2024 Executive Compensation To-Do List for Public Companies

December 8, 2023

Compensation planning for 2024 is well underway. Here are 10 actions for public companies to consider for the 2024 executive compensation and disclosure season.

1. ENSURE APPROPRIATE RIGOR OF FINANCIAL PERFORMANCE GOALS IN SHORT- AND LONG-TERM INCENTIVE PLANS.

Compensation committees continue to face challenges in setting appropriate financial performance goals for short- and long-term incentive plans due to myriad factors, including higher interest rates, supply-chain disruptions, rising labor costs and evolving consumer preferences. In this uncertain environment, companies must strike a difficult balance: set goals that are achievable to appropriately incentivize executive officers while remaining sufficiently rigorous to meet demands of institutional investors and proxy advisory firms. ISS considers the rigor of performance goals in its qualitative review of the pay-for-performance analysis and may recommend that shareholders vote against the say-on-pay proposal where awards are not at risk due to rigorous performance conditions. Similarly, Glass Lewis may recommend a no vote on the say-on-pay proposal due to insufficiently challenging performance targets.

After short- and long-term goals are set, companies should be wary of midstream changes to lower or waive the targets or, if plan goals are not achieved, granting other awards or paying discretionary bonuses to compensate for the low or absent payout. ISS considers these actions problematic pay practices, and Glass Lewis similarly may recommend a no vote in these situations.

2. REVISIT ESG GOALS IN SHORT- AND LONG-TERM INCENTIVE PLANS.

As a result of increased shareholder attention on environmental, social and governance ("ESG") matters, many public companies have incorporated ESG measures into their short- and long-term incentive plans, including climate and other environmental measures and diversity, equity and inclusion ("DEI") goals. In more recent years, there have been some concerns about the inclusion of ESG metrics in incentive plans. Some institutional investors have criticized "fluffy" ESG metrics that they perceive are being

used to inflate bonus payouts to executives. Proxy advisory firms desire more transparency around proxy statement disclosure of ESG measures, including the rationale for selecting ESG metrics, the target-setting process and associated payout opportunities. The Supreme Court's recent decision in *Students for Fair Admissions v. Harvard and UNC* has led to increased scrutiny of workplace DEI initiatives and triggered an uptick in related lawsuits. Companies should ensure that ESG goals included in incentive plans have a strong tie to long-term business strategy and company value and are sufficiently challenging and consult with legal counsel to assess any attendant legal risks.

3. REVIEW PROXY DISCLOSURES AROUND NON-GAAP MEASURES IN SHORT- AND LONG-TERM INCENTIVE PLANS.

Proxy advisory firms and institutional investors are increasingly focused on the use of non-GAAP measures in incentive programs and, in some cases, pressing for issuers to disclose more than the SEC requires. Public companies should review proxy disclosures around non-GAAP measures and consider enhancing disclosure regarding the reconciliation of non-GAAP results used for incentive payout determinations and reported GAAP results. Item 402 of Regulation S-K already requires disclosure of how incentive target levels that are non-GAAP financial measures are calculated from the issuer's audited financial statements, but disclosure practices around the reconciliation of non-GAAP measures in incentive programs to GAAP results are mixed.

The ISS global benchmark policy survey results reported in October 2023 that 60% of investor respondents replied that line-item reconciliation of non-GAAP adjustments to incentive pay metrics should always be disclosed in the proxy statement, and 35% of investor respondents stated that disclosure is only needed when the adjustments significantly impact payouts and/or when non-GAAP results significantly differ from GAAP payouts. ISS's commentary and the survey results suggest that enhanced disclosure around non-GAAP financial measures in incentive plans may also become part of ISS's say-on-pay methodology as it develops its 2024 voting policies. The recently released Glass Lewis 2024 benchmark policy guidelines provide that, especially in situations where significant adjustments were applied to non-GAAP measures that materially impact incentive pay outcomes, the lack of disclosure about these adjustments may be a factor in Glass Lewis's say-on-pay recommendation.

4. PREPARE FOR THE SECOND YEAR OF PAY-VERSUS-PERFORMANCE DISCLOSURES.

The 2024 proxy season marks the second year of the required pay-versus-performance disclosure under Item 402(v) of Regulation S-K. The year two process generally should

be a lighter lift for companies because only one additional year of the pay-versus-performance table (and necessary calculations of "compensation actually paid") is required. However, because the Securities and Exchange Commission ("SEC") has issued several rounds of Compliance & Disclosure Interpretations since Item 402(v) was finalized—most recently on November 21, 2023—issuers should confirm their calculations of compensation actually paid and other disclosures comply with all current SEC guidance.

