# “The Top Compensation Consultants Speak”

## Wednesday, May 21, 2025

## Course Materials

**<u>"The Top Compensation Consultants Speak"</u>**

**Wednesday, May 21, 2025**

2 to 3 p.m. Eastern [archive and transcript to follow]

Our annual webcast focusing on what compensation committees should be learning about — and considering — today. Join these experts:

- **Blair Jones**, Managing Director, Semler Brossy
- **Ira Kay**, Managing Partner, Pay Governance
- **Jan Koors**, Senior Managing Director and Western Regional President, Pearl Meyer

Among other topics, this program will cover:

1. DEI Programs, Disclosures & Metrics: The Compensation Committee's Role
2. Plan Design & Goal Setting Amid Uncertainty & Volatility
3. Key Changes in Investor & Proxy Advisor Policies & Their Impact in 2025
4. Metrics & Perks: Notable Observations from the 2025 Proxy Season So Far
5. Compensation-Related Shareholder Engagement
6. Did Dodd-Frank Rules Reduce or Curb CEO Pay or Change Incentive Design?

**"The Top Compensation Consultants Speak"**

Course Outline

1. DEI Programs, Disclosures & Metrics: The Compensation Committee's Role

    - On January 20, 2025, President Trump signed an Executive Order titled "Ending Radical and Wasteful Government DEI Programs and Preferencing" that, in part, directs federal agencies to terminate federal contracts and grants related to diversity, equity and inclusion, as well as environmental justice related contracts and grants within 60 days.

    - On January 21, 2025, President Trump signed an Executive Order titled "Ending Illegal Discrimination and Restoring Merit-Based Opportunity," which directs the U.S. Attorney General, in consultation with the relevant agencies, to submit a report by May 21, 2025, with recommendations for taking appropriate measures "to encourage the private sector to end illegal discrimination and preferences, including DEI." As part of the plan, the agencies must identify up to nine potential civil compliance investigations of different kinds of organizations, including public companies.

    - The U.S. Equal Employment Opportunity Commission ("EEOC") recently issued two technical guidance documents following up on President Trump's executive order targeting private sector DEI programs.

        - The first is a brief document issued jointly by the EEOC and Department of Justice ("DOJ") titled "What to Do If You Experience Discrimination Relating to DEI at Work."

        - The second, which was issued solely by the EEOC, is titled "What You Should Know About DEI-Related Discrimination at Work," and includes 11 Q&As addressing DEI-related actions that the EEOC regards as discriminatory.

    - Pearl Meyer recently reviewed the first 100 proxy statements filed by S&P 500 companies in 2025 and found that:

- "The significant increase in recent years in the use of ESG and, more specifically, diversity and inclusion measures in executive incentives appears to be reversing course, at least in part due to the current political and social environment. Among the first 100 S&P 500 proxy filers, the prevalence of diversity measures in incentive programs sharply declined from 65% in 2023 to 35% in 2024. We expect a further decline in prevalence in 2025 as several companies proactively disclosed discontinuation for 2025."

2. Plan Design & Goal Setting Amid Uncertainty & Volatility

- Semler Brossy suggests that boards and compensation committees consider developing a framework for responding to tariffs (from a compensation perspective) before they are announced, considering both:

  - In-flight incentives (although any adjustments will attract criticism from investors and proxy advisors), and

  - New awards (where companies may be able to take tariffs into account when setting new goals, even though investors generally expect companies to adjust operations and work through the expected impact).

- They also suggest that boards need to be doing the following in the short term:

  - **Discuss the possible scenarios where adjusting incentives may be necessary.** No matter what happens in the future, the committee can build consensus about how to plan for future actions when and if tariffs are imposed and outline likely scenarios where tariffs may require a change to incentive plans.

  - **Size potential adjustments.** Following alignment on a framework, estimate the cost of any changes and their resulting impacts under various tariff scenarios outlined above.

  - **Build flexibility into existing plan language.** This ensures appropriate discretion/actions can take place should an adjustment be deemed necessary.

  - **Conduct a deep dive into the existing incentive plans.** Keep an eye on ways incentive plans might be made more durable. This could be by adding emphasis on relative metrics, expanding threshold and maximum goal ranges, or adding an additional operational modifier that allows for subjective year-end assessment (note: this list is non-exhaustive).

- Generally, when developing compensation programs in periods of great uncertainty, companies may consider:

  - Diversifying metrics,

  - Using more strategic and/or relative measures,

  - Changing the payout range and/or curve,

  - Shortening performance periods,

  - Delaying setting performance goals, and/or

  - Identifying certain unanticipated events that the compensation committee agrees it will adjust results or goals to address during or after the performance period (and developing related guidelines).

3. Key Changes in Investor & Proxy Advisor Policies & Their Impact in 2025

- Glass Lewis published its 2025 Voting Policy Guidelines in November. Here is the description of the two updates that relate to executive compensation matters from the Summary of Changes for 2025:

  - **Change-in-Control Provisions:** "We have updated our discussion of change-in-control provisions in the section 'The Link Between Compensation and Performance' to define our benchmark policy view that companies that allow for committee discretion over the treatment of unvested awards should commit to providing clear rationale for how such awards are treated in the event a change in control occurs."

  - **Approach to Executive Pay Program:** "We have provided some clarifying statements to the discussion in the section titled 'The Link Between Compensation and Performance' to emphasize Glass Lewis' holistic approach to analyzing executive compensation programs. There are few program features that, on their own, lead to an unfavorable recommendation from Glass Lewis for a say-on-pay proposal. Our analysis reviews pay programs on a case-by-case basis. We do not utilize a pre-determined scorecard approach when considering individual features such as the allocation of the long-term incentive between performance-based awards and time-based awards. Unfavorable factors in a pay program are reviewed in the context of rationale, overall structure, overall disclosure quality, the program's ability to align executive pay with performance and the shareholder experience and the trajectory of the pay program resulting from changes introduced by the compensation committee."

- ISS updated its FAQs on executive compensation policies in December and materially updated the following:

  - **Computation of Realizable Pay (Question 24):** "[T]he realizable pay chart will not be displayed … for companies that have experienced multiple (two or more) CEO changes within the three-year measurement period."

  - **Evaluation of Program Metrics (Question 39):** While still not endorsing TSR or any other specific metric, ISS will consider the following factors when evaluating metrics:

    - "Whether the program emphasizes objective metrics that are linked to quantifiable goals, as opposed to highly subjective or discretionary metrics;

    - The rationale for selecting metrics, including the linkage to company strategy and shareholder value;

    - The rationale for atypical metrics or significant metric changes from the prior year; and/or

    - The clarity of disclosure around adjustments for non-GAAP metrics, including the impact on payouts."

  - **Changes to In-Flight Programs (Question 42):** Consistent with a prior FAQ focused on COVID-era pay program changes, ISS still generally views changes to in-process pay programs (*e.g.*, metrics, performance targets and/or measurement periods) negatively. Clear disclosure is expected addressing rationale and how the changes do not "circumvent pay-for-performance outcomes."

- Most importantly, ISS added the following new FAQ, which was also previewed by the proxy advisor when it announced the opening of the comment period on proposed changes to its benchmark voting policies:

  > **"[Question 34] ISS previously announced adaptations to the pay-for-performance qualitative review effective for the 2025 proxy season, relating to the evaluation of performance-vesting equity awards. What does this entail?**
  >
  > Beginning with the 2025 proxy season, ISS will place a greater focus on performance-vesting equity disclosure and design aspects, particularly for companies that exhibit a quantitative pay-for-performance misalignment. While ISS has historically analyzed the disclosure and design of incentive programs as part of the qualitative review, investors have increasingly expressed concerns with the potential pitfalls surrounding performance equity programs. As such, existing qualitative considerations around performance equity programs going forward will be subject to greater scrutiny in the context of a quantitative pay-for-performance misalignment. Typical considerations include the following non-exhaustive list:

- Non-disclosure of forward-looking goals (note: retrospective disclosure of goals at the end of the performance period will carry less mitigating weight than it has in prior years);
- Poor disclosure of closing-cycle vesting results;
- Poor disclosure of the rationale for metric changes, metric adjustments or program design;
- Unusually large pay opportunities, including maximum vesting opportunities;
- Non-rigorous goals that do not appear to strongly incentivize for outperformance; and/or
- Overly complex performance equity structures.

Multiple concerns identified with respect to performance equity programs will be more likely to result in an adverse vote recommendation in the context of a quantitative pay-for-performance misalignment."

4. Metrics & Perks: Notable Observations from the 2025 Proxy Season So Far

- Increase in reported perquisites due to executive security expenditures:
  - Incrementally in 2025 proxies reporting compensation for 2024, and
  - Expected to increase more significantly in 2026 proxies reporting compensation for 2025.
- Pearl Meyer recently reviewed the first 100 proxies filed by S&P 500 companies and found that:
  - Diversity-related incentive measures significantly decreased in prevalence,

  - Performance-based stock awards continue to be the predominant long-term incentive vehicle, and

  - Relative Total Shareholder Return ("rTSR") continues to be the most prevalent performance-based equity award measure.

5. Compensation-Related Shareholder Engagement

- The Staff in the SEC's Division of Corporation Finance issued updated guidance on beneficial ownership reports in early 2025 in the form of Compliance & Disclosure Interpretations related to the filing of Schedule 13D or the shorter form Schedule 13G. (*See* amended Question 103.11 and new Question 103.12 of the Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting Compliance & Disclosure Interpretations.)

- The fallout from this guidance initially disrupted the willingness of some asset managers to engage with companies in which they have a significant ownership interest as they considered how engagement might affect their beneficial ownership reporting requirements.

- BlackRock and Vanguard resumed engagements, but this might have stifled engagement in the 2025 proxy season.

- Changes to investor engagement practices and voting policies may impact "responsiveness" disclosures, which are often provided after a year of low support due to proxy advisor policies.

  - Specifically, if a company receives less than 70% support (ISS) or 80% support (Glass Lewis), the proxy advisors may recommend against reelection of the company's compensation committee members or the entire board in subsequent years unless it shows "responsiveness" (which entails disclosing the process used to reach out to shareholders, the feedback received, and what the company did in response).

