# IBA 7th Annual Corporate Governance Conference: Executive Compensation During the Pandemic and Beyond

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# Agenda

- **Reflections and Lessons from the Pandemic Era**
- **Increasing Role and Influence of the Compensation Committee**
- **Expanding Regulatory Environment**
- **Performance-Based Pay Issues**
  - Trends
  - ESG Matters
  - Clawbacks and Other Governance Matters
  - Mega Grants and ATypical Arrangements
- **Closing Commentary**

# Executive Compensation in the Headlines

***The Coronavirus pandemic: Executive pay cuts a sign of the times***
(Reuters)

***As the Pandemic Forced Layoffs, C.E.O.s Gave Up Little***
Some corporate bosses offered to cut their pay, but most did not. Those who did gave up less than 10 percent of what they received last year (NY Times)

***Dozens of large companies "rigged" CEO pay during pandemic, study claims***
(CBS News, May 2021)

***CEO pay a mixed bag following a year of volatility in pandemic*** *(Pensions and Investments)*

***C.E.O. Pay Remains Stratospheric, Even at Companies Battered by Pandemic***
While millions of people struggled to make ends meet, many of the companies hit hardest in 2020 showered their executives with riches (NY Times, April 2021)

***WSJ: CEO compensation rose in 2020, despite pay upsets for other workers***
(Wall Street Journal, May 2021)

# Reflections and Lessons from the Pandemic Era

# Reflections and Lessons from the Pandemic Era

- **Initial Crisis Phase and Response**
  - Business Continuity During the Lockdowns
  - Moving Functions to Remote Environment
  - Pay and Compensation Program Adjustments

- **Employee Support and Engagement in Dynamic Work Environment**

- **Government Assistance Programs and Compensation Restrictions**

- **Retention Issues**
  - The Great Resignation
  - “Quiet Quitting”

# Increasing Influence and Role of the Compensation Committee

# Increasing Influence and Role of the Compensation Committee

- **Historic Focus of Compensation Committees**
  - All forms of compensation of executive officers and key employees
  - CEO performance review*
  - Executive-level agreements (*e.g.*, employment agreements, equity-based awards, change-in-control arrangements, severance entitlements and transition agreements)
  - Equity-based compensation for all employees (with some limited delegation)
  - CEO succession planning*
  - Governance items, including stock ownership guidelines and clawback policies*
  - Benefit plan oversight/delegation
  - Review of, and recommendations relating to, director equity awards and deferral programs*

**May overlap with Nominating & Governance Committee and the Board of Directors*

# Increasing Influence and Role of the Compensation Committee (cont'd)

- **Center on Executive Compensation/HR Policy Association Survey**
  - 2/3 of member companies have formally expanded the role of the Compensation Committee (small sample group)
  - 35% expanded charter
  - 32% expanded both charter and Committee name

- **Expanded Role Encouraged by Variety of Stakeholders**
  - Institutional investors
  - Proxy advisors
  - SEC (rule on human capital disclosures)
  - Employees
  - Customers
  - Media/public opinion

# Increasing Influence and Role of the Compensation Committee (cont'd)

- **Expanded Focus on Compensation Committee**
  - Human Capital/Talent Management
  - Diversity, Equity and Inclusion
  - ESG
  - Retention
  - Succession considerations beyond CEO
  - Training/Reskilling
  - Culture and Employee Engagement
  - Pay Equity
  - Safety and Wellbeing

# Increasing Influence and Role of the Compensation Committee (cont'd)

- **Change of Name of Compensation Committee**
  - Compensation and Human Capital Committee
  - HR Committee
  - Compensation and Management Development Committee
  - Various Iterations

- **Change of Charter**
  - Inclusion of expanded duties, functions and responsibilities

- **Additional Processes**
  - Involvement of HR
  - Sharing of additional statistics/information with the Committee

# Expanding Regulatory Environment

# New U.S. Pay Versus Performance Rule

- **In August 2022, the SEC finalized a new rule that requires new disclosures of executive pay compared to company performance**
  - The rule was originally proposed in 2015, but languished for years

- **Rule requires new charts and disclosure (in some cases complex disclosures) comparing executive pay to company performance**
  - All SEC registered issuers must comply (exception for FPIs and limited others)
  - Disclosure begins in next proxy statement
    - Calculations initially go back 3 years, but later expand to 5 years

| Year | Summary Compensation Table Total for PEO | Compensation Actually Paid to PEO | Average Summary Compensation Table Total for Non-PEO Named Executive Officers | Average Compensation Actually Paid to Non-PEO Named Executive Officers | Value of Initial Fixed $100 Investment Based On: | | Net Income | [Company -Selected Measure] |
|---|---|---|---|---|---|---|---|---|
| | | | | | Total Shareholder Return | Peer Group Total Shareholder Return | | |
| | | | | | | | | |

