Pearl Meyer

ARTICLE | OCT 2025

# Hot Topics for the Fall 2025 Compensation Committee Agenda

## Introduction

Each year, informed by our ongoing conversations with directors and company executives, we highlight a number of topics that we believe are – or should be – on the minds of committee members going into their fall planning meetings. This year, the fall agenda comes at a time that is characterized by a continuing stream of changes, disruptions, and challenges.

The macroeconomic environment remains volatile, as a variety of regulations, shareholder expectations, and broader stakeholder involvement all remain in flux. From a financial perspective, compensation committees are wrestling with such challenges as whether and to what extent this environment should impact performance-based equity awards, and when it might be appropriate to use discretion. There are non-financial considerations as well, as the topic of ESG-based incentive metrics continues to be front of mind for many companies. The added strain of this volatility is being acutely felt in the CEO seat, where burnout is high and turnover is increasing, adding pressure on boards to have a robust succession plan in place.

While only a sampling of relevant topic areas, that's a lot on the plates of committee members. Meanwhile, the scope and purview of the committee itself is evolving as well, which brings its own challenges and considerations. That's where we start our exploration of five hot topics for the fall 2025 compensation committee agenda.

## 1. Board Governance Is Evolving: Is Your Compensation Committee Keeping Pace?

Over the past decade or so we have seen an expansion of corporate governance responsibilities for boards. This expansion is due to multiple factors, including broad social movements, health and economic crises, and increasing globalization. The expansion has increased the workload of boards, and their committees, particularly the compensation committee.

The compensation committee (or should we say, the committee formerly known as compensation) has seen its remit expand beyond core compensation areas to include things like talent management and succession planning (deeper than direct reports); company culture and engagement; pay equity; broader people issues, and ESG-related topics. Indeed, as these new areas of focus have evolved, the name of the committee has often changed. Some examples include human resources; compensation and talent; remuneration; and organization and leadership, as well as other variations on the theme.

The changes have not happened overnight, and not all committees have materially evolved. First, we saw some early adopters, mostly larger public companies in industries more sensitive to social trends. Then a slow wave of more companies feeling like “best practices” demanded the expansion. Today, a majority of mid-and large-cap companies have a materially expanded charter, with a good number of those companies having modified their committee’s name. We expect the evolution to continue.

With the expansion comes concerns about expanding board workload, as well as the dilution of time and attention to any specific area of responsibility. In fact, the total meeting time of compensation committees has expanded in fits and starts since Sarbanes-Oxley, both in terms of the number of meetings per year and the average meeting length. The expansion places increased importance on agenda and resource planning, as well as the overall allocation of the board’s governance responsibilities.

With respect to the committee’s agenda, inclusive of the newer items, it is important to think carefully about the resources the committee will need to fulfill its responsibilities. What new information/analyses should be presented, and by whom? Are new outside resources needed? Do the new items change/expand the desired background and experience of committee members? Where will the line be drawn with respect to the proverbial “noses in, fingers out” philosophy of governance? How much time should be devoted to the new items, and does that time come at the expense of existing agenda items, or does the 90-minute meeting now go two hours? Can some items be relegated to read-ahead and consent agendas?

With respect to the overall allocation of the board’s responsibilities, it makes sense for the full board to take a step back and rethink where both old and new items should reside. Some items may be shifted between committees (e.g., director compensation might shift to nominating and governance). Other items might move out of committee and up to the full board, or vice versa. It is also possible that an additional standing committee beyond the core three (audit, compensation, and nominating/governance) is warranted (e.g., risk, finance, technology).

Given the questions and concerns raised above, many companies have proceeded conservatively in responding to the changing environment and evolving governance expectations. However, it is worth noting that, regardless of a board or committee’s formal adoption of expanded governance responsibilities, the broader stakeholder community *expects* that boards are responsible for more than they were twenty, or even ten years ago. Moreover, notwithstanding the current administration’s views, regulatory oversight and reporting requirements on people-related issues has tended to expand over time. So it behooves boards, and the compensation committee in particular, to recognize the evolving business environment and adjust charter responsibilities accordingly, while ensuring that the committee is afforded the time and resources needed to fulfill its governance obligations.