6. Did Dodd-Frank Rules Reduce or Curb CEO Pay or Change Incentive Design?

- Discussion of various requirements that came out of Dodd-Frank rulemaking and whether and how they impacted CEO pay:
  - Say-on-Pay votes required by Exchange Act Rule 14a-21 and Item 24 of Schedule 14A (and frequency of Say-on-Pay votes and Say-on-Golden-Parachute votes)
  - CEO pay ratio disclosure required by Item 402(u) of Regulation S-K
  - Dodd-Frank clawback policies required by listing standards adopted pursuant to Exchange Act Rule 10D-1 and related disclosure requirements under Item 402(w) of Regulation S-K
  - Independence of compensation committee members and requirement to consider certain factors before compensation committees select advisors required by listing standards adopted pursuant to Exchange Act Rule 10C-1 and related disclosure requirements under Item 407(e) of Regulation S-K
  - Pay versus performance disclosure requirements under Item 402(v) of Regulation S-K
  - Risk assessment and related disclosure under Item 402(s) of Regulation S-K
  - Hedging disclosure under Item 407(i) of Regulation S-K
  - Disclosure regarding board leadership structure under Item 407(h) of Regulation S-K
  - Rulemaking under Section 956 of the Dodd-Frank Act related to incentive compensation at financial institutions

**“The Top Compensation Consultants Speak”**

Table of Contents — Course Materials

Pearl Meyer

ARTICLE | MAR 2025

# Executive Compensation Highlights: First 100 S&P 500 Proxy Filers in 2025

Steven Van Putten

SENIOR MANAGING DIRECTOR

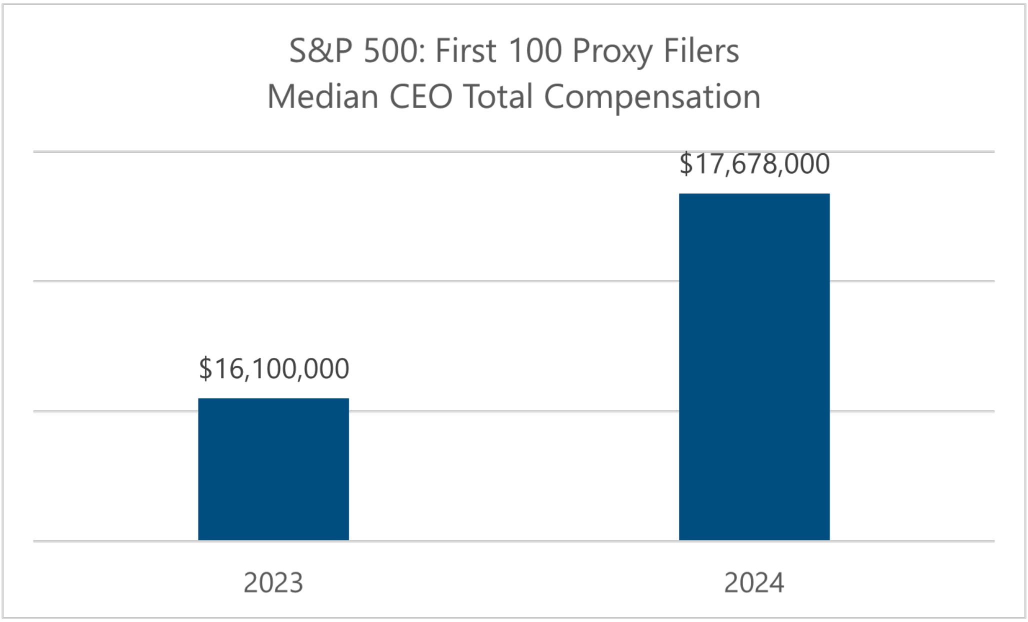
## Introduction

Pearl Meyer examined executive compensation disclosures from the first 100 S&P 500 shareholder proxy statements filed in 2025. Notable findings include the following:

- Median CEO total compensation was $17.7 million in 2024 reflecting a 9.8% rise over 2023, mostly driven by increases in short- and long-term incentive values
- Performance-based stock awards continue to be the predominant long-term incentive vehicle
- Security-related perquisites increased in prevalence likely reflecting heightened board concerns over executive safety
- Diversity-related incentive measures significantly decreased in prevalence as companies increased focus on financial and strategic measures of performance

## CEO Compensation

Among the first 100 S&P 500 proxy filers in 2025, same-incumbent 2024 median CEO total compensation was $17.7 million, reflecting a near 10% increase over same-incumbent 2023 median CEO total compensation of $16.1 million.



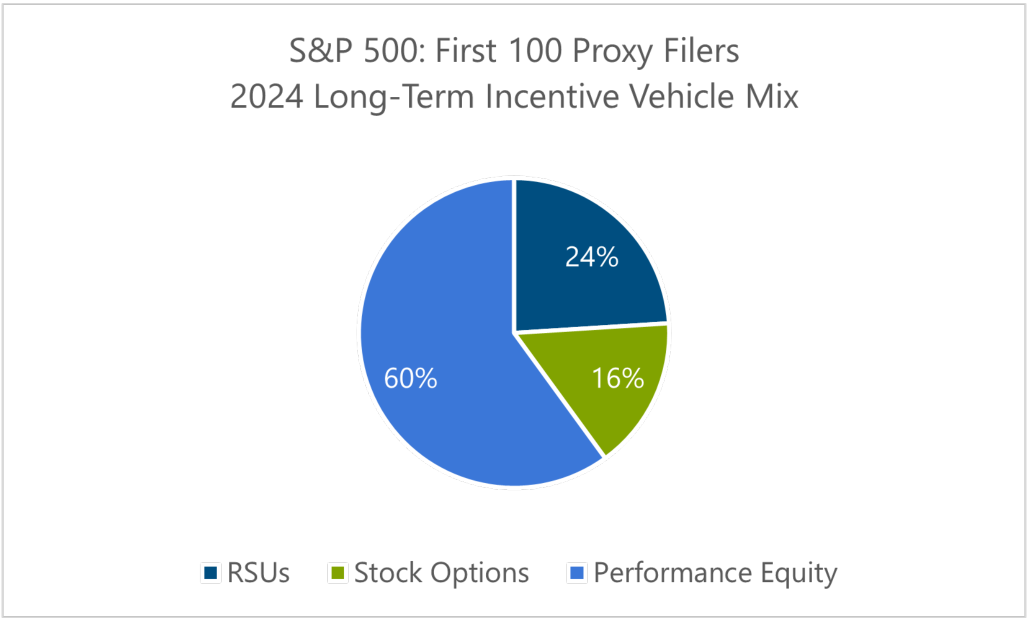

Contributing elements to the year-over-year increase in same incumbent median CEO total compensation are:

- Median base salary of $1,300,000 for 2024 versus $1,250,000 for 2023, reflecting a 4% increase
- Median paid annual cash bonus of $2,410,000 for 2024 versus $2,126,000 for 2023, reflecting a 13% increase
- Median long-term incentive value of $12,490,000 for 2024 versus $11,718,000 for 2023, reflecting a 7% increase

While the median CEO salary increased by 4%, approximately half of the first 100 S&P 500 proxy filers did not provide the CEO with an annual base salary increase. This is consistent with what we have seen in prior years as it has become increasingly common to not provide CEOs with annual merit adjustments and, instead, place greater focus on at-risk, performance-based compensation.

## Long-Term Incentive Design

Among the first 100 S&P 500 proxy filers in 2025, performance-based equity continues to represent the bulk of long-term incentive awards, representing 60% of the total, on average, followed by time-based restricted stock units (RSUs) at 24% prevalence and stock options at 16% prevalence. This 2024 long-term incentive vehicle mix is essentially the same mix as seen in 2023.



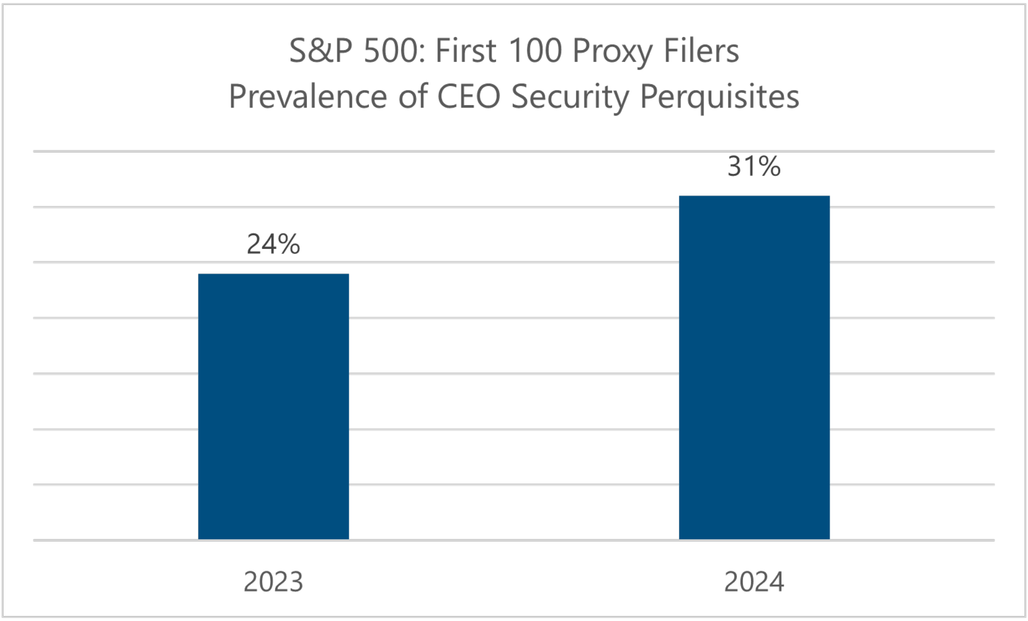

Relative Total Shareholder Return (rTSR) continues to be the most prevalent performance-based equity award measure with 64% of the first 100 S&P 500 proxy filers using that measure in 2024. The prevalence of rTSR is up 1% versus 2023. Most companies (72%) use rTSR as a weighted metric as compared to a modifier (28%), which is essentially the same as in 2023.

Although the use of rTSR avoids the challenges of setting multi-year goals in an uncertain environment, it remains important to identify those financial performance measures that drive value creation and consider such measures for inclusion in the long-term incentive program. For that reason, we encourage combining rTSR with a financial measure or alternatively, use rTSR as a modifier to a financial measure, rather than a weighted metric.

## Security-Related Perquisites

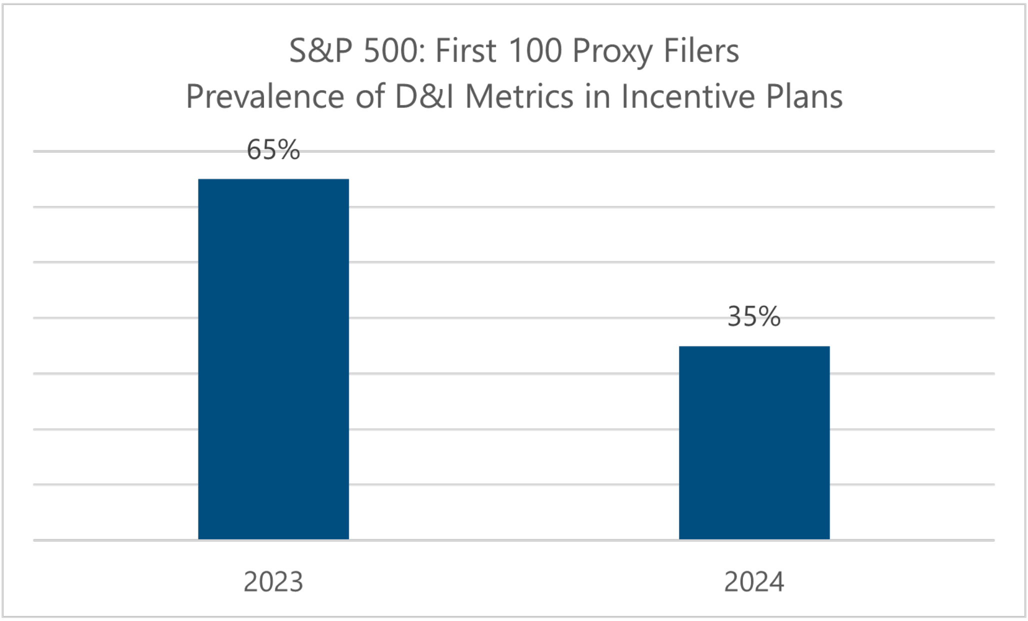
Among the first 100 S&P 500 proxy filers in 2025, there is early evidence of an increase in executive security-related perquisites. We found the prevalence of disclosed security perquisites for CEOs increased from 24% in 2023 to 31% in 2024.

Following the United Healthcare murder late in 2024, boards are increasingly concerned as to the safety of CEOs and senior leadership. We expect the prevalence to increase further in 2025 as several companies prospectively disclosed adoptions of security programs in 2025 that don't yet show up as perquisites for 2024.




