

Hot Compensation Topics

Presentation for:

Executive Compensation Academy -
(Monthly Training Series)
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Presentation by:

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Housekeeping: Questions

- Questions during this presentation
 - We encourage questions (even though your audio lines are muted)
 - To submit a question, simply type the question in the blank field on the right-hand side of the menu bar and press return
 - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

Housekeeping: Recording, CE Credits and Disclaimer

- Recording
 - This presentation is being recorded for internal purposes only
- Continuing education credits
 - A purpose of the webinar series is to provide FREE CE credits
 - To that end, each presentation is intended to provide 1 credit hour in the following areas:
 - CLE: 1 credit hour (CA, FL, GA, NC, NY, TX and VA)
 - CPE: 1 credit hour (Texas)
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 - SHRM: This program is valid for 1 PDC for the SHRM-CPSM or SHRM-SCPSM
 - If you have any questions relating to CE credits, please direct them to Anthony Eppert at AnthonyEppert@HuntonAK.com or 713.220.4276
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 - This presentation is intended for informational and educational purposes only, and cannot be relied upon as legal advice
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About Anthony “Tony” Eppert



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- Tony practices in the areas of executive compensation and employee benefits

- Before entering private practice, Tony:
 - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
 - Obtained his LL.M. (Taxation) from New York University
 - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
 - Editor-in-Chief, Journal of Medicine and Law
 - President, Tax and Estate Planning Society

Upcoming 2021 Webinars

- 2022 webinars:
 - Solving for the Tug-of-War Between Deferred Taxation and Long-Term Capital Gains (3/10/22)
 - Remote Workers: Analysis of Applicable State & International Tax Issues (4/14/22)
 - Current Compensation Designs within Partnership Entities (5/12/22)
 - Granting Equity Abroad: Applicable Tax Considerations (6/9/22)
 - How to Effectively Vet and Hire a Compensation Consultant (7/14/22)
 - Navigating Compensation Rules Applicable to Financial Institutions (8/11/22)
 - Preparing for Proxy Season: Start Now (Annual Program) (9/8/22)
 - Compensation Considerations Due to Upcoming Loss of EGC Status (10/13/22)
 - Aging Executive: Thoughts on Designing Succession Strategies (11/10/22)
 - [Topic TBD] (12/8/22)

Sign up here: <https://www.huntonak.com/en/insights/executive-compensation-webinar-schedule.html>

Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
 - Tax,
 - Securities,
 - Accounting,
 - Governance,
 - Surveys, and
 - Human Resources

- Historically, compensation issues were addressed using multiple service providers, including:
 - Tax lawyers,
 - Securities/corporate lawyers,
 - Labor & employment lawyers,
 - Accountants, and
 - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



Our Compensation Practice – What Sets Us Apart (cont.)

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement “best practices”
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

After-Acquired Evidence Clause and Clawbacks

- After-acquired evidence clauses
 - Consider a scenario where an executive’s employment is terminated by the issuer without Cause, and subsequently the Board learns information that, had such information been known to the Board at the time of the adverse employment action, would have resulted in the Board terminating the executive’s employment for Cause
 - Inserting after-acquired evidence clauses within contracts allows the Board to subsequently recharacterize a prior without Cause termination to a Cause termination
 - Practice note if representing the executive’s interest: the contractual language should further provide that if the Board utilizes the after-acquired evidence clause, then the waiver and release the executive signed at the time of his or her termination of employment shall be rescinded and void

- The concept of an after-acquired evidence clause pairs nicely with an issuer’s clawback policies

Dodd-Frank Clawback Policy

- As background, Dodd-Frank clawback policies would (when contrasted to Section 304 of SOX):
 - Apply to current and former executive officers (whereas SOX applies only to the CEO and CFO)
 - Triggered when an accounting restatement results from “material” noncompliance with a financial reporting requirement under securities laws (whereas SOX applies only if a restatement is “required” and is the result of “misconduct”, thus, SOX has a fault requirement)
 - Once triggered, it applies to all “incentive-based” compensation
 - The look-back period is the 3-year period preceding the date on which the restatement is required (whereas the look-back period under SOX is 12 months)