## 2. Performance-Based Equity Awards and Other LTI Trends

Performance-based equity awards have come under scrutiny recently as concerns have been raised as to whether the underlying performance goals are sufficiently rigorous. Additionally, shareholder advisory firms have indicated they will cast greater scrutiny on long-term performance goals and plan design. They have also indicated they will be more accepting of time-based equity awards that meet certain vesting criteria. These factors, coupled with a highly volatile and uncertain current macroeconomic environment, have led some compensation committees to revisit the appropriateness of continuing with long-term performance-based equity awards.

For the near term, at least, we don't anticipate seeing any notable movement among companies away from performance-based equity. In fact, most investors still prefer performance-based equity. Investors view performance-based equity as an opportunity to hold management accountable for performance on identified key value drivers. For example, if companies are signaling to investors that they expect to grow earnings or expand operating margins, shareholders will typically want to hold management accountable for results and outperformance on those metrics. Compensation committees and management see performance-based equity as an effective tool for aligning management's incentives with those of shareholders in terms of value drivers.

Relative TSR

Relative total shareholder return (TSR) remains the most prevalent metric for performance-based equity. Given the challenges of setting multi-year financial goals in a very uncertain and volatile environment, its prevalence may even increase in the future. But while investors generally like relative TSR, keep in mind that it has its shortcomings. As a point-in-time measurement, it is subject to volatility, and less within the control and influence of management. It is critical to establish the right comparison group to properly account for these dynamics.

TSR is arguably less of an incentive metric and more of an accountability metric. Accordingly, a company should try to balance relative TSR with a line-of-sight financial metric. Having a long-term financial metric provides an opportunity to create dynamic tension with your short-term incentive plans. For example, if a short-term incentive is based on profitable growth, the long-term incentive might be based on return on invested capital or free cash flow. This combination can create a more holistic assessment of performance and hold the management team accountable for delivering on results across all three financial statements.

Broadly speaking, companies should design incentive programs that reflect their own unique set of circumstances. For example, a company that operates in a highly uncertain or cyclical environment may not want to have three-year financial goals given the challenges and possible counter productivity of setting multiyear goals. In this scenario, it may be appropriate to have one-year or two-year financial goals, perhaps counterbalanced with a three-year relative TSR program to ensure accountability to long-term results.

Other Considerations in Equity Program Design

Typically, performance-based equity is not offered broadly in the organization. Time-based equity awards often are seen as a better opportunity to deliver tangible value to the broader employee base. But equity has a cost to the company, so such awards should be considered in the context of other forms of compensation. For example, would dollars be better spent on a more employee-favorable health care cost-sharing split, or on offering an additional percentage point on the merit budget? A conjoint study that looks at how employees perceive the value of different potential compensation spends, whether it be cash, equity, or benefits, could help identify the optimal approach.

Designing a broad-based equity strategy also presents an opportunity to think about the culture that you're trying to create. For example, broad-based equity—such as employee stock purchase plans, broad-based RSU grants, or one-time all-employee awards—can be very effective in creating alignment down into the organization and strengthening a culture of ownership. Alternatively, if you're trying to instill a more selective and merit-based culture, you might target grants only at high performers and high potential employees.

What About Making It All Work?

Of course, you should always test the efficacy of your current design. If you decide to maintain performance-based equity, you need to make sure that your program continues to operate as intended. Is it still aligned with your current priorities in terms of your business and people strategy? Is it evolving appropriately with your changing priorities? Are the goals appropriately rigorous so that your actual pay is aligned with your relative performance?

