EQUITY-BASED REWARDS FOR 2021 AND WHAT LIES AHEAD – WHAT TO DO ? THE SHORT-TERM TACTICS AND THE LONG-TERM VIEW

REFLECTION PAPER & STUDY

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Zurich, 9th of November, 2020.

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Abstract

In this paper, we aim to analyse the issue of **modern Equity-based Rewards** (both in mature companies and in startups), and suggest some **practical actions** that may be taken by **Remuneration practitioners and related stakeholders**, both from the immediate, short-term perspective, and for the longer term.

We begin by commenting on the effects of **Covid-19**, often adverse, on business overall and on Equity-based Rewards. Then we highlight other factors that are also relevant for the topic, especially **Digital Transformation and the Future of Work**. In this regard, we review some current Equity Rewards / Executive Remuneration literature and publications, and suggest that **"one-size-fits-all", generic recipes need to be considered cautiously in actual Reward implementations**, more so in the light of the many parties having their own views on the matter – proxy advisors such as ISS or Glass Lewis, fund managers, private equity firms, consultants, academia, tax advisors, and a long etc.

For the short-term, we propose **checking non-Equity Rewards also**, with some concrete actions. As regards Equity Rewards themselves, we comment on the **criteria of ISS and of the EU**, showcasing some points of importance but that, again, require management discretion and expertise. We conclude this part with a **complete set of particular possibilities that we offer to practitioners** in terms of eligibility, calculations,

instruments, valuation, periods, tranches, grants, vesting, indicators, pay scales, etc. - the value-added residing on the what, why and how to implement.

We go on to put forward that **the long term cannot be ignored**, despite Covid-19 – which has plenty to do with the **Future of Work**, characterized by us here via the World Economic Forum's latest 2020 Report: brisk pace of **technology adoption**; disruption of companies and **economic models**; change in the nature of jobs; need to reskill workforces.

Whilst identifying **key insights** and **relating them to Equity-based Rewards**, we have the position that on top of points such as Reward periods, discounts & amounts, longer or shorter RSUs, etc., the **central discussion should be about performance indicators and pay scales** – what we are exactly paying for, and how Rewards really contribute to business results, not simply share value growth. In this regard, we illustrate the points with **two real life-based hypothetical examples** that might be inspiring; and remark that **Executive Remuneration and Corporate Governance** will themselves be delivered with **much more technology** (apps, blockchain / DLTs, smart contracts, Artificial Intelligence).

We conclude by stating that **true Equity-based Reward** experts can and should have a role to implement what the WEF defines as **"a new vision for the global workforce"**.

To do that, professionals will need to have certifications and a **longstanding, complete technical design and implementation experience**, not mere "reward product" or partial approaches. With that, **Equity Rewards will continue being a powerful management tool** to lead companies effectively and get them ready for the new world that is coming.

Summarized Content

INTRODUCTION. PURPOSE AND STRUCTURE OF THIS PAPER

- Many parties seem to have an opinion these days on what to do now regarding Equity-based Rewards and overall Board / CEO / Executive Remuneration.
- This Reflection Paper intends to **clarify the landscape** for 2021 and beyond, hopefully both for 1) companies' top-level decision makers, and 2) the people who must design and implement decisions. Also, perhaps to investor groups and other stakeholders.

WHY SHORT-TERM TACTICS VS. LONG-TERM VIEW

- **Covid-19** has brought short- and mid-term **economic shock**, except perhaps for pharma, technology and online selling; change in customers, markets, supply chains; and immediate company measures, such as social distancing, WFH arrangements, furloughs, restructurings – and Reward modifications, often downwards.
- However, even if tremendously impactful, **Covid-19 is not the only factor** to consider in the business world: from Brexit to US and China trade wars, from geopolitical

turbulences to regulation, from shareholder activism to investor scrutiny, many other long-range issues affect Equity-based Rewards. Probably the most important: **Digital Transformation**, which will require to look at the Future of Work.

DEFINITIVELY, HERE "ONE-SIZE-FITS-ALL" DOES NOT WORK

- One-size-fits-all Equity-based Rewards will not a be solution for all companies. In this regard, different "recipes" may need to be **taken cautiously** – longer period time-based only RSUs; personal brands of Bonus indexes; use of some self-coined Equity-based "products"; deferred bonus in form of shares, and others.
- Actually, Proxy advisors such as ISS and Glass Lewis, Investors such as the Norges Bank, other Fund Managers, Family Offices, Private Equities, Venture Capitalists, different Associations, consultants, and academia, all have their **own view**.
- What matters is to **understand well the organization, and design and implement accordingly**: Equity Rewards in a startup from the UK are not quite the same as in a mid-sized, small cap bank in Switzerland, a large family-owned international fashion retailer from Singapore, or a large tech US corporation, for instance.