## Prevalence of Diversity Measures in Incentives

The significant increase in recent years in the use of ESG and, more specifically, diversity and inclusion measures in executive incentives appears to be reversing course, at least in part due to the current political and social environment. Among the first 100 S&P 500 proxy filers, the prevalence of diversity measures in incentive programs sharply declined from 65% in 2023 to 35% in 2024. We expect a further decline in prevalence in 2025 as several companies proactively disclosed discontinuation for 2025.




## Conclusion

While it's very important to understand how your company compares to its peers and market norms on the whole, ultimately your executive compensation program needs to achieve objectives that are unique to your business. Keep an eye on the data to inform, but not dictate, the compensation levers that will drive value for your organization.

*Data Source: Main Data Group*

## About the Author

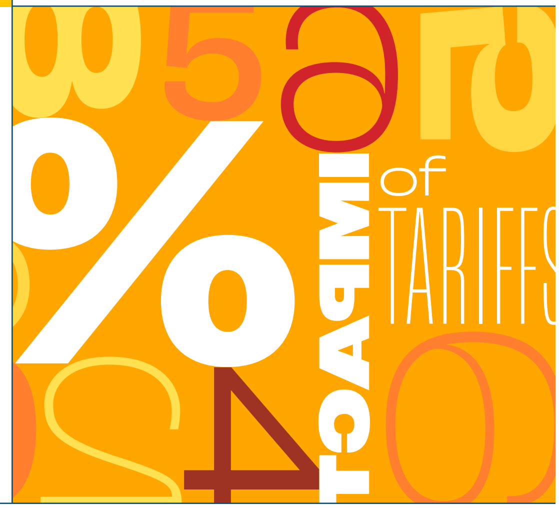
Steve Van Putten is a senior managing director with Pearl Meyer and leads the firm's efforts with respect to thought leadership and intellectual capital development. Steve's primary focus and expertise is on advising compensation committees and senior management on executive and director compensation matters. He has over 30 years of board-level experience consulting to Fortune 500 companies on executive pay.

## 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.

**SEMLER INSIGHT**

Executive & Director Pay Design




# Navigating the Impact of Potential Tariffs on Compensation Programs

MARCH 2025

**Michelle Garrett**

**Michelle Metros**

The impacts of tariffs on business results and incentive programs are a major concern for U.S. corporate boards. Many directors find themselves in an "operational limbo" due to the ambiguous effects of tariffs on compensation programs. On the one hand, the impact of tariffs aligns closely with changes in tax law (e.g., unpredictable, out of Management's control, frequently adjusted out). On the other hand, shareholders expect management to take greater control of tariff impacts, as they can have meaningful long-term effects on the business (analogous to the COVID-19 macroeconomic changes).

Due to the inherent uncertainty of any proposed or potential tariffs and the speed at which they may be implemented (as seen in the recent push and pull between and within governments), it is more vital than ever that boards and compensation committees consider a working framework for responding to possible tariffs before they are announced. This will help them best serve both management and shareholders.

## Two Lenses for Understanding a Tariff's Impacts on Incentives

Tariffs may significantly impact long-term business planning and goal setting, influencing incentive planning through two distinct lenses.

1. **Adjustments Made to In-Flight Incentives** Generally, shareholders and investors view tariffs as having an operational impact that businesses are expected to work through. Any programmatic changes will be scrutinized, particularly on long-term programs versus annual programs. Accordingly, adjustments made to in-flight incentives will generally attract stronger shareholder criticism, as there is an expectation that executives should have had the foresight to consider potential business impacts and, in certain cases, hedged or shifted course where necessary.

## 2. Goal-setting For New Incentive Awards

Looking forward, it is easier to justify taking tariffs into account in goal setting, utilizing the longer time horizon to avoid the appearance of knee-jerk changes. Still, shareholders may be wary about insulating executives from lower payouts if the direct and indirect business impacts from tariffs can't be measured precisely. When adjusting goals to account for tariffs, it is helpful to have appropriate metrics that ensure changes respond to the tariff's impact instead of compensating for a lack of foresight.

There are nuanced considerations on a company-by-company or industry basis that do not lend themselves to a one-size-fits-all approach, and shareholders will take a critical eye to any adjustments. For example, if tariffs force an organization to make rapid changes to short-term plans, adjusting in-flight incentives might be justified to ensure that everyone is aligned toward new priorities. Similarly, companies may find that long-term goals can still be met through organizational changes without adjusting incentive plans.

## Taking Action in the Face of Uncertainty

Given the level of uncertainty around potential tariffs and their impacts, it can be difficult to identify concrete steps to address them. However, there are a variety of proactive, near-term actions that boards can consider now that will set them up for success in any scenario:

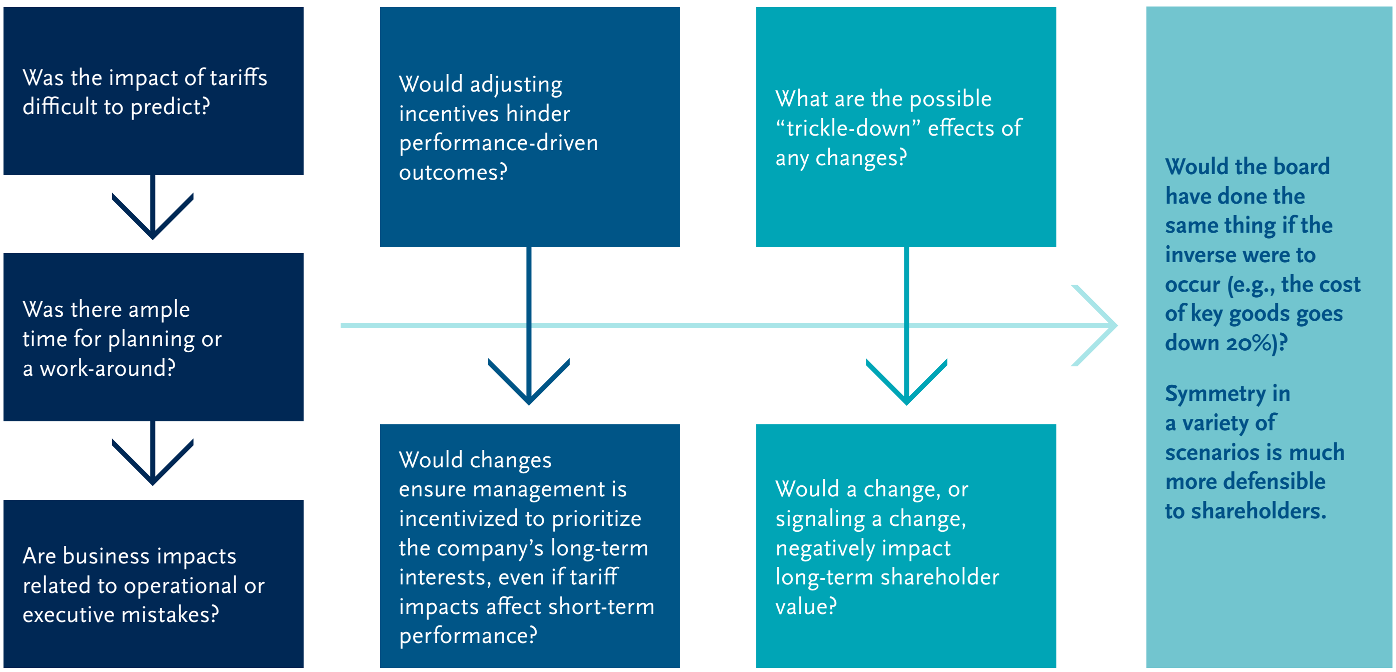
1. **Discuss the possible scenarios where adjusting incentives may be necessary.** No matter what happens in the future, the committee can build consensus about how to plan for future actions when and if tariffs are imposed and outline likely scenarios where tariffs may require a change to incentive plans.
2. **Size potential adjustments.** Following alignment on a framework, estimate the cost of any changes and their resulting impacts under various tariff scenarios outlined above.
3. **Build flexibility into existing plan language.** This ensures appropriate discretion/actions can take place should an adjustment be deemed necessary.
4. **Conduct a deep dive into the existing incentive plans.** Keep an eye on ways incentive plans might be made more durable. This could be by adding emphasis on relative metrics, expanding threshold and maximum goal ranges, or adding an additional operational modifier that allows for subjective year-end assessment *(note: this list is non-exhaustive)*.

In most cases, there is too much uncertainty to build protections into goals today. However, it is critical that boards size the potential business impacts in both the worst and best-case scenarios and then ideate on which situations might warrant an adjustment.

## Planning Ahead: A Proactive Framework

We encourage Boards to put in place/agree to the following framework when assessing whether potential adjustments to in-flight plans should be made and what the correct course of action would be:

In most cases, shareholders will react negatively to adjustments made to in-flight incentives, and in any event, boards could consider that choosing **not** to adjust anything may ensure lessons from the goal-setting process are incorporated into future grants.



## One Size Does Not Fit All: Three Case Studies

***The following hypothetical scenarios illustrate how the above framework can be implemented to best respond to tariffs.***

| Scenario 1 | MANUFACTURING COMPANY |
|---|---|
| Context | • A U.S.-based supplier of aluminum for the automotive industry is facing a 25% tariff on aluminum imports.<br>• So far, however, there has only been a moderate increase in the cost of aluminum in response to the news.<br>• The company has established long-term domestic partnerships that allow it to consider pivoting the source of aluminum, despite facing slightly higher prices locally.<br>• Annual EPS and Net Income goals currently compose 60% of the annual incentive program.<br>• The long-term incentive plan is 100% tied to relative TSR. |
| Impact | • The company estimates that the tariffs are likely to swing annual EPS and Net Income goals slightly below target.<br>• The board determines the remaining 40% weighting of strategic and individual performance metrics could allow them to recognize management's continued execution throughout the year even if targets are missed.<br>• The board concludes that making an adjustment to the incentive plan could inadvertently signal greater headwinds and potentially negatively impact long-term shareholder value. |
| Outcomes | • The company agrees to pass on a small portion of rising costs to clients through a gradual 10% price increase on finished parts.<br>• **The board makes no adjustments to the annual incentive plan,** as final outcomes are expected to be marginally impacted, since industry-wide absorption of tariffs is anticipated in the long term (i.e., likely limited impacts on the 100% relative TSR long-term plan). |

| Scenario 2 | CONSUMER ELECTRONICS COMPANY #1 |
|---|---|
| Context | • A global consumer electronics manufacturer that primarily sources from Asia faces tariffs that could increase costs significantly, with price hikes up to 45%.<br>• The company is in a weak position to renegotiate contracts, and exploring other suppliers would take a longer time horizon (3-4 years) than is feasible.<br>• With insufficient time and lack of foresight to plan appropriately, the company considers immediate operational adjustments as the most viable solution.<br>• Revenue and unit sales growth (USG) drive 100% of the annual incentive plan. |
| Impact | • Revenue and USG are projected to fall below threshold due to the tariff impact.<br>• The company examines if rebranding premium products might maintain value perception despite price increases but determines that the sizing of various strategies is not enough to offset a near-term financial hit.<br>• The board assesses whether tariff-related performance declines were due to uncontrollable external factors rather than internal execution failures. |
| Outcomes | • The company cuts medium-term guidance on a series of metrics, reducing in-flight absolute TSR PSU programs from above target to below target payouts.<br>• **No adjustments are made to in-flight programs,** as management has not adequately structured its sourcing to mitigate long-anticipated tariff risks, issues long anticipated in its primary sourcing region. |

| Scenario 3 | CONSUMER ELECTRONICS COMPANY #2 |
| --- | --- |
| Context | • A company's Generation 3 product has been on the market for a while, and competition is primarily based on price.<br>• A Generation 4 product is in development, with a plan to launch within the next 12 months.<br>• A newly implemented tariff makes it harder to compete on price, and passing the cost increase onto customers is not a viable option.<br>• Net income and cash flow are two key metrics that make up 100% of the annual incentive plan.<br>• The long-term incentive plan is tied to 100% relative TSR. |
| Impact | • The company makes a strategic decision to accelerate the Generation 4 launch, which allows for premium pricing but requires a substantial investment in inventory.<br>• This decision results in a significant write-off of Generation 3 inventory, impacting net income and cash flow.<br>• Despite short-term financial strain, the board determines that Generation 4's pricing advantage will drive future growth, while maintaining the current course will attract sustained performance headwinds in the future.<br>• The board assesses whether failing to adjust incentives could inadvertently discourage management from taking actions that align with shareholder value. |
| Outcomes | • The board determines that had the company continued selling only the Generation 3 product, it would have met at the threshold payout on the annual incentive plan.<br>• The board applies discretion to recognize management for taking the appropriate actions to protect future growth and shareholder value by pivoting to Generation 4.<br>• The company's 100% relative TSR long-term incentive program remains unchanged, as outstanding cycles are expected to appropriately reflect the company's long-term aspirational priorities despite potential headwinds in the upcoming closing cycle.<br>• **The board adjusts the annual incentive plan payout to 60% at the end of the period,** aligning with prior trending performance. |

In each sample case, the estimated size of impacts and the designs of existing programs were primary considerations in determining whether the board considered remediation tactics. Directors' fiduciary duty requires them to use selective and appropriate judgment when considering adjustments or actions regarding executive compensation, even if financial performance is lumpy.

