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Emerging Areas of Challenge: Where to Focus Your CD&A Drafting Efforts Now

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PRINCIPAL

There's no doubt that last year's proxy season was a tough one, especially for those responsible for crafting the Compensation Discussion and Analysis (CD&A). Executive pay narratives had to be totally reframed against the backdrop of COVID-19 (among other challenging social, political, and economic conditions), adding significant complexities to an already difficult task: drafting a CD&A that is clear, concise, and compliant.

If there was one huge lesson learned from last years' experience, it was don't wait until the year is over to start building your message strategy for key pieces of your CD&A narrative. For this upcoming season, there are already three content areas clearly emerging as the most challenging to address:

1. Goal-Setting

You don't need year-end results to draft the rationale for how the compensation committee determined incentive plan performance goals for 2021 since they should have been set early on in 2021. If your organization had to take an alternative approach to setting performance goals for 2021 given the continued market uncertainty at that time, it will be extra important to clearly outline the factors the committee considered in making its final decisions—especially if year-end results are currently projecting to be significantly higher than the original expectations (e.g., we set conservative targets and never could have forecasted how great we'd do by the end of the year).

2. ESG Metrics

If your organization has formally adopted ESG metrics in your annual or long-term incentive plans for 2021 or are planning to adopt them for 2022, make sure the CD&A is putting this change front-and-center and then some. That means highlighting it in the executive summary and outlining the specifics in the incentive plan section(s) of the CD&A. For those that do not have formal ESG metrics in their plans, you'll still want to be clear in the CD&A about how ESG influences compensation committee decisions about NEO pay (e.g., in base salary adjustments, setting incentive plan targets, and/or approving equity grants) to get appropriate credit and not appear as tone deaf on this hot topic.

3. Board Responsiveness and Shareholder Engagement

It doesn't seem to matter anymore what your say-on-pay results were. Even if you had stellar support, if your CD&A doesn't acknowledge how the compensation committee stays connected to shareholders on executive compensation matters, you are open to scrutiny. And, if your organization is in a situation where it has experienced declining support over the years and/or below 70% support (for ISS) and/or 80% support (for Glass Lewis), this should be viewed as a critical area of content to address even if no changes to the plans were implemented. You still need to be able to tell a story about how the board considers investor feedback as it analyzes and makes decisions about compensation plan designs and policies.

Even as the curveballs continue to hurl past (Omicron, supply chain disruptions, inflation) and will likely force some 11th hour rewrites, starting now is still the best course of action. Being proactive will strongly position you and your drafting team to pivot at a moment's notice and provide ample time to socialize any new or sensitive messages with key stakeholders while still in the drafting phases. And, if circumstances stay the course, you'll be that much more ahead of the game.

About the Author

Sharon Podstupka is a principal at Pearl Meyer. She is a trusted advisor to boards and executive management teams in the areas of executive and broad-based employee compensation communication and change management. With over 25 years of consulting experience, she is one of the original pioneers of executive compensation disclosure best practices and has proven success in creating effective strategies and delivering content in challenging business environments and under intense scrutiny from investors and proxy advisory firms. Sharon has extensive experience in a broad range of industries, including financial services, manufacturing, oil and energy, retail, biopharma/biotech, and healthcare.

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