POSSIBLE SHORT-TERM ACTION AND TACTICS (1, 2 and 3) – reexamining non-Equity Reward elements; ISS perspective; recent legal change and the EU case

- To manage Equity-based Rewards in the short term, first it would be useful to look at **non-Equity elements**: review specific jobs' evaluation and market references, and possibly pay gender gaps; adjust Director fees, Salaries and allowances, Short-term Bonus, Benefits, Mobility Compensation, "Intangible" Rewards, Performance management and target setting / evaluation (action ideas in the main text).
- Then, focusing on Equity-based Reward to-do's for the short-term, we found some recommendations and voting support **criteria from ISS** that may be worth considering, even for non-listed companies, especially around disclosure and rationale explanation of extraordinary measures and changes taken.
- We also discuss the **recent EU Directive on Shareholders' Rights**, which contain a number of provisions regarding Equity Rewards and Executive Remuneration for 2021, emphasizing long-term orientation and sustainability for Rewards and introducing novel disclosure statistics, similar in purpose to the US CEO-median pay ratio.

POSSIBLE SHORT-TERM ACTION AND TACTICS (4) – our particular recommendations

- We proceed with our perspective on **incremental Equity Reward improvements** that could be applicable in the next few months. We suggest a full range of possibilities; the value added may lie on **choosing well what to tackle**, why, and how.

- Such **possibilities** (details in the main text), refer to: calculations and assumptions, eligibility, Pay Mix, target pay / expected On Target Earnings, instruments chosen, valuation method, % of Equity required / dilution, performance indicators, weights, Peer groups if any, pay scales and curves, hurdles / thresholds and caps, tranches, grants and discounts, vesting and exercises, blocking periods, form of payment.
- We also mention the possibility of checking **Internal / external analyses themselves and legally binding documents; tax, accountancy, stock market and treasury implications; process, tools, and communications**.

THE LONG TERM VIEW

- Short-term adjustments for Equity-based Rewards are fair enough, and surely required for companies' immediate financial health. But no business-oriented person can afford to ignore what is happening regarding the **Future of Work**.
- We characterize this Future with the latest **World Economic Forum**'s Future of Jobs Report 2020, which among other points we describe in the main text, with profuse evidence, clearly states that:

✓ *The pace of* ***technology adoption*** *is expected to remain unabated and may accelerate in some areas.*
✓ *The future of work has* ***already arrived*** *for the online white-collar workforce.*
✓ *The number of* ***jobs destroyed will be surpassed by the 'jobs of tomorrow'*** *by 2025, but for now job destruction is prevalent.*
✓ *Created* ***Skill gaps continue to be high****; the window of opportunity to reskill and upskill workers has become shorter in today's constrained labour market.*
✓ *Companies need to invest in better metrics of* ***human and social capital*** *adopting* ***ESG metrics****, matched with* ***renewed human capital accounting****.*

- We believe that with respect to the above, the **central discussion** on Equity-based Rewards is not on how difficult or high it can get, vesting periods, etc., but the **performance indicators, weights and pay scales chosen** – and their alignment with the **expected business plans** and company value for the future (ie what we are exactly paying for, and how), not just share value growth.
- To illustrate our points, we propose **two real-life based hypothetical examples** that Reward practitioners may find inspiring, a **mature market-listed company** and a **startup**. In there we detail many design parameters that can turn out future-ready Equity-based Rewards - with plan duration, vestings and nature, instruments and hedging, target reward, indicators and weights, payout scale, etc.
- We close by expressing that **Remuneration delivery with technology is also the future** – facilitated by apps, blockchain / DLTs, smart contracts, and Artificial Intelligence.

CONCLUSIONS

- As the World Economic Forum states, **“*Businesses, governments and workers must plan to work together to implement a new vision for the global workforce*”** - and true Equity-based Reward experts can and should have a role there.
- To do that, Reward professionals with certification and a **longstanding complete, multidisciplinary technical design and implementation experience**, and not mere “reward product” or partial approaches, will be required.
- To the extent that it can contribute towards long-term value, technological leaps and thriving businesses, **Equity Rewards will continue being a powerful management tool to lead companies effectively** and get them ready for the new world that comes.

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DETAILED CONTENT

Introduction to this Paper (in full)

Headhunters. University and MBA professors. Investor associations. Mercantile law Firms. Labour law practitioners. Fund managers and proxy advisors. Private Equity firms and VC. Management consultants. Investment bankers. Tax advisors. Board associations and “think tanks”. Insurers. Finance directors. Software companies. Regulators. Journalists. And of course, Reward / Remuneration data and service vendors.

Probably seeing very good business in doing so, **many parties seem to have an opinion these days**, for better or worse, **on what to do now regarding Equity-based Rewards** and, in a broader perspective, with overall Board / CEO / Executive Remuneration. Long gone are the days in which these topics were only dealt with by some “chosen few” technical professionals. **Where is the truth ?** Well, **probably a little bit everywhere**. Hopefully, we can contribute to the debate and provide useful **insights for later action**.

