;
  - Provide clear and comprehensive compensation disclosures; and
  - Avoid inappropriate pay to non-executive directors (*i.e.*, don't allow pay to compromise independence)

U.S. Voting Guidelines: Generally

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- Vote against say-on-pay proposals if:
  - There is a misalignment between CEO pay and performance of the issuer (*i.e.*, pay-for-performance),
  - The issuer maintains <u>significant</u> problematic pay practices, or
  - The Board exhibits poor communication and responsiveness to its shareholders

- Vote against or withhold from members of the Compensation Committee (and possibly the full board) and against the say-on-pay proposal if:
  - There is no say-on-pay vote on the ballot and an against vote would otherwise have been warranted due to any of the above,
  - The prior say-on-pay proposal received less than 70% support of the votes cast and the Board failed to adequately respond with disclosure of engagement efforts with major institutional investors, disclosure of concerns voiced by lead dissenting shareholders, and disclosure of meaningful responsive action by the Company, or
  - The issuer has recently practiced or approved a problematic pay practice

U.S. Voting Guidelines: Equity & Incentive Plans

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- For equity-based compensation plan proposals, generally vote in accordance with the outcome of the equity plan scorecard

- Additionally, vote against the proposal if certain conditions exist, including:
  - There is a liberal change-in-control definition,
  - The plan would permit repricing without shareholder approval,
  - The plan is a vehicle for problematic pay practices,
  - The plan creates a significant pay-for-performance disconnect, or
  - The plan is excessively dilutive to shareholders

- Vote in favor of proposals to amend equity and incentive plans if the amendment addresses administrative features only

- All other votes are on a case-by-case basis
  - Requests for additional shares will be based upon the Equity Plan Scorecard evaluation and the overall impact of the amendments
  - If there is no request for additional shares, and no request to extend a term, then the request is based upon the overall impact of the amendment and the Equity Plan Scorecard evaluation will be shown for informational purposes only

U.S. Voting Guidelines: Equity & Incentive Plans (cont.)

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- Vote in favor of a proposal to implement an ESOP (or an increase to the shares of an existing ESOP) unless the ESOP would own more than 5% of the outstanding shares

- Vote in favor of a proposal to implement an ESPP if:
  - The discount is no greater than 15%,
  - The offering period is 27 months or less, and
  - The number of shares allocated to the ESPP is 10% or less of the outstanding shares

- Vote against an ESPP proposal if:
  - The discount is greater than 15%,
  - The offering period is more than 27 months, or
  - The number of shares allocated to the ESPP is more than 10% of the outstanding shares

U.S. Voting Guidelines: Non-Employee Directors

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- ISS has a policy with respect to evaluating proposals seeking shareholder ratification of non-employee director cash or equity compensation

- Qualitative factors that will be considered include:
  - Director compensation compared to issuers with a similar corporate profile,
  - Any problematic pay practices with respect to non-employee director compensation,
  - The presence of any stock ownership guidelines (i.e., at least 4x the annual cash retainer) or hold requirements applicable to non-employee directors,
  - Vesting schedules with respect to equity awards,
  - The mix between cash and equity compensation,
  - The presence of any meaningful limits on director compensation (i.e., likely resulting from *Seinfeld* and *Calma*),
  - The presence of retirement benefits or perquisites, and
  - The quality of the disclosure addressing non-employee director compensation

- The above last bullet is yet another reason why robust disclosure should be included within the narrative that directly precedes the Director Compensation Table of the proxy statement

U.S. Voting Guidelines: Non-Employee Directors (cont.)

- With respect to an equity plan proposal for non-employee directors, ISS recommends voting on a case-by-case basis, based upon:
  - The estimated cost of the equity plan relative to the industry and market cap peers, measured by the Company’s estimated SVT (described in later slides);
  - The Company’s 3-year burn rate relative to its industry/market cap peers; and
  - The presence of any egregious plan features

Board Responsiveness & Communications

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- In evaluating an item on a ballot, ISS will consider the Board's responsiveness to investor input and engagement on compensation issues

- Bad facts include:
  - Failure to respond to a majority-supported shareholder proposal on executive pay,
  - Failure to "adequately" respond to a prior say-on-pay proposal that received less than 70% of the votes cast

- Addressing this latter point, ISS will evaluate:
  - The issuer's response, including:
    - Whether the issuer adequately addressed and disclosed engagement efforts with major institutional shareholders on issues giving rise to the low support
    - Whether specific actions were taken to address the issue, and
    - Whether any other actions were taken by the Board

