

A woman with curly hair, wearing a grey blazer, is looking down at a laptop screen. The background is a soft, out-of-focus office setting.

Equity Compensation

What You Need To (OR Should)

Know For 2019

CERTAINTY

INGENUITY

ADVANTAGE

 **Computershare**

Upcoming Events

› Webinar Series

- All Things ESPP @ www.computershare.com/allthingsespp
- All Things Equity Plans @ www.computershare.com/allthingsequityplans

› ESPP Day

- May 16, 2019 Boston
- Learn more at www.computershare.com/esppday

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Introductions



Arthur Meyers

Partner

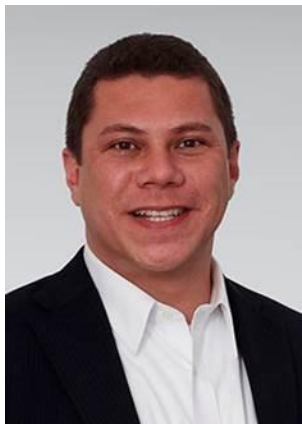
Choate, Hall & Stewart LLP

Art is a partner with Choate Hall & Stewart, a Boston law firm. He focuses his practice on the corporate, employment, tax and securities law aspects of executive and equity compensation, as well as on employee benefits law matters. Art represents a wide range of publicly-traded companies, private businesses, tax-exempt organizations, private equity funds, foreign entities, boards and senior executives. Art is a past president of the Boston chapter of the National Association of Stock Plan Professionals, and is a current member of NASPP's Executive Advisory Committee. He is on the advisory boards of the Eastern New England Chapter of the Society for Corporate Governance and mystockoptions.com. Art is recognized as a leading lawyer in The Best Lawyers in America, Chambers USA and Legal 500. Art graduated from The University of Michigan Law School. He is a frequent speaker on compensation topics. Recently, Art has spoken at conferences for Certified Equity Professional Institute, Charles Schwab, Equilar, E*TRADE, Financial Executives International, Global Equity Organization, NASPP and Society for Corporate Governance.

Introductions

Scott Bellinger, CEP

Vice President, Manager Computershare Plan Managers



Scott Bellinger is responsible for a dedicated and unique relationship management team at Computershare that administers all aspects of both employee equity plans as well as stock transfer agency for a small group of large and fully integrated client companies with highly customizable and complex needs. Scott specializes in bringing an in depth consultative approach to bridging the gap between plan design, system capabilities and ongoing administration. He joined Computershare in 2012 with the acquisition of the Shareowner Services business from The Bank of New York Mellon. He brings over 25 years of experience in the equity compensation, stock transfer agency, corporate banking and financial services industry.

Today's Discussion

- Tax Cuts and Jobs Act of 2018 – The good, the bad and the confusion with 162(m)
- Equity based awards in a volatile market – Preparation for the unknown
- Year 2 CEO pay ratio – Now what....?
- Trending Now..... The #Metoo Movement and Equity Compensation

TAX CUTS AND JOBS ACT (“TCJA”) OF 2018

The good, the bad and the confusion with 162(m)

Prior Section 162(m)

Before 2018 - §162(m) as we knew it:

\$1M per person limit to the annual corporate tax deduction for compensation paid to most named executive officers (“NEOs”) of corporations that were publicly-traded on a US stock exchange

Notable Exceptions:

- › Performance-based compensation such as stock options, performance-vesting stock units (often linked to TSR or earnings), and many cash bonuses and LTIPs
- › Compensation paid after termination of employment such as severance, nonqualified deferred compensation (including deferred payment of equity awards) and death benefits

New Section 162(m) – Potential Negatives

\$1M per person limit to the annual corporate tax deduction for compensation paid to covered employees of corporations that are publicly-held

Expands the definition of “covered employee” to:

- Make it broader than the SEC definition of NEO
- Includes the CFO (again)
- Include any individual who was the CEO or CFO at any time during the fiscal year (instead of a year-end test)
- Permanently treats any individual who was a covered employee in 2017 (or becomes one thereafter) as a covered employee for all future years, regardless of loss of officer status or termination of employment

Expands definition of “publicly held corporation” to include:

- Companies with publicly-traded debt
- Certain large private corporations
- “Foreign private issuers” whose American Depositary Receipts trade on a US stock Exchange

Notable Exceptions:

- ~~Performance based compensation such as stock options, performance vesting stock units (often linked to TSR or earnings), and many cash bonuses and LTIPs~~
- ~~Compensation paid after termination of employment such as severance, nonqualified deferred compensation (including deferred payment of equity awards) and death benefits~~

New Section 162(m) – Future of Performance Awards

- Despite lack of deductibility, most Compensation Committees will continue to follow a pay for performance approach and award performance-based compensation
 - Say on Pay vote
 - Proxy advisory firms
 - Shareholder optics/Media
 - Good governance

- Award designs are becoming more complex as effort is made to combine multiple incentives into a single award

- Often TSR is combined with one or more financial metrics. Independent combinations have been most common, but that might be changing...

