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February 2025

Policy Changes on the Horizon:

Shifting Views on Performance-Based Equity Compensation

With the 2025 annual meeting season almost upon us, the two leading proxy advisory firms, Institutional Shareholder Services ("ISS") and Glass Lewis & Co. ("Glass Lewis"), continue to shape the executive compensation and governance landscape through their respective voting recommendation policies. While both advisors' 2025 policy updates appear modest, closer inspection reveals shifting views regarding how companies may need to approach compensation strategy and disclosure of equity awards. Taking ISS and Glass Lewis policy shifts under consideration in advance of potential 2026 policy changes (which if made will apply to 2025 compensation decisions) will be key for companies aiming to maintain shareholder support and remain competitive and mitigate risks.

The Changing Design of Performance-Based Equity Compensation

One of the most significant themes emerging from ISS' and Glass Lewis' 2024 policy survey results was investors' evolving views on the ability of *both* performance-based and time-based equity awards to align executives' pay with company performance.[1,2] Historically, both proxy advisors have strongly favored long-term incentive programs with majority weighting on performance-based awards as a critical tool to align executive pay and shareholder interests. However, growing concerns from investors regarding the complexity, effectiveness and rigor of such structures are prompting a reassessment. Further, the divergence in survey responses between ISS and Glass Lewis reveal a growing diversity in views among investors.

This divergence, as well as diversity, in investor views related to performance-based awards may make it more challenging to appease all parties going forward, while giving compensation committees more latitude than in past years to develop bespoke structures that better meet their compensation objectives.

[1] See Glass Lewis survey results here "2024 Policy Survey Results." See full ISS survey results here "2024 ISS Global Benchmark Policy Survey"

[2] Non-investor respondents included in both ISS and Glass Lewis surveys are respondents that identified as corporations, board members, advisors, or "other."

Glass Lewis' survey revealed that while 90.9% of responding investors still believe that performance-based equity awards are key to align executive pay with long-term shareholder interests, there is emerging skepticism**. Approximately 15% of investor respondents and 37% of non-investor respondents expressed a preference for time-based equity awards *over* Performance Stock Units ("PSUs").**

Reflecting these results, Glass Lewis updated its policy to:

(1) expand the list of favorable long-term incentive ("LTI") design elements to explicitly include post-vesting holding requirements as a mitigating factor; and

(2) signal flexibility towards supporting say-on-pay proposals at companies that reduce or eliminate PSUs if the company can provide a clear rationale for the change and include shareholder-friendly practices in the revised LTI structure, such as quantum reductions or extended vesting periods.[3]

ISS' survey respondents expressed significantly more skepticism of PSUs and a desire for ISS to implement future policy changes**: Approximately 43% of investor respondents indicated a desire for ISS to continue with its current approach of considering a predominance of annual equity value in time-based equity awards to be negative whereas predominance of value in performance-based awards is a positive mitigating factor in the event of a "pay-for-performance" disconnect.** Further, while 31% of investor respondents explicitly supported a policy change to treat time-based awards with extended vesting schedules comparable to performance-based awards, ISS indicated "near unanimous" support for a policy change in roundtable discussions with investors on the matter. This approach also resonated strongly among non-investor respondents (70% support). Accordingly, ISS signaled that it *may* make a policy change to address these evolving views as early as 2026, subject to continued consideration of structural details that may make time-based awards compelling for investors. Policy change questions in ISS' survey included whether time-based awards should be required to have extended vesting periods (5+ years) or post-vesting holding requirements to ensure shareholder alignment while keeping simplicity and transparency within the compensation program.

[3] See "Long-Term Incentives" policy on p. 55 of Glass Lewis 2025 Benchmark Policy Guidelines available here

Emerging skepticism toward performance-based shares

Time-based equity awards gains support

ISS

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GLASS LEWIS

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Source: 2024 ISS Global Benchmark Policy Survey | 2024 Glass Lewis Policy Survey Results

While ISS made no changes to its benchmark compensation policies for 2025, new additions to its compensation FAQ document demonstrate that it will exercise heightened scrutiny of performance-based equity awards.[4]

In its FAQ document, ISS notes that performance-based awards will face heightened scrutiny in 2025 in the context of quantitative pay-for-performance misalignment. There will now be heavier emphasis on any performance-based equity design or disclosure concerns in its qualitative review, particularly if pay-for-performance misalignment exists.

[4] ISS 2025 Proxy Voting Guidelines available here.

ISS also provided a "non-exhaustive" list of typical factors it will consider in evaluating performance-based awards, including: (1) non-disclosure of forward-looking goals, (2) poor disclosure of closing-cycle vesting results, (3) poor disclosure of the rationale for metric changes/adjustments or program design, (4) unusually large pay opportunities, including maximum vesting opportunities, (5) non-rigorous goals, and (6) overly complex performance equity structures.[5]

Considerations for Compensation Committees Heading into 2025 Annual Meeting Season

These developments highlight a broadening dialogue around equity compensation strategies, compelling companies to review their LTI programs to ensure a proper balance between transparency, simplicity, resiliency, and shareholder alignment. Regardless of where these proxy advisor policies ultimately land, investors' diversifying views underscore the importance of tailoring compensation programs to a company's specific