## Conclusion

The general expectation for most companies is to adjust operations and not accounting, but boards will be expected to run through the appropriate thinking when considering making changes to in-flight incentives and goal-setting on upcoming awards, particularly in the long-term plan. The thinking on the above framework may shift as the policy landscape evolves, and compensation approaches may be re-evaluated consistently with the principles outlined above. In any case, proper disclosure will be critical when communicating the rationale for any changes to stakeholders going forward. ■

*For more information, visit us at* SEMLERBROSSY.COM, *or reach us at 310.481.0180.*

**Michelle Garrett**, Principal
mgarrett@semlerbrossy.com

**Michelle Metros**, Consultant
mmetros@semlerbrossy.com

SEMLER BROSSY
LOS ANGELES | NEW YORK

# Equity Plan Proposals: Strong Shareholder Support Continued in 2024

TEDDY LOMBARDO, LINDA PAPPAS, AND TARA TAYS

## Key Takeaways

- Nearly 25% of Russell 3000 companies submitted an equity plan proposal in 2024. Shareholder support was strong, about 90% on average, and less than 1% of proposals failed to receive majority support (very similar to 2023 levels).
- It is most common for companies to return to shareholders every 2 to 3 years to seek equity plan approvals.
- Proxy advisor opposition to equity plan proposals typically results in lower shareholder support; however, the equity plan proposal failure rate increases very modestly (to a failure rate of less than 4%).
- Russell 3000 companies that received low shareholder support had median potential dilution of 20%, or double the median of the overall Russell 3000 potential dilution of 10%.
- Among the small sample of companies that failed to receive shareholder support over the last two years, approximately half were in the healthcare sector, and the majority of companies that failed had higher potential dilution levels compared to the median of their respective sector.
- There are several steps companies can take to navigate toward a successful shareholder vote outcome for an equity plan proposal, including analyzing the share reserve needs and relative potential dilution, understanding top shareholder voting policies and proxy advisor concerns, and clearly disclosing the shareholder-friendly features of the equity plan.

## A Review of Russell 3000 Equity Plan Proposals

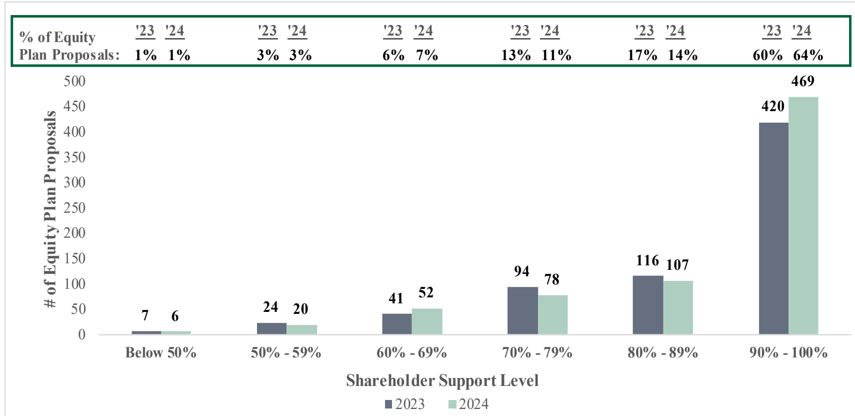
Since 2024 has wrapped up, we observed a similar number of equity proposals and shareholder support levels as in calendar year 2023. Approximately 24% of the Russell 3000 (over 700 companies) submitted an equity plan proposal for shareholder approval between January 1, 2024, and December 31, 2024. Companies have received significant support from shareholders on their 2024 equity plan proposals, about 88% support on average, and only 1% of equity plan proposals failed in 2024.

**Figure 1. Summary of Equity Plan Shareholder Proposal Outcomes in 2023 and 2024[1]**

| # of Proposals | Pass | Fail | Total |
|---|---|---|---|
| 2024 | 728 | 6 | **734** |
| 2023 | 696 | 7 | **703** |
| **% of Proposals** | **Pass** | **Fail** | **Total** |
| 2024 | 99% | 1% | **100%** |
| 2023 | 99% | 1% | **100%** |
| **Avg. Shareholder Support** | **Pass** | **Fail** | **Total** |
| 2024 | 89% | 40% | **88%** |
| 2023 | 88% | 43% | **87%** |

While 2024 shareholder support levels are similar to 2023 results, and the majority of companies received shareholder support in the 90% to 100% range, we observed a year over year decrease in the number of companies receiving support in the 80% to 89% range and the 70% to 79% range. Overall, the 2024 shareholder vote results continue to demonstrate companies receiving overwhelming support when an equity plan proposal is submitted to shareholders for approval. See Figure 2 for year-over-year details (please note two companies in 2024 and one company in 2023 did not report their vote outcomes and have been excluded from the chart).

**Figure 2. Equity Plan Shareholder Proposal Vote Results in 2023 and 2024[1]**




## Impact of Proxy Advisors' Recommendations on Equity Plan Proposal Outcomes

The majority of Russell 3000 companies received favorable recommendations from proxy advisors on their equity plan proposals (71% received support from Institutional Shareholder Services (ISS) and 85% received support from Glass Lewis (GL)). Companies that received ISS or GL opposition, on average, received lower shareholder support by about 17 percentage points and 12 percentage points, respectively. However, the equity plan proposal failure rate increases very modestly (to 1.9% when ISS is in opposition and to 3.7% when GL is in opposition).

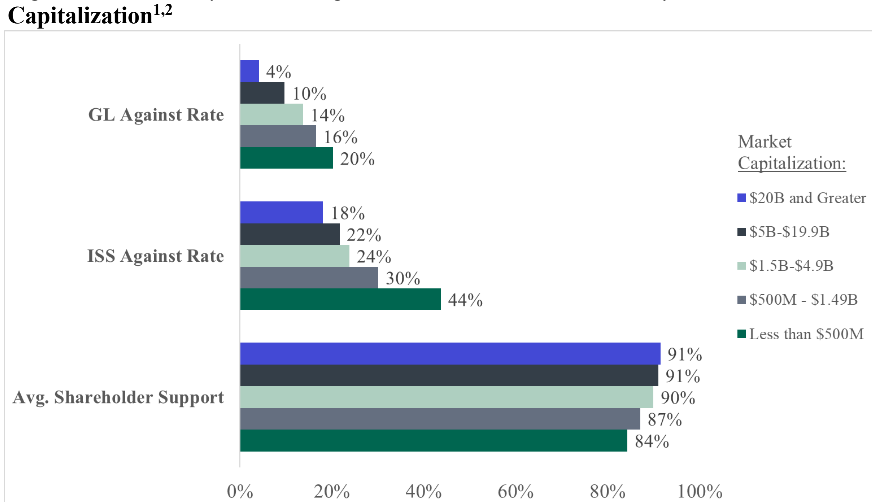
**Figure 3. 2024 Proxy Advisor Vote Recommendations[1,2]**

| Proxy Advisor Vote Recommendation | Impact of ISS Vote Recommendations | | | | Impact of GL Vote Recommendations | | |
|---|---|---|---|---|---|---|---|
| | Prevalence | Avg. Support | # Failed | *Failure Rate* | Prevalence | Avg. Support | *Failure Rate* |
| FOR | 71% | 93% | 2 | *0.4%* | 85% | 90% | *0.3%* |
| AGAINST | 29% | 76% | 4 | *1.9%* | 15% | 78% | *3.7%* |
| **Total** | **100%** | **88%** | **6** | ***0.8%*** | **100%** | **88%** | ***0.8%*** |
| ***% pt. Difference:*** | | ***-17%*** | | ***+1.5%*** | | ***-12%*** | ***+3.4%*** |

When taking a closer look at companies' average shareholder support results based on market capitalization (market cap) and industry sector (based on the 2-digit global industry classification standard (GICS)), we observed the following:

- Companies with market caps of less than $500M received the lowest shareholder support on their equity plan proposals (84% average shareholder support) and received the highest percentage of opposition from ISS and GL (44% and 20%, respectively) in comparison to larger market cap companies.
- Companies with market caps of $20B and greater received the highest support, on average, from both shareholders (91% average

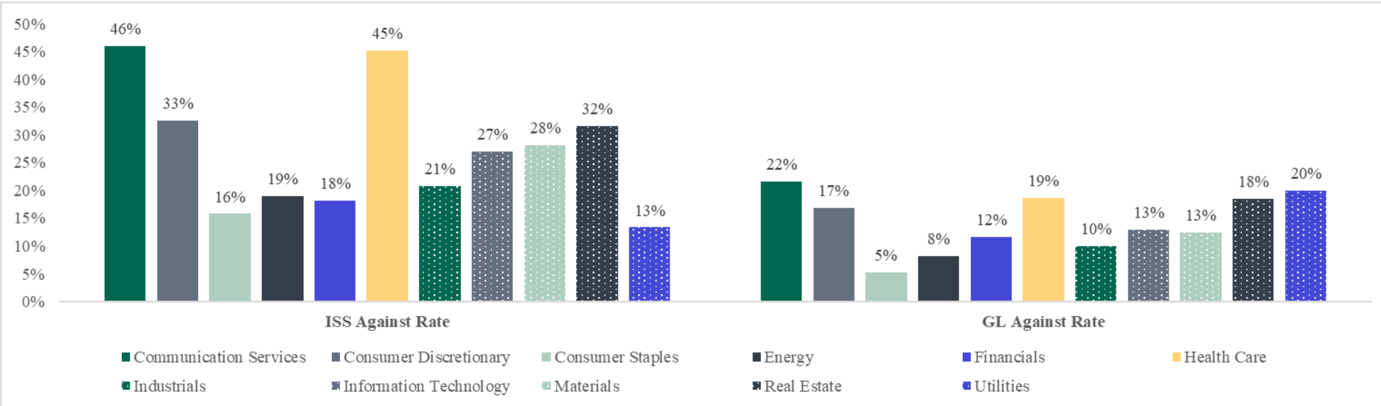
**Figure 4. 2024 Proxy Advisor Against Vote Recommendations by Market Capitalization[1,2]**



shareholder support) and proxy advisors (82% and 96% favorable vote recommendations from ISS and GL, respectively).