New Section 162(m) – Potential Positives

The new rules provide greater freedom in design and operation of plans going forward:

- More flexibility on timing of grants
- More flexibility in setting performance goals
- More flexibility to adjust awards
- No need for Compensation Committee to certify attainment of performance goals
- Reduces need for shareholder approval going forward

New Section 162(m) – Potential Positives

But, ISS's position may temper that freedom:

- Changes to weighting of frequency of shareholder approval in Equity Plan Scorecard
- Certain shifts from performance based pay to discretionary pay may constitute a “problematic pay practice”
- ISS including economic value added (EVA) in its research reports in 2019

Transition to new 162(m)

Transition relief offered under the TCJA:

- Does not limit the deductibility of compensation paid under a “written binding contract” which “was in effect on November 2, 2017” and which is “not modified in any material respect”
- Not enough that a stock or cash plan was in existence on November 2, 2017, award must have been granted, or a binding contract to grant the award must be in existence, with no ability of the employer to exercise discretion or to materially amend the plan or terminate the plan (except on a prospective basis for services not yet performed)

Continued confusion/Need for clarification:

IRS published Notice 2018-68 on August 21, 2018 (“Notice”)

IRS Notice 2018-68

Written binding contract status under the Notice:

- Requires “that the corporation is obligated under applicable law (for example, state contract law) to pay the remuneration”
 - Company’s right to reduce bonus or equity payments may limit grandfathered status to amount not subject to negative discretion
 - Nonqualified deferred compensation plans in effect as of November 2, 2017 in most cases will only be grandfathered as to accrued benefits as of November 2, 2017 because such plans usually reserve the right to reduce or suspend future accruals
- A renewable agreement (e.g., an employment agreement containing a severance benefit that is automatically extended for another year unless notice is given by either party) ceases to be grandfathered as of the effective date as of which the employer may terminate the arrangement

IRS Notice 2018-68 (continued)

Material modifications under the Notice:

- Defined as an amendment to increase the amount of compensation payable
 - Includes acceleration of a payment without a discount for the time value of money
 - Includes deferral of payment of compensation if any interest paid on the deferred amounts is not reasonable
 - Includes side agreement that increases compensation based on the same elements or conditions as the compensation that is paid pursuant to the original written binding contract

Guidance on identifying covered employee status:

- Discussions of the treatment of CFOs
- Impact of a change of control or a delisting

Next Steps

Preserving Grandfathered Status Under Transition Relief:

- Inventory all compensation arrangements that could be grandfathered and determine whether they are grandfathered (note pushback from some independent auditors)
- Consider whether changes or amendments to agreements, plans or awards constitute a material modification
- For a grandfathered plan or agreement, make a new award or payment instead of increasing current one
- Continue to have compensation committee of “outside directors” for grandfathered awards
- Continue to have compensation committee determine and certify performance goals for grandfathered awards
- Adopt new LTIP plans for additional shares

Next Steps (continued)

Consider Design Changes to Mitigate Loss of Deductibility:

- Maintain or decrease number of executives designated as executive officers
- Extend vesting schedules to stay below the \$1M annual limit
- Extend payouts, including automatic deferrals of RSUs
- Implement other benefits such as post-termination medical benefits or enhancements to tax-qualified retirement plans (“QSERPs”)
- Transfer businesses to tax pass-throughs such as LLCs and grant profits interests which do not result in executive compensation subject to §162(m)

Next Steps (continued)

Revise 162(m) Disclosure in Proxy:

- Explain that tax deduction is no longer available for compensation in excess of \$1M paid to covered employees and that definition of covered employee has been expanded
- Reference transition relief for written binding contracts in effect on 11/2/17 that were not materially modified
- Don't give any assurance that prior awards satisfied 162(m) or are grandfathered
- Tell shareholders that company will continue to grant performance-based compensation when appropriate but will not seek shareholder approval of plans, awards or metrics except to extent required by other laws or exchange listing requirements

