Agenda

Equity Plan Votes Scrapped After Tax Reform

By Stephanie Forshee August 6, 2018

Under the **Tax Cuts and Jobs Act of 2017**, public companies are no longer required to put the performance criteria in their incentive plans up for a vote by shareholders every five years. And judging by 2018's proposals, it's likely that most won't in the future.

According to an analysis of S&P 100 proxy statements for 2018 by **Covington & Burling**, most of the companies that would have been due to put their incentive plans up for a vote this year — were it not for the elimination of this rule under Section 162(m) of the tax code — opted not to.

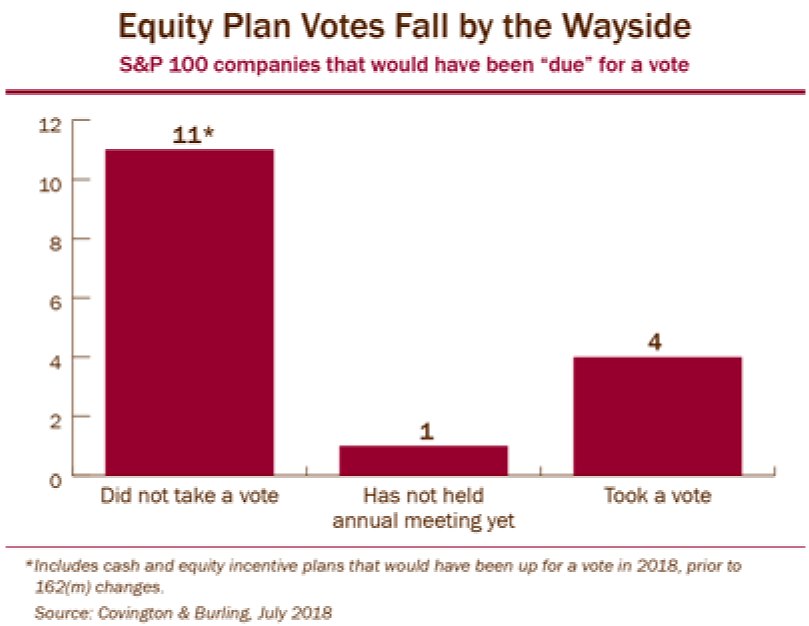
"I suspect this is the beginning of a trend," says **William Woolston**, partner at Covington.

This year, only four of the 14 public companies that held votes on incentive plans in 2013 chose to put their incentive plans up for a shareholder vote, according to the research conducted by Covington.

Nine companies opted not to put the item up for a vote, and one has not yet held its annual meeting.

There were also two cash-based plans that would have otherwise needed to be taken to shareholders this year, but neither company presented them to shareholders, according to Covington.

The law firm acknowledges that it is dealing with a "limited data set" but thinks the findings offer hints, nonetheless, as to what observers can expect next year.



Woolston predicts it's possible that companies will bring the item back to shareholders, though not with the same five-year frequency as before.

He also makes the case that shareholders can still rely on other measures to hold companies accountable for their pay plans. "The proxy advisory services they deal with every year, they're not going away. Say on pay and transparency [in compensation] are big issues that they still care about," he says.

Despite several companies' doing away with the shareholder vote on equity plans, Covington associate **Megan Woodford** points out that "companies have invested in building out their compensation practices," so she's not expecting any other "radical sudden shifts."

That said, she says that companies can view the latest tax reform as "an opportunity for a fresh look" and to "rethink structures."

Rethinking Comp

Under Section 162(m), companies previously enjoyed a tax deduction for executive compensation for equity pay over $1 million — if it was tied to performance. The new tax law scraps those benefits, doing away with the need to justify pay as performance-based.

As **Dan Walter**, managing consultant with **FutureSense**, sees it, 162(m) led to "the existing proliferation of equity as the primary form of pay for executives," since companies were incentivized by the tax deductions to use incentive compensation.

"What that did was accelerate executive pay," Walter says.

Now that those incentives are gone, companies might not feel as compelled to put a premium on performance pay anymore. But that would be a mistake, experts say.

"Shareholders liked having some dialogue on how you're paying [executives] and how that amount is aligned with the performance metrics," says **Kelly Crean**, senior principal at HR consulting firm **Mercer**.

Plus, as Crean and others point out, performance pay still matters to proxy advisors such as **Institutional Shareholder Services** and **Glass Lewis.**

Roy Saliba, ISS's head of global compensation products, says it is undetermined whether the watchdog will issue further guidance on the elimination of 162(m) or focus on the issue in its reports on individual companies.

ISS is also asking investors to weigh in. In a survey released July 30, ISS asks respondents whether it should adjust any metrics used in its pay-for-performance quantitative screen, which currently takes into account total shareholder return and certain other financial measures.

Saliba says that ISS is also awaiting guidance and clarification from the **IRS** regarding the change in tax laws. No release date has been set, but a spokesperson for the IRS confirmed that guidance on this topic is slated to be published.

More Changes Coming?

Meanwhile, with proxy season coming to a close for the bulk of companies, the window is reopening for them to take another look at executive pay plans, though they are advised to be cautious about major changes.

In a Jan. 12 notice to investors, for instance, ISS tells companies to "think carefully about significant departures from your existing compensation framework and, to the extent possible, test those changes with your shareholder base to get early feedback whether they view the changes as beneficial."

That message wasn't received by the compensation committee at **Netflix Inc.**, which days earlier had already signed off on new pay design plans that stripped bonuses from some execs, replacing them with seven-figure salary raises, as *Agenda* has reported.

Both ISS and Glass Lewis advised shareholders to vote no on say on pay at Netflix's June 6 annual meeting. Glass Lewis pointed to the streaming giant's "elimination of performance incentive" as a reason for investors to vote against the company's compensation plan for executives.

Ultimately, the majority voted in favor of the changes in the advisory vote, though a group of shareholders also filed suit as a result of the new compensation plan.

Netflix did not respond for comment on whether it intends to make any additional changes to its compensation packages for executives this year.

Of course, not all companies are expected to take the drastic measures Netflix has.

Executive compensation consultant **Bruce Overton**, who leads the newly created executive compensation division at **Marcum Search**, says that while some companies are expressing concern about losing the tax deduction, he expects the changes as a result of 162(m) to be minimal.

As he points out, a multinational company like **ExxonMobil Corp.**, which brought in $19.7 billion of revenue last year, isn't going to be extremely troubled by losing a few million dollars on tax breaks.

"The larger the company, the less impact," Overton says.