- Industry sectors with relatively high ISS opposition (30% and greater) included communication services (e.g., media and entertainment), health care (e.g., pharma/biotech), consumer discretionary (e.g., retail), and real estate. None of the industry sectors had GL opposition above 30%.
- The industry sectors with the lowest opposition from ISS or GL were utilities (13% from ISS) and consumer staples (5% from GL).

**Figure 5. 2024 Proxy Advisor Against Vote Recommendations by Industry Sector[1,2]**

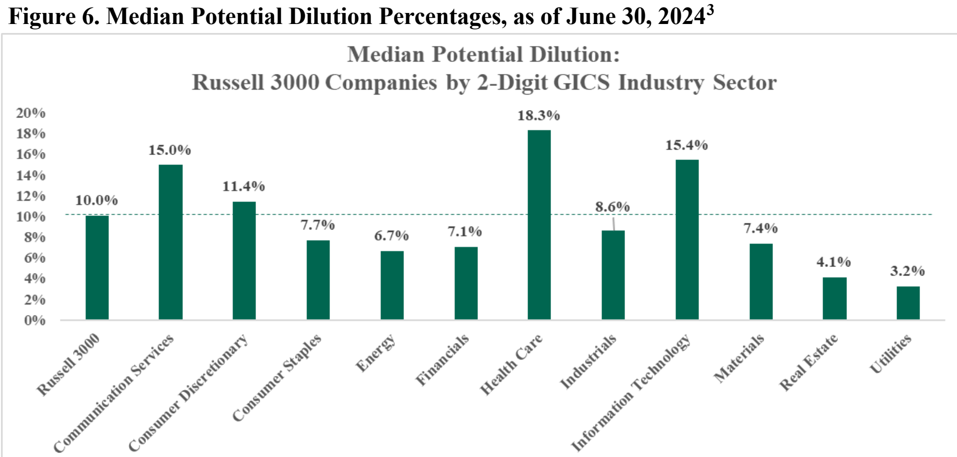



Both ISS and GL utilize proprietary models that consider quantitative aspects of shareholder dilution and equity plan share usage as well as qualitative aspects such as shareholder friendly plan provisions. Despite the complex nature of the proxy advisors' models, shareholder vote recommendations appear to generally come down to how costly the equity plan is in terms of the potential dilutive effect to shareholders and how companies have been managing equity spend.

## Potential Dilution

Potential dilution measures the impact on shareholder ownership of a company from the issuance of equity awards to employees. The dilution calculation assumes that the company grants equity awards using all available shares under the equity plan pool and that all awards are exercised/vested and settled by issuing additional shares. Median potential dilution for Russell 3000 companies is about 10%, with significant variability across industry sectors due to differences in capital structures (higher total common shares outstanding generally results in lower dilution levels), equity grant practices (e.g., award type, award size, eligibility, etc.), pay mix, and other factors. The highest median potential dilution is observed in the health care sector (18%), which includes pharma and biotech companies, while the lowest median potential dilution is found in the utilities sector (3%).

**Figure 6. Median Potential Dilution Percentages, as of June 30, 2024[3]**



A company's potential dilution resulting from a requested share pool increase is an important factor considered by shareholders when voting on an equity plan proposal. Some institutional investors have specific dilution thresholds that are used as a guideline when determining how to vote as well as other factors. For example, The Vanguard Group's Proxy Voting Policy for U.S. Portfolio Companies (effective February 2024) states it is likely to vote against a proposal when "total potential dilution (including all stock-based plans) exceeds 20% of shares outstanding"[4]; and Amundi Asset Management U.S.'s proxy voting guidelines state it will "reject plans with 15% or more potential dilution".[5] Other institutional investors state in their proxy voting guidelines that they consider dilution when determining how to vote on an equity plan proposal but do not disclose a threshold and/or state their evaluation of dilution depends on the company's size, industry, lifecycle, etc.

ISS will automatically recommend that shareholders vote "against" an equity plan proposal that results in dilution of greater than 20% for S&P 500 companies or greater than 25% for Russell 3000 companies.

A company's potential dilution in comparison to its peers and industry is a helpful data point when trying to predict whether a company's new equity plan proposal will be approved.

To test the impact of potential dilution levels, we analyzed potential dilution levels at Russell 3000 companies that received low shareholder support (which we defined as less than 70%) for their equity plan proposals in 2023 and 2024. For this subset of companies, median potential dilution was 20%, or double the median of the Russell 3000 potential dilution of 10%. The size of the new share pool requests was 6% of common shares outstanding, at median, and ranged from less than 1% to 26% in our total sample across all industry sectors. Potential dilution levels in the year of the equity plan proposal were about 8 percentage points higher than the median of the respective industry sector, on average.

**Figure 7. Median Potential Dilution Percentages based on Industry Sector and Low Shareholder Equity Plan Support as of June 30, 2024[3]**

| Industry Sector (GICS 2-Digit) | Median Size of Share Request (% of Common Shares Outstanding) | Median Potential Dilution in Year of Share Request | Industry Sector Median Potential Dilution | Median Difference (% Points) |
|---|---|---|---|---|
| Communication Services | 9% | 21% | 15% | 6% |
| Consumer Discretionary | 5% | 16% | 11% | 5% |
| Consumer Staples | 9% | 19% | 8% | 12% |
| Energy | 5% | 13% | 7% | 6% |
| Financials | 3% | 11% | 7% | 4% |
| Health Care | 5% | 27% | 18% | 9% |
| Industrials | 9% | 17% | 9% | 8% |
| Information Technology | 6% | 20% | 15% | 5% |
| Materials | 7% | 18% | 7% | 11% |
| Real Estate | 4% | 14% | 4% | 10% |
| Utilities | 8% | 11% | 3% | 7% |
| **Total Sample** | **6%** | **20%** | **10%** | **8%** |

### Frequency of Equity Plan Proposals

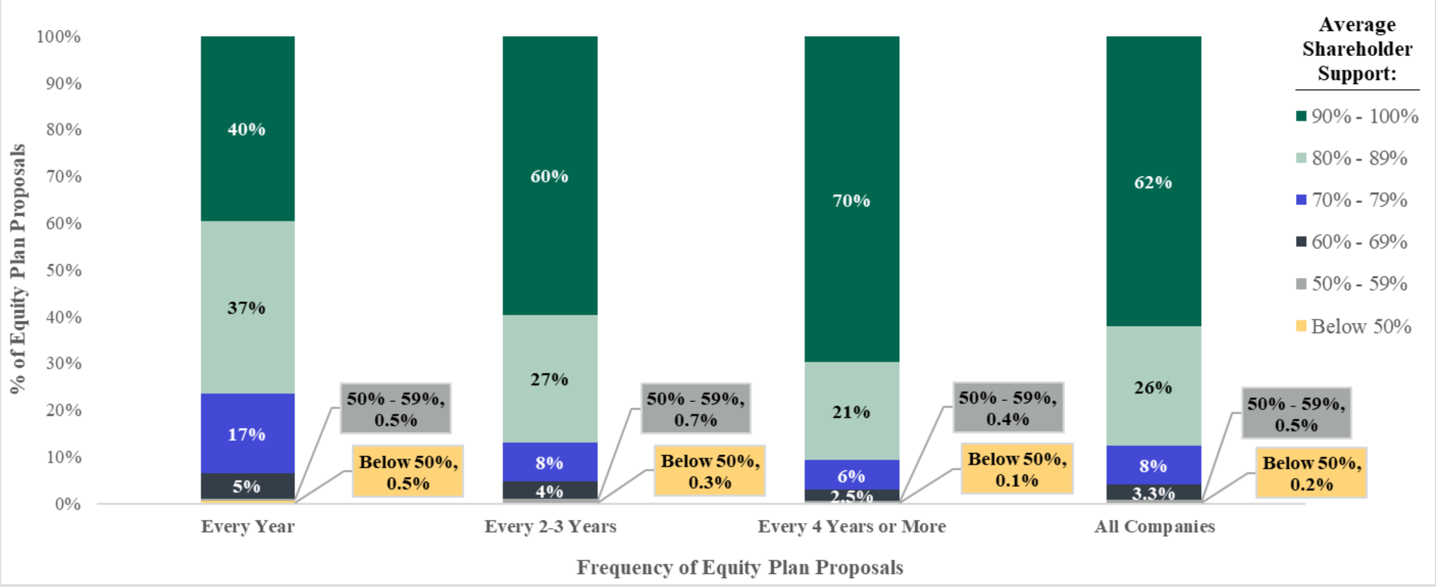
In addition to evaluating potential dilution levels, we analyzed the frequency of equity plan proposals over the last 10 years among the Russell 3000, which resulted in the following conclusions:

- It is most common to return to shareholders every 2 to 3 years to seek equity plan approvals.
- Consumer staples and utility companies' equity share pools typically last the longest, and these companies usually request more shares every 3.5 years, on average.
- Health care companies (e.g., pharma/biotech) generally go back for more shares more frequently: 2.1 years on average.
- Companies with annual equity plan proposals were mostly from the healthcare (e.g., pharma/biotech) and information technology industry sectors, and half of the companies with annual equity plan proposals had a market capitalization of less than $2B.

We also reviewed the correlation between frequency of equity plan proposals and average shareholder support and observed the following (refer to Figure 8 for more details):

| | |
|---|---|
| **General Observations:** | • The majority of companies received strong support regardless of how frequently the company requested additional shares.<br>• There was a slight decrease in average shareholder support as the frequency of proposals increased. |
| **Companies with equity shareholder proposals every:** | |
| **1 year** | • 94% of companies with equity proposals every year received average shareholder support of 70% or greater. |
| **2 to 3 years** | • Companies requesting a share pool replenishment every 2 to 3 years received average shareholder support of 89%.<br>• For companies requesting shares every 2 to 3 years, the proportion of companies receiving 70% or greater shareholder support only increased by 1 percentage point, 95%, compared to companies with annual proposals. |
| **4 years or more** | • Companies with equity plan proposals every 4 years or more had the greatest shareholder support in the 90% to 100% range.<br>• The proportion of companies receiving 70% or greater shareholder support was 97%.<br>• There was a 5-percentage-point difference in the average shareholder support for companies that went to shareholders every year (85.8% average support) versus companies that went every 4 years or more (90.9% average support). |

**Figure 8. Distribution of Average Shareholder Support by Equity Plan Proposal Frequency[1]**



## Why Companies Fail

While the majority of companies with equity plan proposals over the past two years have received majority shareholder support, we thought it would be helpful for readers to understand the characteristics of equity plan proposals that failed obtaining shareholder support. Based on reviewing the 13 proposals that failed to obtain shareholder support of the new share request in 2023 and 2024 (with one company failing two years in a row), we note the following:

- Companies in the healthcare sector represented about half of the proposals that received shareholder support below 50%, with vote outcomes ranging from 19% to 47%.
- All but one of the companies had potential dilution levels above their respective industry sector median with potential dilution 13 percentage points, on average, higher than the companies' industry sector median.
- Problematic executive compensation practices and failed Say on Pay (SOP) votes were not necessarily drivers in a failed equity plan proposal (54% of companies not receiving equity plan support received SOP support of 60% or higher); 69% and 46% of companies received SOP support from ISS and GL, respectively.
- Negative 1-year total shareholder return (TSR) was not likely the driver on why companies failed their equity plan proposal, as 38% had positive TSR.
- At least half of the companies used inducement awards (e.g., granted new hire employee awards from a non-shareholder approved equity incentive plan).