Purpose and Structure

In this Reflection Paper **we intend to offer some inspiration and clarify the landscape a bit for 2021 and beyond**, hopefully both for 1) top-level decision makers, even at the investor / Board / Executive level, and 2) the people who have to design and implement the corresponding decisions in practice, with all pros and cons – CHROs, Compensation and Benefits VPs or Directors, Executive Remuneration Directors, or their equivalent. Also, perhaps to investor groups and other interested stakeholders.

More specifically, we think that the **Rewards' profession** company practitioners, sometimes buffeted from several conflicting sides regarding the subject matter of their trade, could **use a little help** in these Covid-19 days - we suspect as much, having been practitioners ourselves, and our latest advisory work very much confirms it -, more so considering that **the Future of Work is becoming a key topic to ponder upon**.

To show our ideas, we have chosen the following structure:

- Why short-term tactics vs. long-term view.
- Definitively, here "one-size-fits-all" does not work.
- Possible Short-term action and tactics – reexamining non-Equity Reward elements, the ISS perspective, recent legal change and the EU case, our particular recommendations.
- The Long-Term view, and Conclusions.

In this text, for ease of discussion, **we will be using "Remuneration" or "Rewards" interchangeably**, even if the former term should be more appropriate for Board, CEO and Executives, which often includes Equity- or Share-based payments, whereas the latter term perhaps is better for Managers and Employees.

Why short-term tactics vs. long-term view

We are not going to dwell for long on the **economic, cultural, and business implications of the current Covid-19 world** themselves; however, we do need to highlight some relevant points before discussing Equity Rewards, maybe as follows:

- **Short- and mid-term economic shock**. Most industries seriously affected, specially some of them such as travel, tourism, hospitality, outside entertainment; a few industries thrive (pharma, high tech, online selling); general macroeconomic downturn and doubts on expected recovery speed; 2020 financial and business objectives changed / not achievable across many companies; target setting uncertainty for 2021; business reconstruction affected by "second wave" of virus.
- **Customers, markets, and demand**. Deep change in "shopping baskets", consumption patterns and customs worldwide; massive events forbidden; customer fear and preoccupation about health; much more online buying.
- **Supply chains and sourcing**. Disrupted overall; long haul transportation affected; decentralization of factories & logistics; unused inventory; local sourcing.
- **Immediate business and work changes**. Employee safety concerns; workplace & telecom infrastructure redesign; virtual teams' organization; social distancing; "closing the office"; WFH arrangements.

There have been a myriad ongoing "pulse surveys" recently by different parties that evince something clear: **many of the measures taken** in terms of general Rewards and People management, **were fairly commonsense, and necessary**: accelerated planning of

WFH vs. selective "return to work" where applicable; enhanced time / resource management; health, safety and wellness actions and deployment of related benefits / insurance; trainings on virtual work; "virtual coffees" and similar to keep "human touch" and morale, etc. We all have also been witnessing more radical action – furloughs, redundancy, compensation freezes.

Regarding Equity-based Rewards, effective immediately or expected for the next Shareholder Meeting, we are seeing: re-targeting of long term incentives, modifying or repricing Stock Options, deferring bonuses or slashing them altogether, changing cash incentives for some form of Share Reward, etc. (we will comment on all that later).

Still, **even if in a difficult-to-predict environment, we cannot forget that larger questions regarding the overall Future of Work remain open**, thus requiring a long-term view of the decisions to be made. And besides - **Covid-19 is not the only factor** impacting businesses and Equity-based Pay today:

Fig. 1: Macro-level Factors relevant for Business and Rewards' redesign

Source: *Self-elaboration*, Zereon Associates, 2020.

Purposefully we have left for the end what is probably, together with Covid-19, **the most important and far-reaching force operating in the world of business today and for the future**, which is what we may broadly call **<u>the Business world Digitalization Revolution</u>**. In here we include topics such as AI/ML/DL/NLP, Cloud and Platforms, Social Media, Blockchain/DLT, IoT, 5G, AR/VR, etc. – which are transforming whole industries and provoking deep shifts on how companies produce, sell and are themselves defined.

Thus, from the **Equity Remuneration** perspective, we need to make **short-term adjustments** to address Shareholder and Board concerns, very often protect the company cash and save money, avoid demotivation of Executive and Employees, look after other stakeholders, and in general contribute to the company resilience in terms of the next months. All this is already a challenge.

But at the same time, **we must make sure that, technically and organizationally, Equity-based Rewards pave the way for the Future of Work, which has plenty to do with Digital Transformation, Good Corporate Governance and new ways of doing business**. Limited Equity Reward approaches in terms of sole company valuations, sole taxes, sole legal issues, sole financials, sole disclosure, sole mathematics, are not going be effective alone per se. Tackling all the interconnections simultaneously and in depth will be required.