Then, you should make sure your employees—from the most senior executives down through the entire organization—understand the program. If they don’t, then you are at risk of losing the motivational and retentive value of the program. Companies spend a lot of time on getting the messaging right in proxy statements, but the internal communication is equally, if not more, important in getting the most out of your long-term incentive program design.

## 3. How to Approach Discretion in Executive Compensation Programs

Even the best-laid compensation plans can run into unforeseen events that, without being a direct result of effort or leadership, impact the performance of the business. Judiciously deciding whether to adjust formulaic incentive payouts that are based on performance goals that have been affected by unexpected circumstances is an important function of the compensation committee. This is known as discretion.

Discretion can be either negative or positive. Negative discretion involves a decision to override a formulaic payout and reduce the amount paid to recognize performance failures or extenuating circumstances that were not adequately captured by the formula. Positive discretion is just the opposite - increasing an otherwise formulaic payout to achieve a more appropriate relationship between pay and performance, as assessed by the committee.

In either case, these actions require thoughtful deliberations. The objective is to achieve greater alignment between pay and performance while not undercutting the integrity of the incentive program. This is why discretion is a tool seldom used. It needs to be in the committee’s toolkit but should only be used in extreme cases where the formulaic result is clearly flawed.

The Magnitude of Discretion

Discretion is rarely an on/off switch, it’s more of a dimmer control. Committees use discretion to make relatively small but important adjustments to otherwise formulaic payouts. For example, committees may reduce a formulaic payout of 115% of target to 100% of target if there were circumstances suggesting that a target payout would be more appropriate than an above target payout. Similarly, if the company missed its threshold performance level by a very small amount due to external factors outside of management’s control, committees may use discretion to adjust a 0% payout to a 15-25% of target payout. In these cases, Named Executive Officers and other members of executive leadership are often excluded from the discretionary payout.

Rules of the Road When Applying Discretion

Given the potentially negative impact of discretion, both internally and externally, committees should follow a deliberate process when deciding whether to use discretion. One such approach is to think about “The four Ts of Discretion:”

1. Thoughtful. Have we fully considered the reasons for, and potential implications of, discretion in this case? Have we fully and appropriately evaluated all alternatives available to us? Have we arrived at the best solution given the circumstances?
2. Transparent. What do we plan to communicate internally to impacted participants? What do we plan to disclose if including proxy-reported officers? Do our communications and disclosures move beyond “What” we are doing and address “Why” we are taking and applying discretion?
3. Timely. Are we taking action at the right time? Are there any potential benefits of delaying action until a later date?
4. Tailored. Have we arrived at a solution that is customized to our specific facts and circumstances? Have we included/excluded the right people in our use of discretion?

One of the most important principles for applying discretion is that it “has to work both ways.” The use case should be tested to ensure that it could reasonably result in both a positive and negative adjustment at some point based on the particular facts and circumstances.

The Importance of Communication and Disclosure

Any decision to apply discretion must be justified to both internal and external stakeholders. Internally, you need to consider the integrity of your incentive programs. If you are constantly overriding the program or changing the rules midstream, participants may dismiss the program and/or its performance requirements believing instead that the committee will simply decide the appropriate payout despite the formulaic result.

Externally, especially if named executive officers are affected, the use of discretion can raise concerns from shareholders and proxy advisory firms. Positive discretion often receives more scrutiny and concern than negative discretion, which is amplified by the fact that positive discretion often results in compensation being disclosed in unique columns of the Summary Compensation Table and with enhanced narrative disclosure. Shareholder optics is an important consideration anytime you're thinking about applying judgment or discretion to what otherwise would have been formulaic payout results. In this regard, positive discretion may be more difficult to explain; shareholders naturally tend to understand how negative discretion makes sense for the company.

