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Two Things Are True

I scratch my head a lot lately. My standard list of executive compensation truisms is not holding up. Gone are the days when I could pull my trusty list of experienced-hardened facts from my hip pocket to instantly put to bed a hotly debated topic. Instead, I have to remember things are changing, and the pace is accelerating in our COVID-ladened environment.

Here are a few random thoughts generated by recent client discussions in no particular order. Both statements are true, and that leads to my head-scratching.

Incentive Plan Financial Goals

- Incentive plan financial goals increase annually, reflecting company growth
- Incentive plan financial goals increase annually until they don't

Even the strongest performing companies will hit a time when financial results stagnate. A recent article notes 60 Russell 2000 stocks are down 50% from their 2021 highs, including well-known ones like Zillow, Peloton, Discover, and Viacom. CEOs and committees ask about the potential proxy advisory firm fallout if a company lowers performance goals after anticipating a difficult upcoming year. There should be no fallout if a company discloses the reasons for reducing financial goals, especially if the explanation is consistent with institutional shareholder discussions that have taken place over the past year. Establishing a shareholder outreach program that includes periodic talks concerning the executive compensation program design and how it aligns with a company's strategy is the most effective way to manage expectations around next year's reduced financial goals.

CEO to Executive Chair of the Board Pay Transitions

- Transitioning CEO pay to COB pay is a straightforward process supported by established market practices
- Transitioning CEO pay to COB pay is fraught with landmines and may result in an outcome no one supports

The process is straightforward when the CEO transitions to an executive chair role for one year and retires. Market research will guide pay levels and pay structure design, and the board avoids having to think about managing COB pay over a multi-year period.

The issue becomes far more complicated when the CEO assumes the executive chair role permanently. Market practices vary a lot in these situations. Role definition (for the chair and CEO), pay levels, pay mix, at-risk pay, and proxy disclosure may become challenging topics to resolve. In this latter situation, the board would benefit from starting the succession process several years out, including discussing how pay may change when a company splits the chair/CEO role.

Senior Leadership Team Salary Increases

- Senior leadership team members get salary increases annually reflecting performance,

role definition, and cost-of-living increases
- Senior leadership team members get salary increases when warranted

Both practices are in place today. I don't know if we could agree on a best practice. But reviewing pay annually and only adjusting pay when warranted by pay benchmarks, performance, and role changes seems to best support our current governance environment.

Proxy Peer Group Pay Practices

- A company's proxy peer group pay practices influence CEO pay
- Private equity firm pay practices influence CEO pay

We are involved with more CEO "mega-grant" studies this year than we've had in a while. By mega-grant, I mean front-loading three or more years of equity grants in an upcoming grant with a promise, or not, of forgoing several years of future equity grants. I am sure our rapidly evolving US economy can explain some of the interest in this topic. But private equity firm practices offering equity grants significantly exceeding the value offered by public companies is another driving force.

It's too early to tell if private equity firm pay practices will permanently alter US public company practices, but it is apparent some compensation committees will feel a new level of CEO and senior leadership team retention risk as committees discuss and approve 2022 pay.

Proxy Advisory Firm Policies

- Proxy advisory firm policies provide sound guidance on reasonable executive compensation pay levels and practices
- Proxy advisory firm policies wreak havoc when business conditions are unstable

Proxy advisory firm policies can be a helpful resource when considering if a pay practice is in the fairway or out-of-bounds. This statement is true when a company has generally met shareholder financial expectations and avoided questionable pay practices. Still, when the wheels fall off the bus, and the committee makes pay decisions that are in a company's best interests but fall outside of proxy advisory sanctioned policies, guess what happens? Proxy advisory firms get aggressive with their evaluations and may recommend "Against" on say-on-pay. There is something terribly wrong with this outcome. Compensation committees have the responsibility to oversee executive pay practices using judgment when needed. Difficult decisions made during unstable times never fall neatly into prescribed policies, and the proxy advisory firms should understand this dynamic.

Retention Grants

- Time-vested restricted stock units are a time-tested, effective retention device
- Leveraged stock option grants are an effective retention device but not time-tested

You may label me as old school. Retention grants should always include time-vested RSUs. Well, what about a young executive employed by a high-performing company? This individual may view a leveraged equity grant that can deliver outsized awards as an exciting opportunity while viewing a time-vested RSU with a reasonably predictable value as not motivational. Of course, the specific circumstances will dictate the retention grant design, but my go-to RSU grant may not fit the bill in all cases.

Compensation Committees Oversee Executive Compensation

- ~~Compensation committees oversee executive compensation levels and practices~~
- Compensation committees oversee executive compensation levels and practices, leadership development, succession planning, ESG, human capital management, diversity, equity, and inclusion

We've noticed a trend over the past few years. Committees that have expanded beyond their traditional roles can have more thorough discussions linking pay to performance, company, and human capital strategies. The duties of the committees and board are still evolving, with the governance committee or full-board handling of some non-executive compensation topics. My experience shows including human capital-related topics under the compensation committee charter is the most effective way to link pay to performance and company and human capital strategies.

Executive Compensation Philosophy

- Many public companies target median pay practices
- Many public companies target median pay practices and set target pay above the median

Compensation consultants—me included—may say pay that is +/- 15% from the target (median, for example) is competitive. This long-standing belief may result in pay straying from the intended target. Setting pay at 15% above median may result in 75th percentile pay levels under a compressed data set. Maybe it's time for the +/-15% guideline to die a quick death. Instead, use a +/-5% guideline and take non-pay benchmark factors (performance, potential, etc.) into account. This approach better acknowledges benchmark data's imperfections and focuses committee discussions on factors relevant to setting well-reasoned senior leadership pay levels.

As I wrote this blog, I started thinking about how my observations may change a year from now. No one can predict the future, and the haziness surrounding our personal and professional lives seems to have reached new highs. Still, I can guarantee one outcome a year from now: Two things will be true.

About Pearl Meyer