Our Debevoise in Depth from August 2022 provides detailed Q&As on the final pay-versus-performance disclosure rules, and our Debevoise Updates from February 2023, September 2023 and November 2023 describe the Compliance & Disclosure Interpretations published by the SEC.

5. REVIEW PERQUISITE DISCLOSURES FOR NAMED EXECUTIVE OFFICERS AND DIRECTORS.

Public companies should review and confirm that all executive and director perquisites, or "perks," are appropriately disclosed in their proxy statements. The SEC continues to bring enforcement proceedings in this area—most recently in June 2023—underscoring the SEC's continued focus on this issue. In-house lawyers and HR teams should review all potential perks and benefits to ensure disclosure compliance, particularly given the disparate treatment of some perks and benefits for tax and securities disclosure purposes. Companies should consider enhanced internal controls, including procedures for approving and tracking perks and the cost thereof to the company, with a special emphasis on personal use of corporate-owned or charter aircraft by executives and directors given the SEC's particular focus on these expenses over the years.

6. REVIEW POLICIES AND PROCEDURES REGARDING TIMING OF OPTION AND SAR GRANTS TO AVOID ANY UNEXPECTED 2025 PROXY DISCLOSURES.

In December 2022, the SEC adopted new narrative and tabular disclosure requirements for stock option and stock appreciation right ("SAR") awards under new Item 402(x) of Regulation S-K. While this disclosure is not required for calendar year-end companies until the Form 10-K or proxy statement that will be filed in 2025, issuers should be aware of the new disclosures, as option and SAR grants made to named executive officers beginning January 1, 2024 may be reportable in a new table if granted within a period starting four business days before and ending one business day after the filing or furnishing of a Form 10-Q, 10-K or 8-K that discloses material nonpublic information. Our recent Client Update includes more information on these requirements and changes to option and SAR grant policies and procedures for companies to consider in 2024.

7. ASSESS NEXT STEPS ON DODD-FRANK CLAWBACK POLICIES.

Listed companies had until December 1, 2023 to adopt a Dodd-Frank clawback policy that complies with the SEC's Rule 10D-1 and the final listing standards of the stock exchanges. The New York Stock Exchange is requiring NYSE-listed companies to confirm via Listing Manager, no later than December 31, 2023, that they have adopted a compliant Dodd-Frank clawback policy. Nasdaq does not currently have an analogous requirement.

In terms of new required disclosures, each listed company must file its Dodd-Frank clawback policy as an exhibit to its annual report on Form 10-K (or Form 20-F or Form 40-F, as applicable). There are also two checkbox disclosures on the cover of each of Form 10-K, Form 20-F or Form 40-F asking (1) whether any financial statements included in the filing reflect the correction of an error to previously issued financial statements and (2) if any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers. In the event a public issuer is required to prepare an accounting restatement that triggered recovery of erroneously awarded incentive-based compensation under its Dodd-Frank clawback policy, listed companies must provide disclosure under new Item 402(w) of Regulation S-K. More detail about these disclosure obligations is available in our prior client alert.

With adoption of the Dodd-Frank clawback policy out of the way, public issuers should now turn to developing their internal clawback policy playbooks. To the extent they have not already, companies should evaluate their compensation programs to determine whether any elements are "incentive-based compensation" within the meaning of the Dodd-Frank clawback policy. Compensation decisions should be documented appropriately, particularly where discretion is used to determine amounts, so that it is clear what amounts are incentive-based compensation covered by the policy in the event of a future recovery obligation. Companies should review clawback provisions in their compensation plans and programs to ensure they are consistent with (and refer explicitly to) the adopted Dodd-Frank clawback policy. Issuers may also contemplate changes to compensation programs to move some incentive compensation out of the remit of Dodd-Frank clawback policies, such as using time-vesting awards or discretionary bonuses, or incorporating strategic or operational measures, which are not considered "financial reporting measures" under these policies and related rules; however, issuers should exercise caution as such changes may impact the alignment with shareholder interests and the principles of pay for performance.