EQUITY BASED AWARDS IN A VOLATILE MARKET

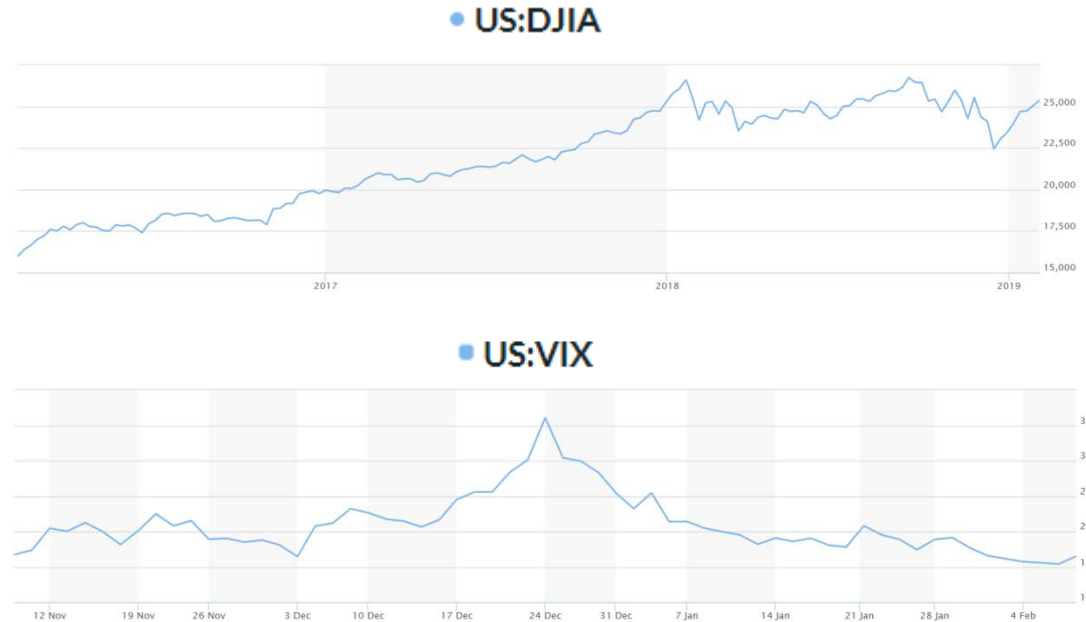
Prepare for the unknown

Volatile Market Environment

Rapidly expanding economy AND a very volatile market...

- Interest rates and uncertain monetary policy
- Earnings slow-down given trailing off of tax cut effects and struggles with global economy
- Foreign policy and global political uncertainty
- National and global debt levels

Is a recession around the corner?
Who knows but we should plan.....



Source: MarketWatch

Executive Compensation in Down Markets

	Equity Environment	Governance Climate	Compensation Strategies
2001 Tech-Led Recession	<ul style="list-style-type: none"> Options heavy Broad-based granting 	<ul style="list-style-type: none"> Relatively lax Free options (no ASC718) Focus on fraud/claw backs 	<ul style="list-style-type: none"> Indiscriminately reprice options
2008 Housing-Led Recession	<ul style="list-style-type: none"> Gradual shift from options Less broad-based granting 	<ul style="list-style-type: none"> Moderate Balancing retention and performance 	<ul style="list-style-type: none"> Value-neutral option exchange programs Performance target resets
The Next Recession	<ul style="list-style-type: none"> Limited use of options 3-Year PSUs Less broad-based grants 	<p>High Governance</p> <p>-----</p> <p>Moderate Governance</p>	<ul style="list-style-type: none"> Limited value restoration Poaching and turnover prevention <p>-----</p> <ul style="list-style-type: none"> Modifications of new varieties Shift to relative awards

Preventative Questions to Consider

- Will turnover increase or decrease in a down-market?
- How will our compensation committee feel about value restoration in a secular downturn?
- Do we have cash and equity available to play offense in a downturn, or do we need to guard against poaching?
- To what extent are our awards insulated from secular downturns?
- Do we have regular investor outreach so that we can take a novel downturn strategy to our key investors?

