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Comp Talks

Compensation Issues and Trends Unique to Life Sciences Companies

At the Comp Talks session on October 20, 2021, **Compensation Issues and Trends Unique to Life Sciences Companies**, our panelists – Cooley partner Nyron Persaud and associate Nicola Squire – discussed a variety of issues impacting life sciences companies, including, among others, performance metrics, equity plan dilution and human capital management (HCM) disclosure. Here are some of the key takeaways summarized by Cooley lawyer Erica Russell:

Life Sciences Companies Have Unique Compensation Considerations. The prospective nature of life sciences companies and the investor focus at the pre-commercial stage on future potential treatment approval, rather than current financial performance, can lead to speculative trading and volatile stock prices, which in turn impact compensation program design. As companies progress through the R&D process and move toward commercialization, the investor focus, and the basis upon which employees and executives are compensated, shifts from the company's product pipeline to financial performance. Another consideration unique to life sciences companies is the talent pool is limited by both specialization and geography with competition for talent greatest in hot spots such as New York, Boston, and the Bay Area.

Pre-Commercial Companies Tend to Use Milestone-Based Awards. Because traditional financial metrics are not appropriate for pre-commercial life sciences companies given the lack of revenue, these companies commonly use milestone-based awards linked to clinical trials progress or regulatory approval. However, utilizing milestone-based metrics can have disadvantages, including a lack of flexibility when organizational goals shift. On the other hand, basing compensation on a formulaic approach may not fully align compensation outcomes with company performance and, in certain instances, may have to be overridden.

Shifting Toward Performance-Based Awards. Life sciences companies rely heavily on time-based stock option and restricted stock unit awards. The appetite at companies for shifting toward performance-based awards depends largely on where the company is in the commercialization process and its investor base. Pre-commercial companies tend to focus on milestone-based awards, whereas companies further along in the commercialization process often start introducing performance-based awards to supplement their other awards. Companies thinking about introducing performance-based awards will want to identify the right metrics including reasonable goals likely to incent the right behavior and result in the intended pay outcomes.

Proxy Advisory Firm Considerations. Proxy advisory firm preferences may present certain compensation challenges for life sciences companies. For example, ISS has a strong preference that at least 50% of a company's long-term incentive awards be performance-based but does not perceive options that vest solely based on time, which are largely used by life sciences companies, as being performance-based. To address these concerns, life sciences companies may consider granting premium stock options with an exercise price set at a "premium" above the fair market value at grant date (e.g., at least 10% greater), or performance vesting stock options, which have a time-based vesting condition and a performance-based vesting condition that usually takes the form of a stock price hurdle. Both grant types considered performance-based by ISS and Glass Lewis and are also viewed as investor-friendly because they are intended to align pay with shareholder value. However, companies should resist the pressure from proxy advisory firms to prematurely introduce performance-based awards.

Other Important Considerations in Connection with Performance-Based Equity Incentives. It is important to consider stock price volatility before committing to stock price-based performance goals as volatility could lead to the loss of retentive and incentive value. For milestone-based awards, compensation programs should remain agile to accommodate shifting organizational goals. Drafting clear and concise metrics in connection with clinical trial and regulatory milestone-based awards is critical including specificity around vesting events, the indications that are subject to approval, the type of regulatory approval required and whether the award is earned if approval is received for a different purpose, and the point during a clinical trial at which an award will be considered earned.

Conserving Shares Under Equity Plans. Life sciences companies rely heavily on stock options and often have widespread employee participation in their equity plans, both of which tend to rapidly deplete an equity plan's share reserve. Two potential ways to conserve shares involve (1) inducement grants for newly hired employees, including new hires in connection with corporate transactions, and (2) granting full value awards for either all or a portion of the equity incentives. Companies considering inducement grants, or grants of full value awards, to non-U.S. employees will want to ensure compliance with any local tax, securities and other applicable laws.

Human Capital Management Disclosure. The panelists noted that the SEC may take a more prescriptive role and issue proposed rules requiring companies to disclose baseline metrics for their HCM policies. Therefore, companies should proactively take steps to evaluate their current HCM policies in light of potential rule changes. In addition, companies should identify appropriate metrics for data-gathering and implement internal controls to ensure consistency across disclosure documents.