8. CONSIDER ADOPTING A BROADER CLAWBACK POLICY.

Many companies have considered adopting a recoupment policy that goes beyond the Dodd-Frank requirements, either as a separate policy or combined with the Dodd-Frank clawback policy (including by integrating the Dodd-Frank requirements into an existing recoupment policy). These broader policies often (a) cover additional triggers, such as fraud or misconduct, (b) feature a longer or shorter lookback period, (c) expand the class of covered individuals (and subject only those at fault to the policy), (d) expand the types of incentive compensation subject to recovery to include time-based awards, awards with strategic or operational metrics and/or discretionary amounts and (e) provide greater committee discretion in determining whether to pursue recovery under the policy and the amounts subject to recovery.

From a governance perspective, proxy advisory firms expect companies to have broader clawback policies: Under ISS's equity plan score card ("EPSC") approach to evaluating equity compensation plans, ISS will award full points for a policy that authorizes recovery upon a restatement and covers *all or most equity-based compensation* for all named executive officers. A Dodd-Frank clawback policy alone will not receive any EPSC points because the policy generally exempts time-vesting equity from the definition of incentive-based compensation. In addition, in the recently updated Glass Lewis 2024 benchmark policy guidelines, Glass Lewis stated that clawback policies should provide companies with the ability to recover incentive compensation "when there is evidence of problematic decisions or actions, such as material misconduct, a material reputational failure, material risk management failure, or a material operational failure, the consequences of which have not already been reflected in incentive payments and where recovery is warranted."

There may be additional incentives for companies to adopt a broader clawback policy for fraud or misconduct. This year, the DOJ implemented a Compensation Incentives and Clawbacks Pilot Program under which companies may seek additional fine reductions where they successfully claw back (or even attempt to claw back) compensation from individual wrongdoers, including from culpable employees and others who had supervisory authority over the employees or business area engaged in the misconduct and/or knew of, or were willfully blind to, the misconduct.

9. STAY UP TO DATE ON NONCOMPETE DEVELOPMENTS AND CONSIDER REVIEWING RESTRICTIVE COVENANT PROGRAMS.

In recent years, there has been a growing movement to ban or otherwise restrict post-employment noncompetes. The Federal Trade Commission is currently considering a proposed rule that would ban noncompetes for most workers, while New York is

likewise considering an even broader ban and several other states have recently passed laws restricting or banning noncompetes or making them more difficult to enforce. The Delaware Court of Chancery, in a string of recent cases, has also applied additional scrutiny to noncompetes, invalidated noncompetes deemed "overbroad" and declined to blue pencil these provisions. Employers should monitor legal developments at the federal level and in those states where business employees reside and work. Even in instances where noncompetes remain permissible, a more judicious approach is recommended, especially concerning low- and middle-wage workers. Priority should be given to implementing noncompetes with employees with access to trade secrets, those engaging with customers in ways that afford them access to customer "goodwill" and individuals possessing unique skills critical to the organization. Employers should consider a thorough review and update of their form restrictive covenants. This includes (1) reviewing the scope and duration of noncompetes to align with the employer's legitimate business interests, (2) revisiting provisions related to confidential information, customer nonsolicitation and trade secret protection and (3) identifying agreements where employee- and state-specific modifications should be included. An emphasis on narrowly drawn and individually tailored restrictive covenants, though seemingly providing a more limited scope of protection, can ultimately result in greater enforceability.

10. REVIEW SEPARATION AGREEMENTS AND OTHER EMPLOYEE DOCUMENTS FOR COMPLIANCE WITH SEC WHISTLEBLOWER PROTECTIONS.

The SEC's Rule 21F-17(a) promulgated under the Securities Exchange Act generally prohibits companies from taking any action to impede an individual from communicating directly with SEC staff about a possible securities law violation. The SEC has brought more than 20 enforcement actions since 2015 (including three in recent months) for violations of Rule 21F-17(a), centering around language in employee agreements that the SEC views as impeding individuals from communicating with the SEC staff or receiving monetary awards for reporting securities law violations. The SEC has taken an expansive view of what type of language in agreements and communications with employees limit or discourage the employee's ability to communicate with the SEC staff. Some of the provisions at issue in the SEC's complaints are fairly common in confidentiality and nondisclosure agreements, employment and separation agreements, employee releases, employee handbooks, compliance manuals, codes of ethics and other company policies, such as provisions requiring an employee to represent that no complaints or charges have been filed against the employer as a condition to receiving compensation and other benefits. Companies should consider a full review of such documentation to confirm no terms or provisions could be interpreted by the SEC to prevent or discourage employees from exercising protected whistleblower rights.

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For more information about disclosure considerations for the 2023 annual reporting season, including related to Rule 10b5-1 trading arrangements by officers and directors and insider trading policies, see our recent Client Update. Please do not hesitate to contact us with any questions.

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