- The SEC reopened the comment period

- We “might” see finalized rules in the near future

Proposed Changes to Rule 10b5-1 Trading Plans

- Rule 10b-5 imposes a presumption in favor of liability, such that if a person is “aware” of material non-public information at the time a security is bought or sold, such person is then presumed to be trading based upon such material non-public information
 - But a properly designed trading plan under Rule 10b5-1 would shift the focus from whether an insider had material non-public information at the time of a trade, to whether the insider had material non-public information at the time he or she became committed to the trade. In essence, a trading plan provides insiders with an affirmative defense

- In December 2021, the SEC proposed new requirements that would have to be satisfied before the affirmative defense under Rule 10b5-1 could be applied. Such proposed amendments include:
 - There must be at least a 120-day cooling off period between the adoption of the plan by an insider and any trade commencing under such plan (such cooling off period would apply equally to changes/amendments to existing plans)
 - A requirement that issuers disclose in their quarterly reports the adoption and termination of 10b5-1 trading plans by directors, officers and issuers, and include within such disclosure the terms of such arrangements
 - A requirement that Section 16 officers and directors disclose on Forms 4 and 5 (by checking a box) whether the reported transaction was made pursuant to a 10b5-1 trading plan

T+1 Settlement Cycle

- On September 5, 2017, the settlement period for open market transactions dropped from 3 days (T+3) to 2 days (T+2)
- In December 2021, the Securities Industry and Financial Markets Association, the Investment Company Institute, and the Depository Trust & Clearing Corporation release a report recommending a T+1 settlement cycle
 - The report recommends implementing T+1 in the first and second quarters of 2024
- An example of how the T+1 settlement would occur (compliments from our friends at NASPP)
 - T: Trade occurs and is recorded in the company's recordkeeping system. Once market closes, the stock plan administration team begins processing the transaction
 - T+1: The share issuance request is sent to the transfer agent and the funds needed to cover the price of the shares and any tax withholding are communicated to the broker
 - T+2: The broker picks up the shares and settles the trade
- The concept of T+1 or T+2 only applies to open market transactions and is not applicable to net exercises or share withholding

Document an Annual Grant Policy

- Issuers with volatile stock price should consider having an annual (or more frequently, e.g., quarterly, monthly, etc.) equity grant policy. Reason is that with respect to dollar-denominated awards that are then converted into equity based upon such dollar amount, and assuming there is no such equity grant policy, such issuers could be susceptible to claims from plaintiffs that the executives (or the Board) was timing the market price
 - This topic is not new. Having an equity grant policy became a hot topic during the financial crisis in '08ish

- And too, the SEC guidance on spring-loaded equity awards is yet another reason why issuers should consider whether it makes sense to have an equity grant policy. Under such SEC guidance:
 - Spring-loading occurs when an equity award is granted just prior to a public announcement that the issuer expects will increase its stock price
 - There are two issues with spring-loaded awards. First, the compensation expense will be lower than it would have been had the award been granted immediately following such public announcement. Second, for issuers with dollar-denominated grants, the executive will have received many more shares than he or she would have received had the award been granted after the public announcement when the issuer's stock price would have been higher
 - The SEC guidance differentiates between routine and non-routine grants, and as a result, such implies that routine grants would not be subject to this guidance. Can having an equity grant policy create "routine"? Such policy could, by example, reflect that grants will only occur on the 10th day of each quarter

Tweak to Retirement-Eligible Vesting

- It is common within equity awards to have accelerated vesting if the employee's employment is terminated due to his or her "retirement"
- For this purpose, retirement is often defined as attaining a certain age plus a certain number of years of service with the issuer
 - Example: Retirement means a separation from service with the Company after attaining age 63 and completing 10 years of continuous service with the Company
- Consider whether it makes sense to modify "retirement" provisions to require the employee to provide advance written notice (*e.g.*, 6 months, 12 months, etc.) of his or her intention to "retire"
 - Such advance written notice will help smooth transitions and provide the issuer with time to find or train up a successor
 - Of course, the advance notice requirement would only apply to the situation where the employee is terminating his or her service with the issuer, and would not apply to the situation where the issuer is effectuating the adverse employment action

Don't Forget Next Month's Webinar

- Title:
 - Solving for the Tug-a-War Between Deferred Taxation and Long-Term Capital Gains

- When:
 - 10:00 am to 11:00 am Central
 - March 10, 2022