Definitively, here "one-size-fits-all" does not work

One of the first ideas that we intend to propose here is that **"one-size-fits-all" is not a solution for all companies, geographies, jurisdictions, cultures, shareholder structures, business situations**. Even within the same industry, the reality of Equity-based Rewards differs, and true expertise is needed to analyse, design, and implement what may be best in each instance.

Now, we are not saying that what some other parties claim, or some current empirical studies express, is to adopt a single approach valid for almost all companies (actually, many prudent sources mention the opposite) - but **there are some recommendations that may need to be taken cautiously as applied to individual company cases**:

- Use time-based RSUs for CEOs, with longer terms than in the past and even with lock-up periods beyond CEO departure [1].
- "(Our Relative Performance) Bonus Index makes executive compensation stable - which is what beneficiaries want - and fully transparent for everyone - which is what shareholders demand" [2].
- Adjust size of new Grants, Rethink Your Equity Mix (SO, RS/RSU, Performance-based Awards), Deliver Cash Plans in Equity [3].
- Use "STARS" (in reality, a form of performance shares, out of many possible others[4]), etc.

There are also others that are pushing the case for bonus deferrals paid in shares (which is mandatory and already done in the EU Banking industry [5]), some voices that claim that "Equity Rewards should be simpler", maintaining that share price captures also stakeholder longer-term, not just shareholder value, etc.

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[1] "Reforming CEO Pay to Grow the Pie for Wider Society", Edmans, A., Harvard Business Review, Oct. 2020.
[2] "Analysis Drives Performance", Obermatt AG (company presentation document), 2020.
[3] "Rethinking Equity Compensation in Response to COVID-19: Upcoming Grants", Dan Kapinos, D., Wanlass, L., Harris, R., Aon Hewitt, Jul. 2020.
[4] "Executive Remuneration Trends in Switzerland", Schmid, R., Wagner, A., Ethical Boardroom, Winter 2020.
[5] "The New Regulatory Environment for Remuneration Policies in EU Investment Firms: Looking into 2021 and Beyond", Ceron, M., Zereon Associates, Jul. 2020.

Not to mention the specific criteria of Proxy Advisors / investors such as ISS, Glass Lewis, the Norges Bank / Sovereign Fund of Norway, or of Family Offices, Private Equities and Venture Capitalists. Or of different Associations, consultants, etc. The list goes on.

Readily admitting that the studies and reflections above can be meaningful for individual company action, some wise choice and application of the advice is in order. The central question here would be: **do we really believe that any single "recipe" for Equity-based Rewards can be valid for all companies such as the ones described below**?.

Fig. 2: Different companies require different Equity Reward approaches

COMPANY	#1	#2	#3	#4
Jurisdiction / Country	United Kingdom	Switzerland	Singapore	United States
Industry	Biotech	Banking / Financial Services	Fashion & Retail	Software and Tech
Market-listed	No (Series B stage)	Yes (small cap)	No	Yes (NASDAQ)
Shareholding structure	3 Founders, 1 Small Private Equity, 2 VC Firms	3 Funds, 1 Family Office of reference, Stock Market	Not listed (3 families)	6 Institutional Investors + some large PE funds
Share evolution	Booming	Flat	Declining (depending on valuation method)	Growing
Board	3 Founders + 4 PE/VC (all Proprietary Directors). * No Committees	6 Proprietary Directors (family & funds) + 2 Independents. * Audit, Remuneration and Compliance / Risk Committees	Yes, with Committees. Full authority rests informally with Chairman	6 Proprietary Directors + 4 Independents + 2 Executives. * Full Audit + Strat & Investments + Remuneration Committees
Chairman and CEO separate	No	Yes	Yes	No
Revenue Size	17 mill. USD	1,900 mill. USD	7,000 mill. USD	23,000 mill. USD
Profitability / Return on Sales	(Not that relevant)	Middle / in line with industry	Low vs. industry	Very high
Investment / Business Strategy Cycles	1-2 years	2-3 years	3-4 years (in principle)	1-2 years
Countries of Operation	4 in one world region	9 in one world region	16 in two world regions	63 in all world regions
"Historical" company LTI indicators	Company valuation at exit / liquidity event	Several - a blend of profitability, solvency, liquidity and some ESG	Board evaluation of personal performance	Relative TSR vs. industry peers; EPS over inflation

Source: Self-elaboration (inspired on real data), Zereon Associates, 2020.

Possible Short-term action and tactics (1) – reexamining non-Equity Reward elements

So – what to do ? Looking towards changing within the next four-six months range, several actions may be suggested. Firstly, we would **start by re-examining items other than Equity-based and Long-Term Rewards**. All this will require effective Change Management, and selective execution by collectives, countries, areas, and divisions.