Mitigating the Need for Discretion Through Plan Design

The best strategy may be to design incentive plans in a way that naturally mitigates the need for discretion. The following are examples of the ways in which companies are designing incentive plans to be more resilient to changing conditions:

- Including Non-Financial Metrics. Including non-financial metrics can provide an avenue for relief when financial results are more variable due to external factors. For example, including (i) metrics such as safety or customer satisfaction or (ii) performance categories such as Strategic Objectives or Individual Performance can provide opportunities for payout if financial results are unexpectedly depressed. These types of metrics or categories generally comprise 25% or less of the overall incentive payout opportunity.
- Wider Performance Ranges. Widening the distance between Threshold and Maximum performance can increase the probability of being on the payout curve and thus limiting the need to consider a discretionary adjustment. For example, if the typical performance range width is 90-110% of target, using a range width of 85% - 115% of target.

## 4. Revisiting ESG-Based Incentive Metrics – Again

To start, let's acknowledge that the catchphrase ESG (Environmental, Social, and Governance) presents inherent challenges. It covers such a wide, varied landscape of issues that one can question the rationale behind the combination. And, in the current climate, the term ESG itself has been imbued with certain political overtones that may not always be warranted.

Taking a step back, certain ESG metrics, such as customer service, safety, and employee satisfaction, have long been part of the way companies measure performance for their businesses and the way they incent their employees. What makes those metrics "work" as part of an incentive plan is that employees and shareholders alike understand the direct connection between performance on these "leading indicators" and subsequent strong financial results.

## The Current Controversy

In the wake of the #MeToo movement and Black Lives Matter, many companies adopted more proactive, public positions on diversity, equity, and inclusion (DEI) initiatives. And some companies added DEI metrics to their management incentive plans to underscore their organizations' commitment to these efforts. In fact, between 2020 and 2023 we saw the prevalence of DEI-related incentive metrics increase from 16.4% to 45.8% among the S&P 500. We're now seeing the pendulum swing back, as companies react to Executive Orders, activist shareholders, and potential legal action. In the most recent 2025 proxy season, we saw the use of DEI-related incentive metrics drop to 1.2% among the S&P 500.

As committees calibrate their response to the DEI roller-coaster, how can they lower the temperature, elevate the conversation, and find equilibrium?

## It's Just Another Non-Financial Metric

The goal of an incentive plan is to reward the actions and behaviors of employees that the board and management team have identified as creating value for the organization. Most companies rely heavily on financial metrics in incentive plans because they represent the concrete results of the organization's efforts. However, financial metrics are backwards looking. Thoughtfully selected non-financial metrics can provide a good forward-looking counterbalance in incentive plan design.

Committees considering using DEI, or any other ESG measure, as an incentive metric should assess the metric through the same lens as any non-financial metric. Good questions to consider include:

- Is the measure a leading indicator of future value creation, i.e., will strong performance in the ESG measure lead to improved future financial performance?
- Can performance be measured, and do we have a sufficient baseline to be able to set realistic and achievable targets?
- Are the metric results measurable, consistent, and repeatable?

Establishing a consistent, impartial set of criteria to evaluate all non-financial metrics can neutralize the potential rhetoric around hot button issues.

What Else?

Of course, an incentive plan is not the only means that the board and management has to reinforce corporate priorities. The benefits and perquisites a company offers, and its work environment, send signals about corporate culture. Companies have opportunities to send messaging to their workforce, customer base, and investors based on who they hire and who they promote. For example, in succession planning one of the criteria could be whether a candidate demonstrates the values that you want to recognize and reward through promotion. The same is true for choosing the criteria for recruiting and hiring, salary increases, and career development opportunities.

Considering the full range of factors that impact the employee-employer relationship, rather than focusing solely on compensation, allows the committee to expand the discussion around ESG.

Find the Sweet Spot

Applying a measured, intentional, and thorough approach to the discussion of ESG allows the committee to ensure alignment between the right measures and the right human capital focus, whether that's as a metric in the incentive plan, a part of the promotion criteria, or some other manifestation of the role ESG plays in long-term company success.

## 5. Executive Succession and CEO Turnover

The most important decision a board of directors will ever make is usually choosing the next CEO. And the CEO role has arguably never been more challenging.