## Key Equity Plan Proposal Considerations

As companies are preparing for equity plan proposals, there are several things that can be done to increase the likelihood of a successful shareholder vote outcome. We highlight some of these considerations below:

1. Analyze the share reserve pool under various stock price scenarios to help determine how many shares are needed over the next 1 to 3 years.
2. Calculate current and potential dilution levels and share usage levels on an absolute basis and relative to your peer group and overall industry sector.
3. Understand the voting guidelines on new share requests of your largest institutional shareholders, including any brightline policies such as excessive dilution thresholds. Also, understand how likely your institutional shareholders might follow a vote recommendation from ISS and GL.
4. Understand what the proxy advisor "dealbreakers" are (e.g., allowing for option repricings or cash buyouts without shareholder approval, "evergreen" provisions that automatically replenish the share reserve pool). Estimate the likelihood of proxy advisors' vote recommendations on the proposal. If opposition is anticipated, consideration should be given to engaging with the largest shareholders well before the annual shareholder meeting.
5. Ensure the proxy disclosure of the equity plan proposal is clear and complete. Within the equity plan proposal disclosure, highlight shareholder friendly design features and practices (e.g., reasonable dilution and share usage levels, requiring shareholder approval of option repricings or cash buyouts) and the role equity plays in attracting, motivating, and retaining employees as well as why it is important to the success of the company.

**General questions about this Viewpoint can be directed to Tara Tays (tara.tays@paygovernance.com) or Linda Pappas (linda.pappas@paygovernance.com).**

---

[1] Source: ISS Corporate, Voting Analytics database
[2] Source: Diligent Market Intelligence
[3] Potential dilution percentages based on information in ESGAUGE's database and industry sector is based on 2-digit GICS codes
[4] The Vanguard Group. Proxy voting policy for U.S. portfolio companies. February 2024. https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/us_proxy_voting_policy_2024.pdf.
[5] Amundi Asset Management US, Inc. Proxy Policy. January 2021. https://nationwidefinancial.com/media/pdf/proxy-amundi.pdf.

# Checklist: Executive Security

***By TheCorporateCounsel.net and CompensationStandards.com***

It's common for high-profile public companies to engage and pay for personal security services for their CEOs and other senior executives. Some public companies also require their executives to use company aircraft for personal travel due to security concerns. In addition to their typically higher profile, public companies may also have heightened security concerns for their executives since they are often required by Regulation FD to disclose their executives' involvement in certain public events.

The December 2024 shooting of the CEO of UnitedHealthcare has caused public companies to reassess, and sometimes enhance, their security arrangements and other measures they take to protect the safety of their executives. This checklist addresses recent trends in personal security spending by public companies and additional steps companies are now considering to minimize risks to their management teams. It also discusses considerations related to board fiduciary duties, SEC disclosure requirements, institutional investor and proxy advisor positions, and tax and benefit implications of personal security arrangements — all of which boards and management teams should be aware of as they consider enhancements to executive security programs.

1. **Trends in Company Spend on Personal Security:**

   Numerous sources report that approximately a quarter of S&P 500 CEOs received home or personal security services in 2023. But, per Compensia, company spend varies significantly — ranging from tens of thousands of dollars to almost $10 million per year — with technology/technology-related entertainment companies and financial institutions most likely to provide personal security arrangements to their executives. Compensia also reports that personal security spend is trending up — contrary to the overall downward trend for prerequisite spending generally — and expanding in type. In addition to security detail, in 2023, companies reported spending on home security systems, personal security monitoring and private secure transportation for their executives.

2. **Security Considerations:**

   Public companies concerned about the potential for increased risk to their executive officers have considered making a number of changes in the last few weeks. For example, law firm and compensation consultant memos identified the following enhancements under consideration:

- Engaging security advisors
- Commissioning a third-party, independent security study to identify and document specific security concerns
- Conducting threat assessments
- Developing comprehensive security plans
- Removing management team headshots (and sometimes biographies) from publicly available websites
- Engaging or increasing security personnel (*e.g.*, bodyguards, chauffeurs) for executives or expanding the number of executives that have security personnel for all travel, including personal and family travel
- Adding home security detail or alarm systems to executives' homes
- Providing secure methods of transportation to executives, including adopting policies to require that executives use company aircraft or company vehicles for commuting purposes or personal travel
- Engaging personal emergency response services for executives
- Providing situational awareness training
- Implementing threat detection technologies
- Getting background checks on employees, contractors and partners
- Encrypting communications
- Restricting access to sensitive information
- Adding data protection and privacy procedures

- Improving or expanding cybersecurity training

3. **Governance & Fiduciary Duties:**

A January 2025 Covington memo suggests that executive security implicates a board's duty of oversight. One of the interesting implications of that suggestion is that directors could face *Caremark* claims in the event that lax personal security arrangements lead to the death or injury of a key executive. It also means that the board's agenda should periodically provide time for the board to be apprised of any threats to the company's officers and employees, and to understand other potential risks to the safety of these individuals in light of the social, economic and political environment; the public profiles of the individuals; and the company's specific location(s), business(es) and industry(ies). This information should inform the board's consideration — in the event of new threats or changes to the company's risk profile — of the adequacy of the company's existing security arrangements and policies and procedures to monitor, respond to and escalate threats to law enforcement.

Before implementing new security measures, the board and compensation committee should be aware of, discuss and consider:

- Need and appropriateness of each type of security enhancement and expenditure, which may include:
  - Commissioning an independent third party to conduct a security study
  - Using internal resources to understand the source and extent of executive security risk and where to invest resources to best mitigate that risk
  - Reporting to the board the details of any significant threats made to company executives
  - Company's policies and procedures to monitor and respond to security threats, including when to escalate to law enforcement

- Disclosure requirements and any contextual disclosure the company may provide for investors to better understand the appropriateness of security expenditures (discussed below)
- Potential for concern by proxy advisors, investors, other employees or the public
- Historical values of perks reported by the company and its peers, which should be reevaluated periodically
- Whether the company has appropriate controls in place to identify and correctly disclose perks
- Tax and benefit implications

As described below, the SEC considers certain security services to be compensatory perquisites. As compensatory perquisites, the provision of such services should be approved by the board or the compensation committee, depending on the terms of the board's committee charters and delegations of authority. To avoid any potential allegations that perquisites were provided to an executive officer or director without authorization, companies often adopt a perquisites policy to provide an unambiguous demonstration of the compensation committee's role in authorizing and overseeing perquisites. Decisions to enhance security arrangements for executive officers or employees may require the board or compensation committee to amend the company's perquisite policy. Any changes should be supported by concurrent documentation of the board's rationale for enhancing executive security in the minutes, written consent or board materials.

**4. <u>Disclosure:</u>**

As companies consider increasing their spending on personal security arrangements for their executives, they should be aware that the SEC considers personal security arrangements to be disclosable as compensatory perquisites or other personal benefits (often referred to together as "perks"). Per Item 402 of Regulation S-K, public companies must disclose the details of their executive compensation programs in proxy statements, periodic reports and registration statements. Perks are required to be included in the "All Other Compensation" column of the

Summary Compensation Table for each named executive officer ("NEO") and identified by footnote unless the aggregate amount of such compensation is less than $10,000. If any perk is valued at the greater of $25,000 or 10% of the NEO's total perks, its value must be disclosed in a footnote to the table.

The SEC provided a two-step framework to help companies determine which items and arrangements should be considered perks in its 2006 proposing release and then supplemented this guidance later that year in its adopting release. Under this framework, the two central factors to be considered in determining whether an item is a perk are the following:

1. An item is not a perk or personal benefit if it is integrally and directly related to the performance of the executive's duties.

2. Otherwise, an item is a perk or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a nondiscriminatory basis to all employees.

Notwithstanding the beliefs of most boards that security expenditures are necessary to ensure the safety of their management team, particularly where they frequently travel, the SEC has expressly stated that it considers many expenditures incurred to ensure the personal safety of a NEO to be disclosable perks. Specifically, the SEC has held that business purpose or convenience does not affect the treatment of an item as a perk where it is not integrally and directly related to the performance by the executive of his or her job. Accordingly, a company's decision to provide an item of personal benefit for security purposes does not affect its characterization as a perk.

For example, a policy that, for security purposes, an executive (or an executive and their family) must use company aircraft or other company means of travel for personal travel or must use company or company-provided property for vacations does not affect the conclusion that the item provided is a perk. Similarly, even if, for example, security enhancements result from the recommendations of an independent third-party security study or there are ongoing security threats to an executive, that will not impact the analysis of whether security expenditures are perks.

While applying the two-step test to certain facts involves a degree of judgment, companies generally distinguish between security services provided at company facilities or during business travel (if the travel is integrally and directly related to the performance of the executive's duties) and those same services provided during personal travel, at the executive's personal residence, for the executive's commute or to an executive's family members.

When reporting perks, the value reported is the aggregate incremental cost to the company. This may not equate to the amount attributable for federal income tax purposes or the fair market value. The rules do not prescribe how aggregate incremental cost is to be calculated, and historically the SEC staff has provided little guidance on the acceptable methods for computing aggregate incremental cost. Generally, the Staff takes the view that how a company computes the aggregate incremental cost depends on the particular facts and circumstances. In a 2006 speech entitled "Principles Matter," John White, the then Director of the SEC's Division of Corporation Finance, noted that with respect to analyzing the aggregate incremental cost of perks, companies should:

> "… provide your investors with the value of the perquisites your company accords its executives, based on their aggregate incremental costs. And provide your investors with the material information they need in order to understand that valuation, its context, and the particular facts and circumstances of those perquisites. Remember, principles matter."

In a 2007 decision by the 10th Circuit, *U.S. v. Lake and Wittig*, the court took the view that aggregate incremental cost should be the actual additional cost incurred by the company in providing the perk (in this case, personal use of a corporate aircraft by a relative of the executive). The Court noted that "[t]his extra cost might be the additional fuel to fly with the weight of one more passenger plus luggage."

Even with the benefit of the revised rules, there still are questions as to how to calculate the aggregate incremental cost to the company for certain types of perks. But it's clear that, when calculating aggregate incremental cost, companies need to consider additional related costs beyond those that may be fixed — this includes incidental expenses like overtime, meals for any individuals providing security or transportation services, and gas.

Some perks may involve no aggregate incremental cost to the company, depending on the particular facts and circumstances. To the extent that the minimum disclosure threshold is triggered for a NEO, these "costless" perk items should be described in the footnote to the "All Other Compensation" column of the Summary Compensation Table, but with no dollar value added.

When a perk must be individually quantified (see above), the company must also describe the method for computing the aggregate incremental cost in a footnote to the Summary Compensation Table.

Given the low dollar threshold for disclosure and the judgment involved in the perks analysis and in calculating aggregate incremental cost, companies need to develop, maintain and follow policies and procedures to closely track security expenditures and ensure the appropriate expenses are disclosed.

In a memorandum suggesting that the SEC should revise its policy on this topic, Cooley pointed to the blurring of lines between personal and business activities since the time of the 2006 adopting release due to technological advancements and the rise of remote and hybrid work. Cooley also noted, while perks disclosures have frequently been the subject of SEC enforcement actions, the SEC's 2024 perk enforcement action in *In the Matter of Express, Inc.* did not identify the failure to disclose expenses for the CEO's personal security services, even though the company subsequently determined those services were not "integrally and directly related" to the performance of his duties and issued corrective disclosure. The firm is quick to note that it's unclear whether this omission was a "deliberate shift away" from how the SEC has historically viewed personal security expenses.