Fig. 3: Non-Equity Reward items or aspects to be actioned upon

ITEM	Possible action
Re-evaluate jobs, market references and possibly pay gender gaps	• Correct specific people's job classification, inflated job titles and benchmark misalignments. • Correct Compensation of over-classified / over-priced people. • A great moment, and legally sponsored in many instances, to curb excessive Pay gender bias.
Director fees, Salaries and guaranteed allowances	• Freeze, except for legal / statutory increases or compulsory payments – unless the company is doing well through the Covid-19 times. • Keep what little can be shared for the truly exceptional performers. • Negotiate reductions for people paid over market. • Have Board members / CEOs decrease their own salaries or Director fees a bit to set example. • With care, you can try and change salary for shares to save cash – it can have tax advantages, but it can become a delicate process (redundancy payment, pension, overtime, legal limits and equity capital consequences).
Short-term Bonus / Variable Pay	• Make them zero in most cases, or defer for a later date – again, unless the company is being financially successful. • Fixing formulae with broken objectives can be too time-consuming at this moment – suspend and offer instead selected spot, non-consolidable, non-pensionable awards, or even highly focused retention bonuses, for key people helping with business continuity. • Recognize the people that kept the supply chain running, the best sales / clients, the most important projects and vital support areas, as well as the ones that "kept the spirit alive" and were instrumental to work virtually and keep morale high.
Pensions / Benefits	• If company is in trouble, prudently modify them downwards. Defined contributions can be lowered, benefits / yields / payments limited. • Life / health / accident insurances can be trimmed down – but not for Covid-19 tests and treatments !. • Company car models or choices can be limited or taken out outright. • Other perquisites, except perhaps for the most "symbolic" ones, might be halted or suppressed altogether.

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ITEM	Possible action
"Intangible" Rewards	• Training and Developmental actions with an explicit cost may be postponed, vertical Promotions may be made scarce or non-existent for the moment; more "on-the-job" and online self-training instead. • Time to stick together, to recognize efforts publicly, to show people that the company is doing what it can. A moment in which leaders must prove motivational and team integration capability. • Create and recognize a supportive, cooperative "we are in this together" atmosphere – no greed, egos or departmental bickering now.
Performance management and target setting / evaluation	• Add incremental improvements to performance management tasks (interviews, performance rating analysis, skill gap identification), with more emphasis on appreciation of motivation and resilience. • In target evaluation, fairness will be important, perhaps comparing vs. accurately restated targets to carve out what was not really under executive and employee control. • Target setting for 2021 even more rigorously done internally than before – good moment to improve processes and ensure that objective cascade-down from the C-Suite for the next year is comprehensive and truly reaches the lower organizational levels.
Mobility / Expatriate Compensation	• Reasonable reductions can certainly be applied - localization / "local+" arrangements, relocation packages, housing and schooling allowances, COLA calculations, tax and social security equalizations, short-term assignment "per diems", hardship and risk allowances, etc.

Source: Self-elaboration (inspired on real data), Zereon Associates, 2020.

With a little luck, measures like the ones above can mitigate restructurings / lay-offs, and deliver cash-flow savings without disrupting the organization excessively.

Possible Short-term action and tactics (2) – the ISS perspective

Having peered into the other Reward and related components, different things can be done as regards **Equity-based, Disclosure and Long-Term Rewards in themselves**. Even if referred to large, listed corporations in the US, interesting pieces come from ISS [6]:

[6] "U.S. Compensation Policies and the COVID-19 Pandemic Frequently Asked Questions", ISS' Global Research Department, Oct. 2020, as summarized by "ISS Guidance on COVID-19 Compensation Issues", Hauder, E., EXEQUITY, Oct. 2020.

- **Lowered financial or operational targets below prior year's actual levels achieved** — offer reasonable explanation and disclosure by Board, especially if pay-out opportunities are not reduced accordingly.
- **Changes to outstanding Equity/Long-Term incentive awards granted in 2020** — no drastic changes will be seen as positive, unless the underlying business strategy has fundamentally changed; more modest changes are acceptable.
- **Changes to outstanding performance-based Equity/Long-term Incentive awards** — smooth performance over a long-term period necessary. Changes to current performance cycle awards will be viewed negatively, especially for pay-for-performance misalignment with ISS particular tests.
- **Covid-19 related retention or other one-time Long-Term Compensation awards** — award rationale, magnitude, and structure, describing how that furthers investors' interest. Long-term vesting, performance-based and with safeguards to avoid windfalls. Not to be granted merely as a replacement for forfeited performance-based awards, or to insulate executives from lower pay.
- **Board / Remuneration Committee responsiveness** — if say-on-pay receives less than 70% support, ISS generally requires proxy statements or Board reports to disclose 1) Board's efforts, 2) specific shareholder feedback, and 3) actions taken. If a company is unable to implement changes because of Covid-19, then it would have to mention why and how. If changes are delayed or do not fully address shareholder concerns, then a long-term plan to go around it should be disclosed.
- **No changes in ISS policies towards problematic pay practices or option repricing because of the pandemic; and increase of the ISS's equity plan scorecard ("EPSC") passing scores / thresholds**. This means that requirements on those aspects will be as high as before or even slightly more demanding, and maybe less share availability compared to 2020, so companies may need to think in advance to request more shares for shareholder approval.