  - Whether the issues raised are recurring or isolated;
  - The issuer's ownership structure; and
  - Whether support was less than 50% (which would require the highest degree of responsiveness)

Problematic Pay Practices

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- There are numerous problematic pay practices that ISS will evaluate on a case-by-case basis to determine whether such are contrary to a performance-based pay philosophy, including:
  - Multi-year guarantees of pay,
  - Excessive new-hire packages,
  - Incentives that motivate excessive risk-taking (discussed on next slide),
  - Abnormally large bonus payouts without performance linkage or proper disclosure,
  - Egregious pension/supplemental executive retirement plan payouts,
  - Excessive or extraordinary perquisites,
  - Excessive severance and/or change-in-control provisions (*e.g.*, single triggers, new or materially amended agreements containing excise tax gross-ups, etc.),
  - Excessive reimbursement of income taxes,
  - Dividends or dividend equivalents paid on unvested performance shares or units,
  - Internal pay disparity (*i.e.*, excessive differential between CEO total pay and that of the next highest paid NEO), and
  - Repricings without prior shareholder approval

Problematic Pay Practices (cont.)

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- Additionally, there are certain problematic pay practices that are deemed "significant," the presence of which will likely result in an adverse recommendation from ISS, such being:
  - Repricing without shareholder approval,
  - Excessive perquisites or tax gross-ups,
  - New or extended executive agreements that provide for:
    - Change-in-control payments exceeding 3x base + average/target/most recent bonus,
    - Single trigger or modified single trigger change-in-control severance payments without a substantial diminution of duties,
    - Excise tax gross-ups for change-in-control payments,
    - "Good Reason" termination definitions that are not conducive to an adverse constructive discharge theory and present windfall risk. [Note: Definitions that are triggered by the failure of an acquiring entity to assume the agreement in question no longer trigger the problematic pay practices policy.]
    - Multi-year guaranteed awards or increases that are not at risk due to rigorous performance conditions, and
    - Liberal change-in-control definition combined with any single trigger change-in-control benefits
  - Insufficient executive compensation disclosure by externally-managed issuers, such that a reasonable assessment of the pay programs and practices for such externally-managed issuers is not possible
  - Severance payments made when termination is not clearly disclosed as involuntary,
  - Any other provision or practice deemed to be egregious and presents a significant risk to investors

Problematic Pay Practices (cont.)

- The following are examples of incentives that could motivate excessive risk-taking:
  - A single or common performance metric used for both short-term and long-term plans,
  - Multi-year guaranteed bonuses,
  - Mega annual grants providing unlimited upside and no downside risk, and
  - High pay opportunities relative to industry peers

- ISS acknowledges that risky incentives can be mitigated with rigorous clawback provisions and robust stock ownership/holding guidelines

Problematic Pay Practices (cont.)

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- Excessive non-employee director compensation
  - ISS will issue an adverse vote recommendation for board members responsible for approving non-employee director pay when the issuer exhibited a recurring pattern of excessive pay without a compelling rationale over two or more consecutive years
  - The following circumstances would typically mitigate concern:
    - Onboarding grants for new directors that are clearly identified to be one-time in nature, and
    - Payments related to corporate transactions or special circumstances
  - To determine whether compensation is excessive, ISS will compare individual non-employee compensation to pay outliers, representing individual non-employee directors who are paid above the top 2% of all comparable directors within the same index and sector
- Front-loaded awards
  - ISS is unlikely to support front-loaded awards that are intended to replace grants covering more than 4 future years (*i.e.*, the grant year plus three future years)
  - With respect to front-loaded awards of 4 years or less, ISS requires the issuer to make a firm commitment to not grant additional awards over the covered period

Equity Plan Scorecard

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- The equity plan scorecard (EPS) was adopted by ISS in 2015 and weighs positive and negative factors around the following 3 pillars (EPS does not apply to non-employee director plans):
  - Plan cost,
  - Plan features, and
  - Grant practices

- “Plan cost” means the total estimated cost of the issuer’s equity plans relative to industry/market cap peers, measured by the issuer’s estimated Shareholder Value Transfer (SVT) in relation to peers. [SVT measures the estimated value of the issuer that will be transferred to employees & directors] Plan cost considers both:
  - SVT on new shares requested, plus outstanding unvested/unexercised grants; and
  - SVT on new shares requested, plus shares remaining for future grants

- “Plan features” considers:
  - The presence of any single-trigger awards,
  - Discretionary vesting authority,
  - Liberal share recycling,
  - Lack of minimum vesting periods,
  - Dividends payable prior to the award becoming vested, and
  - Quality of disclosure of award upon a change-in-control

Equity Plan Scorecard (cont.)

