



## Compensation Season 2017

Posted by Michael J. Segal, Wachtell, Lipton, Rosen & Katz, on Saturday, January 7, 2017

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Boards of directors and their compensation committees will soon shift attention to the 2017 compensation season. Key considerations in the year ahead include the following:

### Regulatory Rollback and Tax Law Changes

Companies should closely monitor statutory and regulatory developments in the new year. The president-elect and Congressional leaders have articulated an ambitious agenda to reduce business regulations, simplify the tax code and lower tax rates. Any of these changes could have a significant impact on compensation design. Stay tuned.

### Dodd-Frank Regulations

The SEC adopted final rules regarding pay ratio disclosure in 2015. Registrants must include the pay ratio disclosure for proxy statements filed in respect of the first fiscal year beginning on or after January 1, 2017. If a company has a calendar year fiscal year, it will have to include pay ratio disclosure in its Form 10-K or annual meeting proxy statement filed in 2018. We continue to await final regulations regarding clawbacks, disclosure of pay for performance, disclosure of hedging by employees and directors and financial institution incentive compensation, although the fate of these rules remains uncertain in light of the 2016 election results.

### Say-When-On-Pay

Dodd-Frank requires a nonbinding vote, at least once every six calendar years, to determine the frequency of say-on-pay votes. A public company that first held a say-when-on-pay vote in 2011 must hold another frequency vote during the 2017 proxy season, offering stockholders the opportunity to choose among annual, biannual or triannual say-on-pay votes. In 2011, the vast majority of companies implemented an annual vote. Absent extraordinary circumstances (such as the existence of a controlling shareholder), an annual vote is the prevailing (and perhaps most prudent) approach, as it provides shareholders, ISS and Glass-Lewis with an avenue to express displeasure with a company's compensation program other than by taking action against compensation committee members.

## Say-on-Pay

If a company anticipates a challenging say-on-pay vote with respect to 2016 compensation, it should proactively reach out to large investors, communicate the rationale for the company's compensation programs and give investors an opportunity to voice any concerns. Sooner is better than later.

## Annual Limits on Director Equity Grants

Consider including in new or amended omnibus equity plans provisions specifying the precise amount and form of individual grants to directors or a meaningful director-specific individual award limit. These limits may help to avoid and to defend claims challenging the level of director compensation.

## Equity Award Tax Withholding

Last year, the FASB revised its standards to provide that settling equity awards net of applicable taxes using the maximum, rather than minimum required, statutory tax rates would no longer result in liability (i.e., "mark-to-market") accounting treatment. Accordingly, companies may wish to update their equity plans to incorporate the increased flexibility afforded by the FASB change. Under applicable NYSE and Nasdaq guidance, such a change will not constitute a material amendment requiring shareholder approval. The FASB revision is effective for annual reporting periods beginning after December 15, 2016 and interim periods within those periods.

## Whistleblowers and Release Agreements

It is customary and appropriate for companies to require that an employee execute a release of claims as a precondition to receiving severance or other termination benefits. However, a release must accommodate certain legally mandated exceptions, such as EEOC and whistleblower claims. In the last year, the SEC has penalized at least two companies that entered into agreements that would have had the effect of prohibiting a whistleblower claim. A company should ensure that any nondisclosure of confidential information covenants and release of claims provisions reflect the appropriate exclusions for whistleblower claims.

## ISS

On December 16, 2016, ISS updated its FAQs regarding U.S. executive compensation policies and U.S. equity compensation plans, to, among other things, (i) add to its list of problematic pay practices "payment of bonuses despite failure to achieve pre-established threshold performance criteria," (ii) clarify that a severance formula that includes pay elements other than base salary and bonus constitutes a problematic pay practice, (iii) confirm that, regarding the frequency of say-on-pay votes (see item 3 above), ISS generally will recommend in favor of annual votes, (iv) note that ISS considers single-trigger equity award vesting a "poor practice" and takes into account "windfall potentials" for purposes of the advisory vote on golden parachutes, and (v) encourage companies that are proposing plan amendments, in addition to seeking Section 162(m) reapproval, to unbundle the plan amendments and present them in a separate proposal.

Management and compensation committees should understand the potential consequences of their decisions under applicable ISS policies, but should not waver in their commitment to create a culture that attracts and retains talented personnel who will contribute to the long-term success of the company.