Again, these measures may or may not be fully applicable in the EU, in CH, in the UK, in APAC, LATAM or African countries, or with family or non-institutional shareholders, non-listed companies, etc. And other Proxy Advisors and investors indeed may have different ideas. **Practitioner discretion and specific analysis will be needed for each case**.

Possible Short-term action and tactics (3) – recent legal change and the EU case

At least in the European Union, **the way in which Equity-based Rewards are to be implemented for next year in stock market-listed companies, will be legally different**

from previous years – with very small variation, the **recent Shareholder Rights Directive** has been fully transposed into internal law structures, all over the EU countries [7].

There are **diverse topics** in the Directive, such as 1) transparency of Asset Managers holding company shares, 2) right of the company to identify its ultimate shareholders beyond intermediaries, 3) obligation to further clarify related-party transactions (e.g. Board members or significant shareholders with the company or its subsidiaries), and 4) the requirement that **Proxy Advisors themselves publish a Code of Conduct and an Annual Report explaining the rationale of their vote recommendations** and advice.

The Directive adds **other improvements in Corporate Governance and capital markets**: Board Directors as actual people (not entities), new requirements in annual and quarterly financial information / auditing, specifics on prospectuses and Corporate Governance reporting, etc. Regarding **Remuneration Policy**, in addition to elements already present such as financial and non-financial criteria for granting variable pay (Bonus and Equity), deferrals, "malus" and "clawback" clauses, Board Directors' contracts or arrangements' duration and applicable notice periods, etc. - the following aspects are now compulsory:

✓ *How the* ***Policy contributes to the business strategy, stakeholder interest, and long-term sustainability of the company****, thus promoting Reward transparency and long-term management of the business.*
✓ *How the* ***reward and employment conditions of the company's workers have been taken into account*** *when setting the Policy.*
✓ *In the event of a Policy review,* ***explanation on significant Policy changes and how shareholder votes have been considered****.*
✓ ***Possibility of applying temporary exceptions****, if it is for the* ***benefit of long-term interests and sustainability*** *of the company (for instance, for Covid-19 reasons).*
* *More detail was added on how to proceed if the Remuneration Policy or the Annual Remuneration Reports are rejected by the General Shareholders' Meeting.*

With respect to the **Annual Remuneration Report**, it shall include:

✓ ***A novel statistic****, with similarities to the US's CEO Pay Ratio:* ***annual amounts*** *accrued and* ***variation experienced in the year*** *in the following categories:* ***a) Board Remuneration, b) performance of the company, and c) average remuneration on a FTE basis*** *of employees other than Board Directors, over at least the* ***last five years****, to allow for clear evolution comparisons.*
✓ *How the* ***annual Executive and Non-Executive Board Directors' Remuneration contributes to the sustainable and long-term performance*** *of the company.*

Obviously, non-market listed companies, or companies based on non-EU jurisdictions, are not legally affected by the provisions above – but these provisions manifest that

[7] Directive (EU) 2017/828 of the European Parliament and of the Council, of 17 May 2017, as summarized by "Seis temas clave de la Directiva de fomento de la implicación a largo plazo de los accionistas en las cotizadas" (Spanish), San Nicolas, M., De la Pena, M., KPMG, Oct. 2020.

shareholder and regulatory scrutiny, **long-term orientation** and **sustainability** are becoming **very relevant** for all kinds of **modern Equity-based Rewards internationally**.

Possible Short-term action and tactics (4) – our particular recommendations

Without intending to be dogmatic, here is a particular list of actions that may work short-term. We do emphasize, though, that every company will have to ponder carefully what is and is not appropriate for them, beyond pure imitation of others.