- "Grant practices" considers:
  - The issuer's 3-year burn rate relative to its industry/market cap peers;
  - Vesting provisions in the most recent CEO equity grants (with a 3-year look-back);
  - The estimated duration of the plan (based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted during the prior 3 years);
  - The proportion of the CEO's most recent equity grant/awards subject to performance conditions;
  - The existence of any clawback policy, provided, however, that no points for a clawback policy will be provided if the policy only complies with the minimum requirements of Dodd-Frank because such Dodd-Frank rules generally exempt time-based vesting equity from compensation covered by such policy (thus in order to receive credit for being "robust," the policy must explicitly cover all time-vesting equity awards);
  - The existence of any post-exercise or post-vesting share-holding provisions

- For S&P 500 and Russell 3,000 issues, each of the above 3 pillars have the following scoring, with 59 (S&P 500) or 57 (Russell 3000) or 55 (Non-Russell 3000) points out of 100 potential points required to "pass":
  - Plan cost = 43 (S&P 500, Russell 3000) and 45 (non-Russell 3000) potential points
  - Plan features = 22 (S&P 500 and Russell 3000) or 29 (Non-Russell 3000) potential points
  - Grant practices = 35 (S&P 500 and Russell 3000) or 26 (Non-Russell 3000) potential points

Pay-for-Performance

- The purpose of the pay-for-performance analysis is to identify strong or satisfactory alignment between pay and performance over a sustained period. For companies in the S&P1500 or Russell 3000, the requisite alignment consists of two parts:
  - 1st part – peer alignment
    - Addresses the degree of alignment between the issuer's annualized TSR rank and the CEO's annualized total pay rank within a peer group, measured over a 3-year period
    - The rankings of the CEO's total pay and the Company's financial performance within a peer group, measured over a three-year period
    - Analyzes the multiple of the CEO's pay relative to the peer group median in the most recent fiscal year

    (For purposes of the above, the peer group will generally consist of 12-24 companies, organized by market cap or revenue (assets for financial institutions), GICS industry group, and certain of the issuer's selected peer group members. Market cap is the only metric for oil, gas and consumable fuels companies)

    - If needed, ISS will use a financial performance measure to assess the alignment of CEO pay and the Company's performance using performance metrics from: return on invested capital, return on assets, return on equity, EBITDA growth, and cash flow (from operations) growth
  - 2nd part – absolute alignment
    - Addresses the degree of alignment between the trend in the CEO pay and the issuer's TSR over the prior five fiscal years

Pay-for-Performance (cont.)

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- If ISS believes the peer group alignment or absolute alignment demonstrates the existence of significant misalignment of long-term pay-for-performance, then it will analyze certain other qualitative factors, including:
  - The ratio of performance-based to time-based equity awards, as well as the overall ratio of performance-based compensation to discretionary or fixed compensation;
  - Whether performance targets are easily achievable;
  - The issuer’s peer group benchmarking practices;
  - Realizable pay compared to grant pay;
  - Disclosure practices; and
  - Other relevant factors

Other Thoughts

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- Texas Senate Bill 2337 introduced new regulations that will require proxy advisors (e.g., ISS) to make certain disclosures when making voting recommendations to shareholders of Texas companies if such voting recommendation is not solely in the financial interests of the company (e.g., ESG – which include DEI within the "S") and certain other factors are present (e.g., the recommendation is inconsistent with the recommendation from the issuer's management team)
  - SB 2337 becomes effective September 1, 2025
  - The bill is intended to promote transparency with respect to recommendations that prioritize an agenda that is other than financial returns
  - Under SB 2337, a Texas company is one organized in Texas, has a principal place of business in Texas OR is in process of becoming re-domesticated in Texas
  - Such disclosure includes a written statement within the recommendation that such advice is not based solely on the financial interests of the shareholders, and the disclosure must explain how the non-financial interests contained within the recommendation might conflict with the financial interests of the shareholders

- In July 2025, ISS and Glass Lewis each filed lawsuits to challenge SB 2337 alleging violation of First Amendment rights

- Stay tuned

Don’t Forget Next Month’s Webinar

- Title:
  - Preparing for Proxy Season: Start Now (Annual Program)
- When:
  - 10:00 am to 11:00 am Central
  - September 11, 2025