Specifically, ahead of 2026 we advise that Compensation Committees consider:

- **Analyzing the company shareholder base:** Understand specific investors' views regarding equity compensation and pay-for-performance alignment, as well as the degree to which each investor specifically relies on ISS' and/or Glass Lewis' voting recommendations in assessing say-on-pay proposals
- **Reviewing compensation structures:** Assess whether existing LTI programs effectively balance the company's retention and motivation objectives while ensuring rigorous goals that align with long-term holistic performance and shareholder interests
- **Enhancing disclosure practices:** Provide transparent explanations for equity award design choices, particularly for performance-based metric goals and award quantum
- **Monitoring policy updates:** Stay informed about investor policy updates, as well as ISS and Glass Lewis announcements, as their voting policies continue to carry significant influence in the market

[5] Full ISS Compensation FAQ document here "US Executive Compensation Policies: Frequently Asked Questions"

Other Updated Policies

ISS and Glass Lewis have made several other policy updates for the 2025 proxy season, including:

Four new/amended ISS Compensation FAQs related to:[6]

- **Realizable Pay Calculations:** Realizable pay includes all non-incentive-based compensation actually paid, the value of equity or cash incentive awards earned, or, if the award remains ongoing, revalued at the target level as of the end of the three-year measurement period. Realizable pay charts will not be displayed in ISS reports for companies that have experienced multiple CEO changes within the three-year measurement period.
- **Changes to In-Progress Incentive Programs: I**SS clarified its approach to evaluating mid-cycle changes to incentive compensation programs, emphasizing that such changes will generally be viewed negatively unless robust disclosures and a clear rationale for the adjustments are provided.
- **Robust Clawback Policy:** In an October 2024 update, ISS explained that for a clawback policy to be considered "robust," it must exceed the Dodd-Frank Act requirements and explicitly cover all equity awards, including time-based awards.
- **Incentive Program Metrics - Considerations for Total Shareholder Return ("TSR"):** ISS noted that it has no preference regarding the use of TSR as an incentive program performance metric. Instead, its evaluation focuses on whether goals are objective/quantifiable, the rationale for metric selection and its link to strategy and shareholder value, the reasoning behind "atypical" metrics or significant year-over-year changes, and disclosure around adjustments for non-GAAP metrics, including their impact on payouts

Additional Governance-Related Policy Changes:

ISS

- **Board Diversity:** For shareholder meeting reports published on or after February 25th, ISS will no longer consider the gender and racial and/or ethnic diversity of a company's board when making vote recommendations with respect to the election or re-election of directors at U.S. companies.[7]

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[6] Full ISS FAQ document here "US Executive Compensation Policies: Frequently Asked Questions"

[7] Full ISS Statement found here "Statement Regarding Consideration of Diversity Factors in U.S. Director Election Assessments"

- **General Environmental Proposals:** ISS rebranded its policies on biodiversity and related topics as “Natural Capital-Related and/or Community Impact Assessment Proposals.” This update broadens the factors ISS considers when reviewing such proposals, better reflecting the variety of submissions companies are likely to receive.
- **Short-Term Poison Pill:** ISS clarified its case-by-case review of “other factors” considered while evaluating whether a board’s action adopting a short-term poison pill was reasonable or whether the adoption should be deemed a governance failure.
- **SPAC Proposals and Extensions:** Addressing concerns around "zombie SPACs", ISS updated its current practice by supporting extensions of up to one year from the original termination date.

GLASS LEWIS

- **Board Diversity:** Glass Lewis is reviewing its approach to voting guidance on board diversity at U.S. companies and will advise investors and companies of any changes to its policies and guidelines in March 2025.[8]
- **Board Oversight of Artificial Intelligence (“AI”):** Glass Lewis expects boards to be cognizant of, and take steps to, mitigate exposure to material risks that could arise from AI. If material incidents exist, Glass Lewis will (1) review governance practices and identify which directors/committees have AI-related risk oversight, and (2) evaluate response/management of the incident and associated disclosures. Glass Lewis may recommend against responsible directors should it find the board’s oversight, response or disclosure insufficient.
- **Treatment of Unvested Equity Awards:** Companies with discretion to accelerate unvested awards must commit to transparency by explaining how these awards will be treated in the event of a change in control.
- **Highly-Supported Shareholder Proposals:** In instances where shareholder-sponsored proposals garner substantial support, typically exceeding 30%, Glass Lewis expects boards to proactively engage with shareholders. Glass Lewis notes that following this engagement, boards should provide comprehensive disclosure that specifically addresses shareholder concerns and outreach initiatives.

[8] According to Reuters February 19, 2025 article “Glass Lewis reviewing DEI policies following recent Trump actions, memo shows”

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Need Assistance?

Compensia has extensive experience in helping companies establish executive compensation programs and practices and developing disclosure of such practices in their proxy materials taking into consideration SEC disclosure requirements, proxy advisor policies and investor expectations. If you would like assistance with or if you have any questions on the subjects addressed in this Thoughtful Disclosure Alert, please contact your regular Compensia team members or the authors of this Alert:

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About Compensia

Compensia is the leading independent compensation advisor to technology and life sciences companies. For more than two decades, Compensation Committees and C-Suites have looked to us to develop customized solutions that balance the interests of a company, its shareholders and its executives.

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