# New U.S. Pay Versus Performance Rule (cont'd)

- **Discussion of metrics evaluated by Compensation Committee**

- **Compensation "actually paid"**
  - What does it mean?
  - Complex and new calculation

- **Discussion Items**
  - Placement of new disclosure
  - Utility of new disclosure
  - Compliance burden

# U.S. Clawback Rules: Coming Soon

- **In the U.S., the Dodd-Frank Act required the SEC to adopt rules providing for the clawback of performance-based compensation in the event of accounting restatements**
  - Rules were proposed in 2015, but languished for several years
  - In October, the SEC reopened a comment period on these proposed rules

- **Expectation is that final rules will be adopted in the near term**

- **Issues to consider:**
  - Effective Date
  - Application to Restatements and Financial Statement Revisions
  - Stock Price Goals
  - Foreign Private Issuers
  - Others

- **Similar Non-U.S. Rules**

# European and UK/Irish Regulatory Developments

- **Executive remuneration in financial institutions – EU regulatory developments**
  - Various amendments to existing legislation and introduction of new prudential regimes which impact executive remuneration in financial institutions
  - CRD V regulates bankers' bonus payments and payouts, including malus and clawbacks, bonus deferrals, and a requirement to pay a portion in shares or instruments
  - Under the new IFD/IFR regime, Investment Firms are now subject to a new remuneration regime closer to CRD V. Two key differences with the CRD are the absence of a mandatory bonus cap; and investment firms are exempt from the requirements to pay out variable remuneration in instruments or from deferring the payment of variable remuneration where the firm has on and off balance sheet assets equal to or less than €100 million
  - EBA High Earners Collection of Data – reporting and disclosure requirements for financial intuitions. Brexit has had a significant impact on the high-earners disclosed. The separate collection of data from credit institutions and investment firms should provide an interesting comparison between institution types

# European and UK/Irish Regulatory Developments

- **Insights from the FCA "Dear Remuneration Committee Chair" letter for 2022 / 2023 addressed to remuneration committee chairs of proportionality level one banks, building societies and PRA designated investment firms**
  - FCA views remuneration as an important driver of firm purpose, values and long-term strategy
  - The letter also details how the FCA sees pay as a key tool by which firms can embed regulatory imperatives such as diversity and inclusion, ESG, operational resilience and individual accountability. As such, there is an ever-increasing emphasis on the requirement on firms to utilise pay adjustments (whether in-year, malus or clawback) to align risk and performance with remuneration outcomes
  - Letter does not appear to contain any expectations that should come as a surprise - majority of topics covered, and the interaction with a firm's remuneration, have been areas of focus for the UK regulators for a number of years.

# European and UK / Irish Regulatory Developments

- **The Gender Pay Gap legislation in Ireland and the UK**
  - The Gender Pay Gap refers to the difference in the average hourly pay of women compared to men in a particular organisation and is designed to capture the extent to which women are evenly represented across an organisation.
  - The Gender Pay Gap Reporting legislation places reporting and publication obligations on both private and public sector employers.
  - In the UK, the regulations apply to employers with 250 or more employees. In Ireland, they apply to employers with 250 or more employees for the first two years after their introduction. In the third year, the Regulations will also apply to employers with 150 or more employees. After three years the Regulations will apply to employers with 50 or more employees.
  - While both jurisdictions require employers to report the proportion of men and women who receive bonuses, Ireland also requires employers to report on the proportion of men and women who receive benefit in kind and requires both private and public sector employers to report on the difference in the average hourly pay of women compared to men in their organisation

# European and UK/Irish Regulatory Developments

- **ESG reporting requirements for companies and mandatory disclosures by financial services firms are expanding rapidly with Europe leading the way**
  - The proposed EU Corporate Sustainability Reporting Directive (CSRD) further develops the Non-Financial Reporting Directive (NFRD), which requires around 11,000 large companies to disclose proportions of turnover and expenses relating to environmentally sustainable activities
  - The CSRD will Extend the scope of NFRD to all large companies and all companies listed on regulated markets (except listed micro-enterprises), with future capture of non-listed entities. The CRSD will also expand the reporting requirements and require the audit of all reporting information
  - As disclosure obligations increase, expect the appointment of ESG disclosure committees to ensure diversity of perspectives and focus on reporting quality. Such new committees would have broad representation across the company, including not only finance and audit, but also legal, HR, and investor relations - a cross-functional ESG committee.

