Pay for Performance – Current Trends and Best Practices

1. There have not been any significant changes to performance compensation since the amendments to Section 162(m) of the Internal Revenue Code made by the Tax Cuts and Jobs Act, except that (1) the number of equity plan proposals has decreased and (2) companies are taking advantage of the ability to increase their use of discretion.

2. Performance goals should reflect a company's business strategy. In setting compensation performance goals, a company should ask two key questions – first: "what is our business strategy?" and second: "what performance goals will help us motivate employees to further that strategy?" Since the amendment of Section 162(m) noted above, such performance goals may include "soft" or non-financial goals, such as rewarding the CEO for completing certain steps in a succession plan or for increasing customer satisfaction.

3. Typically, long-term incentive compensation programs use more than one performance goal, including at least one earnings metric (such as Net Income, EBITDA, or net operating profit) and one return metric (such as ROIC, EPS, or TSR).

4. Relative performance goals (such as relative TSR) are popular performance goal choices because relative goals do not require a "crystal ball" to predict future income, profit, or expenses.

5. Regardless of the performance goals a company selects for its annual and long-term incentive compensation programs, those goals and the progress towards achieving those goals should be communicated to program participants to maintain their focus and line of sight. Quarterly communications have evolved as a "best practice."

6. Economic Value Added (EVA) is a performance metric that has been well received by the investor community and is now being used by ISS in its pay-for-performance modeling, but it has not been widely adopted by issuers (it is currently estimated that 6% of companies use EVA as a performance metric in their incentive compensation programs).

7. EVA is calculated as Net Operating Profit After Tax – (Weighted Average Cost of Capital x Capital Invested).

8. Compensation clawbacks that cover financial restatements have become a "best practice" even though the SEC has not yet issued the final clawback rules under Dodd-Frank.

9. A recent trend is companies expanding (or considering expanding) their compensation clawback policies to include clawbacks for violation of company policies (including, for example, anti-harassment policies) or other behaviors that could be detrimental to the company's reputation. However, panelists caution against making these policies too broad – if these policies are so broad that they cannot or will not be enforced by the company, they may create issues from a PR perspective in the event that a company *can* clawback compensation, but chooses not to do so.

10. Companies considering expanding their compensation clawback policies should also confirm that such policies are consistent with their other executive compensation documents. For example, companies should consider (1) whether their clawback policies cover a broader range of behaviors than the provisions in their employment agreements relating to "for cause" terminations and (2) whether their standard separation and release agreements account for potential compensation clawbacks post-termination of employment.

11. The SEC adopted final hedging disclosure rules in 2019. Most issuers must begin to comply with the new rules in their proxy or information statements for the election of directors during fiscal years beginning on or after July 1, 2019. However, smaller reporting companies and emerging growth companies need not comply until they file proxy or information statements for the election of directors during fiscal years beginning on or after July 1, 2020. Most issuers are likely already including disclosure in their proxy statements regarding their anti-hedging policies, but issuers should review the final rules to ensure that their disclosure fully complies with the rules, especially since the definition of what constitutes a "hedging transaction" may be broader than the definition previously used by issuers.