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Glass Lewis Clarifies its Approach to "One-Off" Equity Awards for Executive Officers

In recent years, proxy advisory firms have increased their focus on special retention and new-hire equity grants for executives. Glass Lewis' 2016 policy updates provide a much-needed clarification on how such awards will be viewed going forward.

In mid-November, Glass Lewis released its final proxy voting policies and methodologies for the upcoming year. While most compensation policies remained largely intact from prior years (see our complete summary of compensation and governance policy changes here), this year's release includes much-needed guidance on Glass Lewis' approach and requirements for reviewing the use of off-cycle equity grants.

Specifically, Glass Lewis made changes to its executive compensation evaluation in the area of "transitional" and "one-off" awards (Glass Lewis' terms for awards granted outside of incentive plans, including any new-hire and retention awards of cash or stock). These awards are often viewed by companies as necessary "make whole" payments to recruit new executives leaving behind unvested equity awards, and are a long-standing practice.

Nevertheless, in recent years, both ISS and Glass Lewis have cited "mega-grants" numerous times as a contributing factor for recommending against a company's say-on-pay vote. This is what makes Glass Lewis' clarification of its policy toward evaluating mega-grants particularly helpful to compensation committees. In a sense, corporate directors and executives have been navigating the governance waters around one-off awards with their hands tied behind their backs—not knowing exactly the terms around the usage of these awards that will get them a thumbs down by proxy advisors.

Glass Lewis says it wants to see issuers clearly disclose the amount of the stock award, the circumstances around the decision to grant the award, the terms of negotiation, and how it will impact ongoing compensation arrangements. The proxy advisory firm says it may review the executive's regular target compensation levels or sums paid to predecessors, where applicable, in evaluating the reasonableness of the award. Glass Lewis also evaluates the terms and size of the grants in the context of the company's overall incentive strategy and granting practices, as well as the current operating environment.

The clarification reinforces the importance of good disclosure. Establishing a case for the necessity of special awards will help proxy advisory firms and your investors understand and, ultimately, support your compensation plan. We recommend the following additional actions to our clients if they are considering a large new-hire or retention grant:

- Run ISS and Glass Lewis pay-for-performance models to understand how a one-off award may impact your say-on-pay vote (Aon Hewitt's governance services now allow Radford and Aon Hewitt clients the ability to model Glass Lewis' policies)
- Be prepared with a response in the event of an ISS or Glass Lewis no vote recommendation and the corresponding actions that you would take

- Consider the feasibility of adding a performance-based component to new-hire and retention grants; tying awards to financial or operating goals typically makes them more palatable

- Disclose how the size of the grant was determined in your CD&A (e.g., target position to market and potentially inclusion of make-whole awards to compensate for equity an incoming executive is leaving behind elsewhere)

- Discuss vesting provisions and emphasize the use of vesting to provide a true retentive value

Overall, while Glass Lewis's clarification is helpful, it does not represent a substantial departure from the "facts and circumstances" approach historically employed by both proxy advisors and institutional investors when evaluating the reasonableness of one-off new hire or retention grants to executives. For companies needing to make such awards, an enhanced CD&A discussion of the grant will continue to be the best means of pre-empting concerns and mitigating risk.

To learn more about participating in a Radford survey, please contact our team. To speak with a member of our compensation consulting group, please write to consulting@radford.com.

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