The role of CEO has been steadily getting more complex over the last 10-15 years. Nowadays, the level of change is constant. Geopolitical issues are becoming greater. Pressure from the investment community is high. Activists are getting more involved. CEOs are being asked to constantly perform at levels that have never been required before.

At the same time, and for many of the same reasons, CEOs are burning out more frequently. At some point, a mature, self-aware CEO knows when they've hit their limit. Indeed, the data indicate that average tenure is decreasing by about 20-30%. At one time, the average CEO tenure was around 8-10 years. Now it's more likely to be 5, 6, or 7 years.

Smart Succession Planning Starts Early

On day one of a new CEO's tenure, then, the board should be saying, "Let's start talking about planting the seeds for selecting our next CEO." A smart, experienced, and secure CEO will be right there with them, saying, "I know I'm new, but I also believe that it's important to build the bench of the future, so I want to start now."

The fact of the matter is, if you don't plant the seeds early, you won't be ready in 5, 6, or 7 years, at which point succession planning becomes a hurried necessity rather than a thoughtful strategy. In reality, it's never too early to start preparing for the future.

What Good Process Looks Like

To start, the CEO succession process should be grounded in the business strategy. The board can begin by clarifying requirements for the next CEO based on the company's expected future needs. Once the board has created the CEO profile and the set of competencies that are best attuned to your business strategy, engage with the current CEO to identify potential internal candidates. Often, the CHRO also helps with planning for the development and assessment of potential candidates.

Going forward, the board can then focus on monitoring the development of promising candidates. Along the way, constantly revisit the criteria you've identified for the future to make sure the candidates are a good fit. Also, the compensation committee should update the entire board quarterly on the development and assessment process. When you get closer to the time of succession—within the last couple years, say—accelerate the board's involvement in getting to know the candidates and their capabilities, and determining if one or more might be the right person to take over the organization.

A More Expansive View of Succession

Increasingly, boards are becoming more involved with succession more broadly, for example, with the first layer of leadership that reports to the CEO. Sometimes, compensation committees look even deeper into the organization. For example, knowing what the top 50 executives look like in relation to your forward-looking criteria gives the board a leg up in understanding how the company is building for the future.

If there's no depth in the C-suite and you haven't developed any promising internal candidates, then you will be forced to bring in someone from the outside. While that can be the right decision, depending on circumstances, you don't want that to be your only option.

During succession planning, organizations often look to a third party to help in assessing, developing, and coaching the potential candidates you've identified. An external third party can also provide the board with a partner that they can look to for objective feedback on these individuals.

Be Transparent

In the past, many boards and organizations were reluctant to reveal any information on their succession plans because they thought it was tipping their hand. Now, though, it's seen more as an indication of good governance.

The key is to let it be known that you are working on a multi-year executive succession plan. By having a long-term process in place to look at the next CEO—or even the next two

CEOs—you can avoid roiling the waters with a sudden or unexpected announcement along the lines of, “Well, the CEO is turning over in the next 18 months, so we better start looking.”

Additionally, a board will be ripe for activism if you don't appear to have a strong slate of executives driving forward into the future. There are plenty of examples of companies where activists are looking for a long-term growth plan that includes actively developing the people who are going to be leading the charge. In addition, a greater level of transparency not only helps externally, but also internally in terms of making sure that you have the appropriate retention across management team.

Finally, recognize that no two CEO successions are alike. But regardless of your particular situation, remember that you’re much more likely to regret starting the succession process too late than starting it too early.

## In Conclusion

One thing is certain: 2026 will bring more change. In our experience, working with thousands of public and private companies, two board attributes that help weather heavy storms are a proactive stance and a core philosophy of making strategic decisions based on the individual facts and circumstances of each organization. Whether it’s actively exploring these five scenarios, or others that might arise, the good news is that compensation and human capital committees (whatever they might be called) have numerous opportunities and tools available to help steer their companies and management teams to successful outcomes.

## About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.