For purposes of explaining the amounts of reported perks, especially when a company is an outlier or has a significant increase in reported perks amounts compared to prior years, companies may also want to consider providing additional, voluntary contextual disclosure. *See* "Institutional Investor and Proxy Advisor Policies" below. For more on perks, *see also* "Chapter 7: Perks & Other Personal Benefits" in the *Executive Compensation Disclosure Treatise*.

## 5. Institutional Investor and Proxy Advisor Policies:

Perks remain one of the biggest "hot button" issues with critics of executive pay, including the proxy advisory firms and institutional investors. It's not because they materially impact a company's bottom line — as they rarely do — but because a company's perk practices are seen as a window into the company's culture, particularly its attitude about corporate governance practices.

Historically, ISS's scrutiny of perks expenditures has included perks related to personal security. However, many practitioners expect that institutional investors and proxy advisory firms will be understanding of increases in security-related expenditures in the upcoming proxy seasons where the company provides contextual disclosure explaining why the expenditures were appropriate.

- **ISS:** In the past, ISS has singled out personal security arrangements for criticism. Specifically, on multiple occasions, as part of its qualitative evaluation of an executive compensation program, ISS has questioned the costs of such arrangements, deeming them "excessive" in the context of the limited number of companies that disclose providing security protection for their executives. ISS considers the provision of excessive or extraordinary perks as a problematic pay practice that carries significant weight and may result in an adverse vote recommendation for Say-on-Pay.

  During our webcast "ISS Policy Updates and Key Issues for 2025," ISS's Marc Goldstein discussed the expected increase in reported perks due to executive security expenditures — incrementally in 2025 proxies reporting compensation for 2024 and more significantly in 2026 proxies reporting compensation for 2025. Marc confirmed that, like with all perks, ISS expects companies that are outliers in terms of reported perks amounts to explain why that's the case. That said, ISS recognizes that there are certain sensitivities with this disclosure in the case of security expenditures and does not expect companies to disclose the specific types of threats that their executives may have received or why their executives are more vulnerable than those of other companies, which may exacerbate vulnerabilities. However, ISS would like to see evidence of measures the board took to ensure that the types and cost of security benefits are appropriate and reasonable, such as if a company has hired a third-party consultant and followed those recommendations.

- **Glass Lewis:** When assessing the performance of compensation committees, Glass Lewis will consider recommending that shareholders vote against all members of the compensation committee if excessive employee perks and benefits were allowed. For purposes of Say-on-Pay recommendations, egregious or excessive perks are viewed negatively and, when weighed with other negative pay practices, may cause Glass Lewis to recommend voting against a company's Say-on-Pay proposal. Presumably, contextual disclosure such as the type ISS would like to see explaining the nature and rationale for executive security expenditures will be welcomed by Glass Lewis as well.

Although companies tend to focus much of their attention on the disclosure of perquisites and other personal benefits in the Summary Compensation Table, they should also address their overall policies on the use of perks — and the reasons the company provides them — in the Compensation Discussion & Analysis. While it's unlikely that the value of any perks provided to NEOs will comprise a material portion of their executive compensation package (at least from a dollar standpoint), perquisites practices are an important subject for shareholders. A Covington memo suggested that companies making changes effective for 2025 compensation may also want to preview this development in proxy statements for their 2025 annual meetings, even if the increased security expenses did not impact 2024 compensation.

6. **Tax & Benefits:**

Company-sponsored personal security measures may be taxable fringe benefits to the executive, meaning the executive may owe income taxes and the employer may be required to withhold payroll taxes. However, per an A&O Shearman alert, if a company establishes an "overall security program" (*i.e.*, the company provides 24/7 security or conducts an "independent security study"), an executive may receive certain related benefits on a tax-free basis under the regulations governing taxation of fringe benefits. Specific requirements apply to establish an "overall security program," and even where 24/7 security is provided or a qualified security study is conducted, the value of some benefits still must be imputed as income.

# ARE EXECUTIVE INCENTIVE PLAN PAYOUTS FOR AIP AND PSUS ALIGNED WITH SHAREHOLDER RETURNS?

PATRICK HAGGERTY, IRA T. KAY, AND MIKE KESNER

## Introduction

There is a widespread belief among shareholders, executives, board members, media, and academics that incentive plan metrics, goals, and the resulting performance and payouts, should be closely aligned with a company's total shareholder return (TSR) over time. This alignment reinforces that companies are focusing on performance measures that correlate with shareholder value creation and setting sufficiently challenging goals so that if achieved, demand for the stock will go up, and if not achieved, demand for the stock will go down. Based on the high levels of majority shareholder support for Say on Pay (SOP) over the years, including 99% of companies receiving majority support in 2024, it would appear companies are meeting shareholders' expectations.

Recent research reports conducted by one of the proxy advisory firms, however, suggest that both annual and long-term incentive plan goals may not be sufficiently rigorous, as most large companies have paid above-target incentives in each of the last 5 to 6 years. Pay Governance delved deeper into this phenomenon by examining if above target incentive payouts were aligned with returns to shareholders and how often individual companies exceeded target over the last 5 to 6 years. **Our research indicates that over the last 6 years, S&P 500 companies* that had above-median annual incentive plan (AIP) and performance share unit (PSU) payouts also had higher TSR compared to companies that had below-median AIP and PSU payouts.** Our analysis includes comparisons on both an industry sector and total sample size basis, with comparable results.

We also found that only a small percentage (3%) of companies persistently paid incentives significantly above target over the 5-to-6-year measurement periods.

| | % of Companies That Persistently Paid Incentive At/Above Target | | |
|---|---|---|---|
| | AIP Paid Between 100%-200% of Target | AIP Paid Between 125%-200% of Target | AIP Paid Between 150%-200% of Target |
| Paid AIP each of the last 6 years | 20% | 7% | 3% |
| Paid AIP each of the last 5 years | 29% | 14% | 3% |

* We excluded companies in the Energy, Utilities, and Real Estate industries due to regulatory differences as well as unique compensation practices and incentive metrics that do not align with other industries

## Our Research Demonstrates Consistent Alignment of Incentive Payouts and TSR Over Time

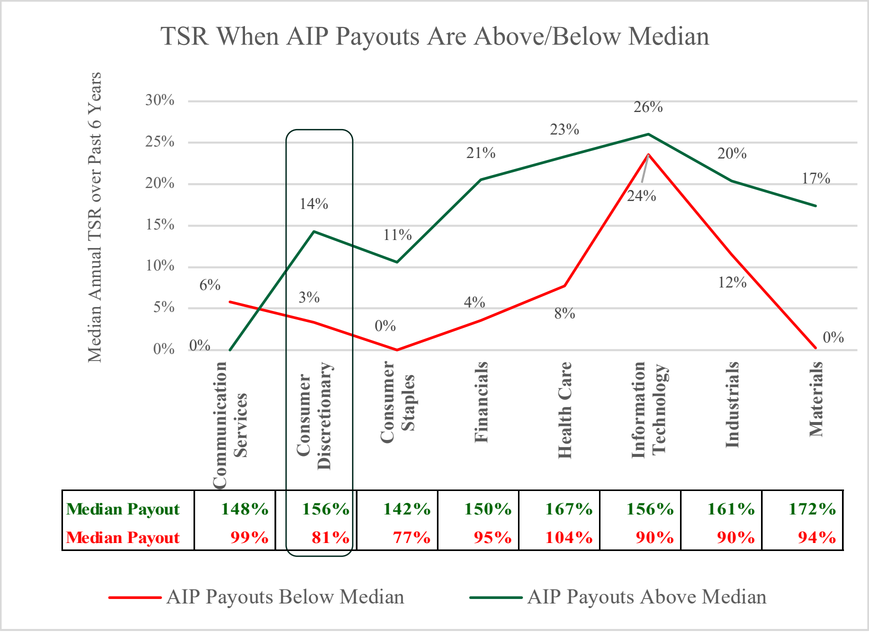
### AIP Alignment

Most AIPs are based on financial and non-financial measures that focus on the achievement of short-term results that position companies for long-term success. As a result, attaining these annual incentive measures may not have an immediate impact on stock price or TSR, but over time there should be a relationship of annual incentive payouts to shareholder returns.

Our AIP analysis is based on 6 years of data from 315 S&P 500 companies, totaling approximately 1,900 datapoints to assess shareholder alignment of AIP payouts and TSR both on an industry and total sample size basis. A summary of our key findings includes:

1. **AIP Industry Analysis:** As detailed in Chart 1, in every industry except communication services, companies with above-median AIP payouts have higher TSR compared to companies with below-median AIP payouts. For example, in the consumer discretionary industry, for the group of companies that had above-median AIP payouts (median payout = 156% of target) during the past 6 years, median TSR was +14%, while for the group of companies with below-median AIP payouts (median payout = 81% of target), median TSR was +3%.

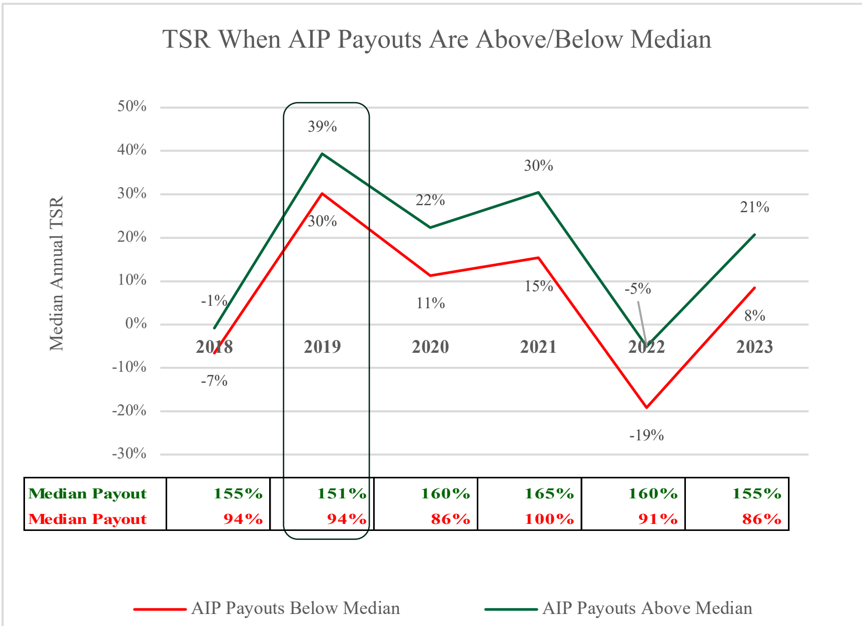
Chart 1: AIP Industry Analysis




| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Median Payout | 148% | 156% | 142% | 150% | 167% | 156% | 161% | 172% |
| Median Payout | 99% | 81% | 77% | 95% | 104% | 90% | 90% | 94% |

**AIP "All Industry" Analysis by Year:** As detailed in Chart 2 which includes all industries, over the past 6 years, companies with above-median AIP payouts have higher TSR compared to companies with below-median AIP payouts. For example, in 2019, for the group of companies with above-median AIP payouts (median payout = 151% of target), median TSR was +39% while for the group of companies with below-median AIP payouts (median payout = 94% of target), median TSR was +30%.

Chart 2: AIP "All Industry" Analysis by Year




Alignment of annual TSR and AIP payouts is not perfect for year-over-year comparisons due to macroeconomic factors. For example, in 2022, when the economy had recession concerns, overall TSR was negative, but AIP payouts were only modestly different from prior years because internal operating goals were likely lower but still achieved. Each company sets their guidance and goals based on expectations of strong tailwinds or headwinds and other strategic factors typically during the first quarter of the fiscal year, which can result in above-target AIP payouts even when fiscal year-end TSR is below prior year.