Recession “Resistant” Award Designs

Design Approach	Choices	Considerations
Relative Awards	<ul style="list-style-type: none"> ▪ Relative TSR ▪ Relative Financial Metric (e.g., EPS) 	<ul style="list-style-type: none"> ▪ rTSR much easier to implement ▪ Slight growth in relative financial ▪ Peer quality, timing, etc. matter
Longer or Shorter Performance Horizon	<ul style="list-style-type: none"> ▪ Implement multiple 1-year metrics ▪ Implement 5- or 7-years stock targets 	<ul style="list-style-type: none"> ▪ Goal-setting easier on 1-yr metrics ▪ Performance recoverability with longer-term stock price targets
Dollar Cost Averaging	<ul style="list-style-type: none"> ▪ Spread grants out over a full year ▪ Expand vesting frequency 	<ul style="list-style-type: none"> ▪ Lessen impact of point-in-time events ▪ Complications with grant spreading
Cash Awards	<ul style="list-style-type: none"> ▪ Cash-settled, equity-linked ▪ Cash-denominated 	<ul style="list-style-type: none"> ▪ Avoid excessive share pool burn ▪ De-link compensation and equity

YEAR 2 CEO PAY RATIO DISCLOSURE

Now what.....?

Median Employee Identification – Year 2

Many companies should be able to use the same median employee in 2019 as they used in 2018

- SEC rules require a company to identify its median employee only once every three years (and calculate total compensation for that employee each year), unless there has been a change in
 - the original median employee's circumstances, or
 - the company's employee population or employee compensation arrangements that the company "reasonably believes would result in a significant change in its pay ratio disclosure"
 - For example, if the median employee used in calculating the 2017/2018 ratio received a large bonus or equity award, the company probably could not use that employee

***** But it may be easier and quicker for many to simply refresh the analysis *****

Disclosure Statements – What We've Learned

- Most investors and compensation professionals agree that the best approach to disclosure is to keep it simple
 - Investors observed that they found lengthy explanations of the ratio and alternative ratios to be confusing
 - Resist the urge to explain or provide supplemental disclosure
- ISS research reports will display the company's disclosed (i) median employee pay figure, and (ii) the CEO pay ratio from the current and prior year (as available).
- Currently, the CEO pay ratio does not impact vote recommendations. ISS will continue to assess the CEO pay ratio data and will continue to receive feedback from investors on the usefulness and application of this disclosure

Disclosure Statements – Some Pushback

A group of 48 public employee union pension funds, religious orders, and social investment funds has suggested supplemental disclosure (which Item 402(u) permits) as to the CEO Pay Ratio and lists 12 what they “believe to be best practices”:

- Identification of the median employee's job function
- Breakdown of the workforce by job function and/or business unit
- Geographic location of the median employee
- Country-level breakdown of global employee headcount
- A breakdown of full time vs. part time employment status
- Use of temporary or seasonal employees
- Use (or non-use) of subcontracted workers
- Tenure and experience of the workforce
- Workforce education levels and skillsets
- The company's overall compensation philosophy
- Employee compensation mix (benefits and incentives)
- Alignment of CEO pay practices with pay practices for other employees

Pay Ratios – Summary

Majority of companies experienced little to no controversy

- ✓ Obvious exceptions
- ✓ More fallout internally with employees

Things to consider going forward:

- Is the calculation process automated and controlled?
 - Turnover
 - Changing circumstances
- Are there other side benefits to capture as a result of the analysis process?
 - Example: many companies use the data gathering exercise to kick-start pay equity studies



TRENDING NOW.....

The #Metoo Movement and Equity Compensation

What Can Be Put Into Place..... Extension of Clawback Policies

- SOX and Dodd-Frank are limited to recovery for fraud and financial misstatements
- Companies sometimes include clawbacks for breach of confidentiality and competition/solicitation
- Trend is to include recovery for violations of company codes of conduct and company policies, including sexual harassment and reputational harm
- Establishing consideration for new company rights to recover or deny payment can be challenging
- Implementation must be thoughtful or some “innocent” candidates may be put-off from joining company

What Can Be Put Into Place..... Other Steps to Consider

- Revise definition of “cause” in employment and severance agreements to cover sexual harassment and other egregious behaviors, and extend to bonus plans, deferred compensation plans and equity plans
- Consider application of post-termination discovery of cause
- Think about redesigning equity awards to pay out over multiple years (not lump sum)
- Weigh implementation of post-vesting holding periods of shares to facilitate clawbacks
- Ask executive candidates to affirm in writing no prior problems as a condition to being hired
- Conduct extensive social media and other due diligence
- When making acquisitions, seek specific representations of no bad behavior by executives within past 5 (or 10) years
- Increase employment practices liability coverage
- Determine whether progress on reduction of incidents of sexual harassment and improved company culture can be incorporated into pay for performance metrics
- Educate Compensation Committee and obtain buy-in from senior management

Questions / Speaker Contact Information



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