Fig. 4: Some possible short-term actions regarding Equity-based Rewards

<table>
<tr><th>EQUITY-BASED REWARD TYPE</th><th>INCENTIVE TYPE</th><th>ASPECTS TO REVIEW</th><th>POSSIBLE SHORT-TERM ACTIONS</th></tr>
<tr><td rowspan="6">Full share value</td><td>Unconditional Share awards</td><td rowspan="8">• Calculations and assumptions
• Eligibility.
• Pay Mix proportions.
• Target Pay / expected On Target Earnings.
• Instruments chosen.
• Valuation method.
• % of Equity required / dilution.
• Performance indicators.
• Weights, if any.
• Peer groups, if any.
• Pay scales and curves, under- and over-achievement, hurdles / thresholds, and caps.
• Tranches.
• Grants (and discounts).
• Vesting (and Exercise, if applicable).
• Blocking periods.
• Form of payment.
+
• Internal / external analysis and legally binding documents.
• Tax / Soc. Security, accountancy, stock market and treasury implications.
• Process, tools, and communications.</td><td rowspan="8">✓ Limit eligibility / include mostly best performers.
✓ Lower the expected Pay / On Target Earnings.
✓ Lower or freeze % of Equity available.
✓ Select well-blended performance indicators; reward also “failed efforts”.
✓ Set stiffer performance requirements, refine peer groups (and apply them wherever possible).
✓ Choose tougher scales, hurdles, thresholds, caps.
✓ Reprice / reduce number of RSU / shares / SO at grant, value instruments <u>at end</u>.
✓ Modify / increase the number of tranches for same number of shares or options.
✓ Reduce periodicity of awards.
✓ Lengthen the vesting, exercise and/or blocking periods, offer extras at end.
✓ Look for further tax and social security advantage.
✓ Cancel existing programs and launch new ones.
✓ Recalculate and re-simulate under new assumptions, apply better math techniques.
✓ And - Manage Change !!</td></tr>
<tr><td>Purely Time-based RS / RSU</td></tr>
<tr><td>Performance-based RS / RSU</td></tr>
<tr><td>Phantom Stock</td></tr>
<tr><td>Deferred Bonus paid in shares</td></tr>
<tr><td>ESPPs</td></tr>
<tr><td rowspan="2">Value increase</td><td>Unconditional SO/SAR
(transmissible / not)</td></tr>
<tr><td>Performance-based SO/SARs
(transmissible / not)</td></tr>
</table>

Source: Self-elaboration (based on actual clients' experience), Zereon Associates, 2020.

The long term view

So far, we have seen a variety of short-term adjustments for Equity-based Rewards that may be applicable – fair enough, and surely required for companies' immediate financial health. But **no business-related or -oriented person, and for sure no Rewards practitioner**, tax and legal advisor, investor, corporate governance expert, finance professor, **can afford to ignore** what is happening regarding **the Future of Work – the 4th Industrial revolution indeed**. According to the World Economic Forum [8]:

Fig. 5: The 2020 World Economic Forum Key findings regarding the Future of Jobs

1	*The pace of technology adoption is expected to remain unabated and may accelerate in some areas.*
2	*Automation, in tandem with the Covid-19 recession, is creating a 'double-disruption' scenario for workers:* ***43% of companies will reduce workforce by 2025; 34% will actually expand workforce; 41% will increase use of specialized contractors****.*
3	*Although the number of jobs destroyed will be surpassed by the 'jobs of tomorrow' created, job creation is slowing vs. previous years while job destruction accelerates.* ***In 2025, though, 97 million jobs will be created, and 85 million jobs displaced.***
4	*Skills gaps continue to be high, as in-demand skills across jobs change in the next five years: critical thinking and analysis, problem-solving, etc.*
5	*The future of work has already arrived for a large majority of the online white-collar workforce.*
6	*In the absence of proactive efforts, inequality is likely to be exacerbated by the dual impact of technology and the pandemic recession.*
7	*Online learning and training is on the rise but looks different for those in employment and those who are unemployed.*
8	*The window of opportunity to reskill and upskill workers has become shorter in the newly constrained labour market.*
9	*Despite the current economic downturn, the large majority of employers recognize the value of human capital investment.*
10	*Companies need to invest in better metrics of human and social capital through adoption of ESG metrics and matched with renewed human capital accounting.*
11	*The public sector needs to provide stronger support for reskilling and upskilling for at-risk or displaced workers.*

Source: World Economic Forum, Oct. 2020.

[8] "The Future of Jobs Report 2020", World Economic Forum, Oct. 2020

To make all this operational into better Equity-based Reward schemes for the future, internal and external statistics on those specific topics will have to be gathered and analyzed (the World Economic Forum itself provides interesting data) – on top of appropriate financial, organizational and business indicators.

We at Zereon Associates believe that the central discussion on Equity-based Rewards, whilst taking care of how difficult they can get, on vesting periods, on how much tax you can save, on the amounts, on all other design parameters - lies in the performance indicators, weights and pay scales chosen – and their alignment with the expected business plans and company value (ie what we are exactly paying for, and how). Too "financial" indicators, and no matter what you claim, you tend to forget sustainable, long term business. Too operational, and you lose sight of shareholder value. To illustrate our point, two examples:

Fig. 6: A possible robust Equity-based Reward scheme example –LISTED COMPANY "X"