# European and UK/Irish Regulatory Developments

- **Trend amongst European regulators of increasing focus on the impact of remuneration on conduct**

  Regulators expect that Remco chairs are responsible for appropriate, timely and transparent adjustments to remuneration where there is evidence of regulatory failure, and there should be a clear, strong link between conduct and remuneration outcomes

  Companies need to be prepared for conduct risk inspections, including:

  - preparing teams for regulator interviews and audit of information disclosed; and
  - preparing for full, targeted or thematic conduct risk assessments – significant focus on remuneration

# Performance Based Pay Issues

# Performance Based Compensation - Background

- **A key compensation issue during and post pandemic era relates to the treatment of performance based compensation**
  - Winners and losers
  - Performance goals and corresponding targets were not achieved for certain companies in 2020/2021 due to economic challenges, stock volatility and business uncertainty surrounding COVID-19 and continue to be an issue
  - Other companies rebounded and/or had strong performance

- **Some companies that sponsor these arrangements amended or substituted performance-based plans, programs and practices, as well as the underlying awards, and/or considered modifying pre-established performance goals**

# Key Action Steps/Considerations for Addressing Performance Based Compensation

- **<u>Review Arrangements</u>. Review and analyze current arrangements and the impact of current business conditions on performance based compensation**
- **<u>Are Changes Advisable and Possible</u>? Determine whether the current program works and whether changes to performance goals and targets are necessary or advisable**
- **<u>What Changes are Appropriate</u>? Consider what changes to performance based awards should be made**
  - New metrics
  - Resetting goals
  - Use of absolute versus relative performance goals
  - Use of non-financial metrics (*e.g.*, operational goals, ESG)
  - Increased use of discretion
  - Special incentives
  - Adjusting equity grant practices

# Key Action Steps/Considerations for Addressing Performance Based Compensation (cont'd)

- **<u>Document Limitations</u>. Determine whether the company has the legal authority under the applicable documents to make changes (such as to the targets and the performance goals); how much discretion (if any) is include in the documents?**
  - Adjustment provisions
  - Need for employee consent?
  - Share limits
- **<u>Award Windfalls</u>. In addressing performance based compensation, care should be taken to avoid award windfalls**
  - Challenges with share grants based on fixed cash value when stock price is depressed
  - Impact of large number of awards on burn rate
  - Impact of market rebound
- **<u>Stockholder Approval Requirements</u>. Depending on the actions taken to address performance based compensation (and, specifically, equity-based incentive compensation), companies may need to seek stockholder approval (*e.g.*, increase in share reserve, option repricings)**

# Key Action Steps/Considerations for Addressing Performance Based Compensation (cont'd)

- **<u>SEC Disclosure Considerations</u>. Actions impacting equity plans and/or the named executive officers will likely trigger SEC disclosure for publicly-traded companies**
- **<u>Views of Institutional Investor and Proxy Advisory Firms</u>. For publicly-traded companies, these views should be considered. We saw some additional flexibility this past year, but likely to have less flexibility moving forward.**
  - Transparent disclosure is very important
- **<u>IRC Section 409A Considerations</u>. Care should be taken to ensure that any modification to awards complies with the deferred compensation rules under Internal Revenue Code Section 409A**

# Key Action Steps/Considerations for Addressing Performance Based Compensation (cont'd)

- **<u>Tax Deductibility</u>. Amendments and other modifications to grandfathered performance based awards could jeopardize grandfathering treatment under Internal Revenue Code Section 162(m)**
  - $1 million compensation deduction limit on CEO, CFO and next three most highly compensated officers
  - Elimination of performance based exception, although certain arrangements are grandfathered (as long as not materially amended)
  - Less relevant now
- **<u>Accounting Treatment</u>. Changes to performance-based compensation or the use of discretion may trigger adverse (liability) accounting treatment instead of fixed accounting treatment**

# Mega Grants and Atypical Arrangements

# Mega Equity Grants in the Pandemic Era

- Palantir and DoorDash CEOs Top List of Biggest Pay Packages in 2020. Data-analysis company’s Alexander Karp and meal deliverer’s Tony Xu received compensation far exceeding that of S&P 500 CEOs (Wall Street Journal, June 2021)
- Regeneron's CEO, CSO pay under fire from advisory firms, who call on shareholders to oust a board member (Fierce Pharma, June 2021)

# Mega Equity Grants in the Pandemic Era

- **2020/2021 was been a boom time for IPOs**
- **Many IPO companies are providing Founders with large one-time equity awards with ambitious performance stock price targets**
  - Many of these awards are valued at hundred of millions of dollars at grant, representing high risk/high reward opportunities
  - Executives usually will not receive another award for many years
- **Also, during the height of the pandemic, some companies made significant grants to executives tied to stock price turnarounds**
- **Investor reaction is mixed**
- **What happens if awards become unachievable?**

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