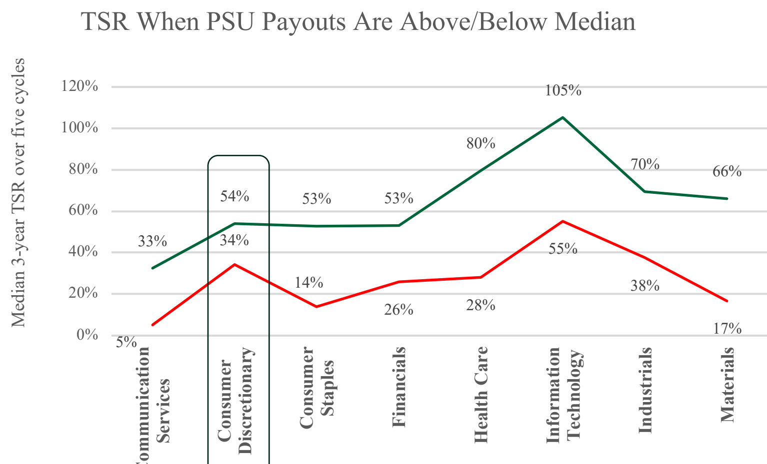
## Long-Term Incentive Plan / PSU Alignment

Most performance-based long-term incentive plans are linked to the achievement of multi-year financial measures that are intended to align with shareholder outcomes. As a result, shareholders are likely to closely scrutinize long-term incentive plan payouts that do not align with shareholder returns. Indeed, one of the major proxy advisory firms has begun to take a closer look at the design and performance measures of these plans if they determine there is a pay for performance disconnect.

Our PSU analysis is based on the five completed PSU cycles (in the case of 3-year performance cycles: 2017-2019, 2018-2020, 2019-2021, 2020-2022, and 2021-2023) for 290 S&P 500 companies, totaling 1,450 datapoints to evaluate shareholder alignment of PSU payouts and TSR. A summary of our key findings includes:

1. **PSU Industry Analysis:** As detailed in Chart 3, all industry segments show that companies with above-median PSU payouts have higher TSR compared to companies with below-median PSU payouts. For example, in the consumer discretionary industry, for the group of companies with above-median PSU payouts (median payout = 150% of target) during the past five cycles, median TSR was +54 while for the group of companies with below-median PSU payouts (median payout = 88% of target), median TSR was +34%.

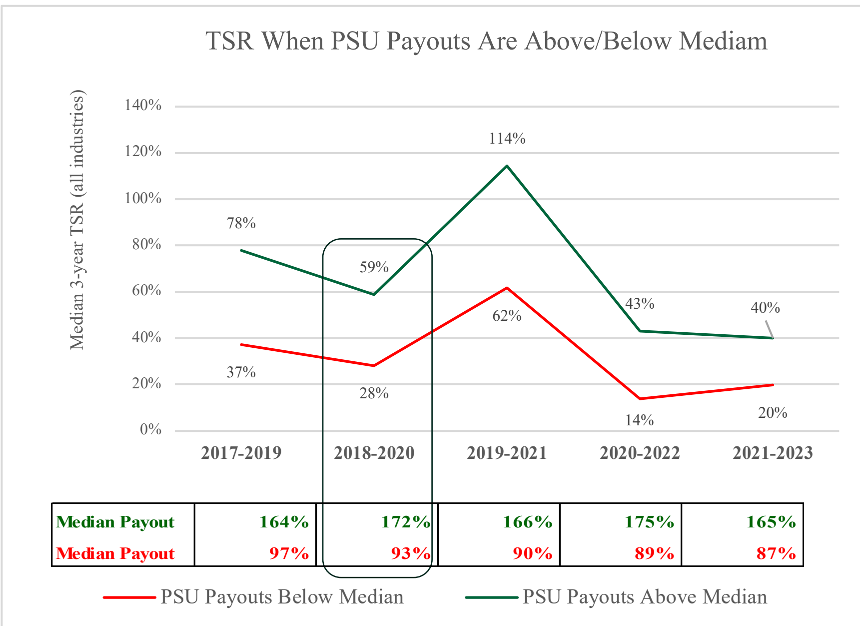
Chart 3: PSU Industry Analysis




| | Communication Services | Consumer Discretionary | Consumer Staples | Financials | Health Care | Information Technology | Industrials | Materials |
|---|---|---|---|---|---|---|---|---|
| Median Payout | 112% | 150% | 151% | 156% | 187% | 164% | 178% | 172% |
| Median Payout | 68% | 88% | 72% | 91% | 91% | 98% | 96% | 84% |

2. **PSU "All Industry" Analysis by Cycle:** As detailed in Chart 4, over the past five cycles for all industries, the group of companies with above-median PSU payouts have higher TSR compared to the group of companies with below-median PSU payouts. Among the group of companies with below-median PSU payouts, their average PSU payout over the past five cycles is below 100% of target for all cycles. For example, in the 2018-2020 cycle, for the group of companies with above-median PSU payouts (median payout = 172% of target), median 3-year cumulative TSR was +59% while for the group of companies with below-median PSU payouts (median payout = 93% of target), median 3-year cumulative TSR was +28%.

Chart 4: PSU "All Industry" Analysis by Cycle




**Are there other factors that confirm the alignment of AIP/PSU payouts and TSR results?**

Yes, three additional factors affirm this alignment:

1. Companies with positive TSR are more likely to pay AIP and PSUs above target.

   - In the five PSU cycles reviewed, 67% of payouts were at/above target and in 91% of these cases, the companies had positive TSR while only 9% had negative TSR. This indicates that misalignment or shareholder-unfriendly outcomes are not prevalent.
   - Across all six AIP cycles reviewed, 69% of payouts were at/above target, which is similar to the results reported in the proxy advisory study. Of these companies, 72% had positive TSR while 28% had negative TSR. It is our experience that AIP payouts are generally less correlated to TSR compared to PSUs, as the AIP measures are often designed to promote future success.
   - Combining both AIP and PSU incentive plans represents 3,200 data pairs. Based on the combined dataset, 67% of payouts were at/above target. Of the companies with at/above target payouts, 80% had positive TSR while 20% of those companies had negative TSR. In

our view, this demonstrates a robust alignment of incentive payouts with shareholder outcomes among the 290 companies included in the test companies over the past 6 years.

2. The role of providing guidance to investors.

    - Generally, exceeding annual guidance positively impacts stock prices unless subsequent guidance disappoints.
    - If a company consistently beats guidance, resulting in above-target payouts perceived as being too easy to achieve, the market may eventually respond negatively.

3. Separately, Pay Governance conducted research[1] on the alignment of CEO pay with TSR based on the Pay Versus Performance rules mandated by Dodd Frank. Our analysis found a strong correlation of Compensation Actually Paid (CAP), with TSR over 2020-2023.

## Conclusions and Implications for Individual Companies

Contrary to the concern and criticism that AIP and PSU performance measures may not be sufficiently rigorous and the resulting incentive payouts may be too high, our study shows that such payouts are aligned with shareholder outcomes. This may partially explain why shareholders have consistently and strongly supported Say on Pay for the last several years. We recommend that companies continue to set appropriate and rigorous performance targets when issuing investor guidance and setting incentive plan goals. This disciplined process observed by many companies increases the likelihood that payouts are aligned with operating performance, shareholder experience, and yield motivation and retention value.

Typical analytical tools used by Pay Governance and many companies for selecting appropriate performance measures and testing goal rigor include:

1. Ensure that incentive metrics are correlated with TSR.

2. Compare the goals before final approval with a multidimensional assessment of internal and external expectations of the company's performance including, for example, analysts' expectations for company and peers, history of goals, and other relevant factors.

3. Assess historical alignment of incentive payouts and TSR.

4. Utilize realizable pay and CAP to assess the payouts for a multi-year period and alignment with TSR to evaluate if changes are required to improve alignment.

[1] Ed Sim, Ira Kay, and Mike Kesner. Does Compensation Actually Paid Align with Total Shareholder Return? Harvard Law School Forum on Corporate Governance. August 8, 2024. https://corpgov.law.harvard.edu/2024/08/08/does-compensation-actually-paid-align-with-total-shareholder-return/

## Appendix

| **Table 1: AIP Industry Analysis** | | When AIP Payout is **Below** Median | | When AIP Payout is **Above** Median | |
|---|---|---|---|---|---|
| Industry | Count | Median Annual **TSR** over Six AIP Cycles | Median AIP **Payout** over Six Cycles | Median Annual **TSR** over Six AIP Cycles | Median AIP **Payout** over Six Cycles |
| Communication Services | 13 | 6% | 99% | 0% | 148% |
| Consumer Discretionary | 41 | 3% | 81% | 14% | 156% |
| Consumer Staples | 29 | 0% | 77% | 11% | 142% |
| Financials | 41 | 4% | 95% | 21% | 150% |
| Health Care | 58 | 8% | 104% | 23% | 167% |
| Information Technology | 52 | 24% | 90% | 26% | 156% |
| Industrials | 55 | 12% | 90% | 20% | 161% |
| Materials | 26 | 0% | 94% | 17% | 172% |

| **Table 2: AIP "All Industry" Analysis by Year** | | When AIP Payout is **Below** Median | | When AIP Payout is **Above** Median | |
|---|---|---|---|---|---|
| Year | Count | Median Annual **TSR** | Median AIP **Payout** | Median Annual **TSR** | Median AIP **Payout** |
| 2018 | 315 | -7% | 94% | -1% | 155% |
| 2019 | 315 | 30% | 94% | 39% | 151% |
| 2020 | 315 | 11% | 86% | 22% | 160% |
| 2021 | 315 | 15% | 100% | 30% | 165% |
| 2022 | 315 | -19% | 91% | -5% | 160% |
| 2023 | 315 | 8% | 86% | 21% | 155% |

| **Table 3: PSU Industry Analysis** | | When PSU Payout is **Below** Median | | When PSU Payout is **Above** Median | |
|---|---|---|---|---|---|
| Industry | Count | Median 3-Year **TSR** over Five PSU Cycles | Median PSU **Payout** over Five Cycles | Median 3-Year **TSR** over Five PSU Cycles | Median PSU **Payout** over Five Cycles |
| Communication Services | 11 | 5% | 68% | 33% | 112% |
| Consumer Discretionary | 33 | 34% | 88% | 54% | 150% |
| Consumer Staples | 28 | 14% | 72% | 53% | 151% |
| Financials | 40 | 26% | 91% | 53% | 156% |
| Health Care | 54 | 28% | 91% | 80% | 187% |
| Information Technology | 48 | 55% | 98% | 105% | 164% |
| Industrials | 52 | 38% | 96% | 70% | 178% |
| Materials | 26 | 17% | 84% | 66% | 172% |

| **Table 4: PSU "All Industry" Analysis by Cycle** | | When PSU Payout is **Below** Median | | When PSU Payout is **Above** Median | |
|---|---|---|---|---|---|
| PSU Cycle | Count | Median 3-Year **TSR** | Median PSU **Payout** | Median 3-Year **TSR** | Median PSU **Payout** |
| 2017-2019 | 292 | 37% | 97% | 78% | 164% |
| 2018-2020 | 292 | 28% | 93% | 59% | 172% |
| 2019-2021 | 292 | 62% | 90% | 114% | 166% |
| 2020-2022 | 292 | 14% | 89% | 43% | 175% |
| 2021-2023 | 292 | 20% | 87% | 40% | 165% |

**General questions about this Viewpoint can be directed to Patrick Haggerty (patrick.haggerty@paygovernance.com), Ira Kay (ira.kay@paygovernance.com), or Mike Kesner (mike.kesner@paygovernance.com).**