DESIGN COMPONENT	Description
Business plan and Equity-based plan duration	• x years (202x-202x) - the same. • Overlapping cycles limited and linked to end / achievement of current Business plan.
Instrument and hedging	• Fixed-period Performance Shares (max x % of Common Stock). • Hedging: Treasury shares or xxxxx; Valuation at grant / delivery: xxxx. • Paid xx% in the form of Shares and xx% in Cash. • Min shareholding equivalent to x% of Salary, achieved in xx years.
Time structure	• x tranches of x years each (202x-202x: xx% vesting; 202x-202x: xx%). • Vesting subject to objectives' evaluation in 202x and in 202x. • Blocking period: x years after vesting / evaluation of objectives.
Target Reward (for CEO) ** expressed as M.U. or monetary units – it could be USD, EUR, CHF, GBP, etc.*	• "x" times the average Fixed Compensation of her/his last x years as target at the end of the plan (**requires xxxxxx*). • ie Avg last Salaries "X" M.U. → Long Term On Target Earnings derived from Share delivery = xxxxx M.U. + xxxxx M.U.
Indicators and weights (all tranches)	• xx% TSR vs. international Industry Peer group (xx companies). • xx% Accumulated Free Cash Flow (**includes clauses on xxxxx*). • xx% Digital Transformation (**evaluated in xxxxx way – selected projects*). • xx% Company's ESG Score (**evaluated in xxxxx way -externally*).
Payout scale	• TSR – peer group centile X, xx% of shares; centile xx%, xx%; centile xx% or more, xxx% (xxx scale in between). • Other KPIs: Min xx% achievement, xx% of target shares; 100%, 100% of shares; Top xxx% achievement or more, xxx% of shares. • Cap: xxx% of LT On Target Earnings → X M.U. (**applied in xxx way*).

Source: Self-elaboration (based on actual clients' work), Zereon Associates, 2020.

Fig. 7: A possible robust Equity-based Reward scheme example –STARTUP "Y"

DESIGN COMPONENT	Description
Business plan and Equity-based plan duration	• x years (202x-202x); 202x = next expected closing of Series B round / liquidity event.
Instrument and hedging	• Performance-based Stock Options (max x % of Series A share pool). • Hedging: Share pool or xxxxx; Valuation at grant / delivery: xxxx. • Exercisable as xxxxx or xxxxxx, paid as xxxxx or xxxxx. • Min shareholding equivalent to x% of Salary, achieved in xx years.
Time structure	• x tranches of x years each (202x-202x: xx% vesting; 202x-202x: xx%). • Vesting subject to objectives' evaluation in 202x and in 202x. • Blocking period: to be analyzed.
Target Reward (for CEO) ** expressed as M.U. or monetary units – it could be USD, EUR, CHF, GBP, etc.*	• x times the Fixed Compensation as target <u>at expected closing of Series B round / liquidity event</u> (**requires xxxxxx*). • ie Salary "X" M.U. → Long Term On Target Earnings derived from Stock Option exercise at liquidity event = xxxxx M.U. ("x" times x "X").
Indicators and weights (all tranches)	(* all at vesting:) • xx% Target Company Valuation at exit / liquidity event. • xx% Target Net Revenue figure. • xx% Target Number of countries of operation with Net Revenues. • xx% Target Net Number of Engineers hired + retained. • xx% Target Net Number of Sales & Marketing people hired + retained.
Payout scale (all indicators)	• Min xx% achievement, xx% of target Options; 100%, 100% of Options; Top xxx% achievement or more, xxx% of Options. • Cap: xx% of Series A shares / multiplier investment of Series A owners / xx% of Series B cash or shares → X M.U. (**applied in xxx way*).

Source: *Self-elaboration (based on actual clients' work), Zereon Associates, 2020.*

Similar models could apply to **future-looking companies**, in a shape depending on specific business model and circumstances. In our experience, when set-up and rolled out by people who truly know how to do it, schemes like the ones above are fair, market competitive, and usually bring about **great satisfaction for all stakeholders**.

As a closing remark, **Remuneration delivery with technology** will also be the future, in our opinion. It will be much more automated, most probably with **user-friendly apps** for both its **internal management** and its **check by Directors, executives and employees**, maybe supported by **blockchain / DLTs**, relevant **smart contracts** and who knows, paid into **cryptocurrencies / tokens**, and definitively enabled by **Artificial Intelligence**. We see the marriage between Good Corporate Governance and Long-Term incentive design by human-supervised Deep Learning algorithms coming soon - **we are ourselves already active and working with technologists in that direction**.

Conclusions

We cannot help but close this paper with the very nice and added caveat words from the Preface of the World Economic Forum 2020 study:

> *"Human ingenuity is at the root of all shared prosperity. As the frontier between the work tasks performed by humans and those performed by machines and algorithms shifts, we have a short window of opportunity to ensure that these transformations lead to a new age of good work, good jobs and improved quality of life for all.*
>
> *In the midst of the pandemic recession, this window is closing fast. Businesses, governments and workers must plan to work together to implement a new vision for the global workforce".*

For sure, true Equity-based Reward experts can and should have a role there; to do that, certified professionals with not just a solid theoretical background, but with a **longstanding complete, multidisciplinary technical design and implementation experience**, and not mere "reward product" or partial approaches, will be required.

To the extent that it can contribute towards long-term value creation, technological leaps and thriving businesses which can make people and society prosperous, **Equity Rewards will continue being a powerful management tool to lead companies effectively**, get them ready for the new world that comes, and produce wealth for all parties.

. . . .

For more information on this paper and Zereon Associates's Remuneration and overall advisory services:

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