

Executive Compensation: Insight on companies' governance

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Introduction

Governance professionals report on how their boards are involved in executive compensation planning, investor interest in the space and the potential influence of ESG and Covid-19



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Governance professionals report on how their boards are involved in executive compensation planning, investor interest in the space and the potential influence of ESG and Covid-19

Oversight of executive compensation features on boards' list of key duties. Board members must take into account a mix of fixed and variable compensation – and its form – for senior managers while looking at both short and long-term performance and how peers are making similar decisions.

Boards need the right processes for assigning responsibility and gathering input on both industry practices and what investors are looking for. Some investors are showing greater interest in both executive compensation plan outcomes and how those plans work, including how they relate to ESG criteria. As part of this increased scrutiny, there are signs some investors may be less inclined to support compensation plans when exercising their voting power.

In this special report, we present results from a survey conducted among governance professionals

such as general counsel, corporate secretaries and their teams. Their responses help create a picture of which members of the board are involved in compensation oversight, the extent to which outside advisers are used, the impact of Covid-19, investors' questions in the space, director engagement and linking executive compensation to ESG.

Key findings

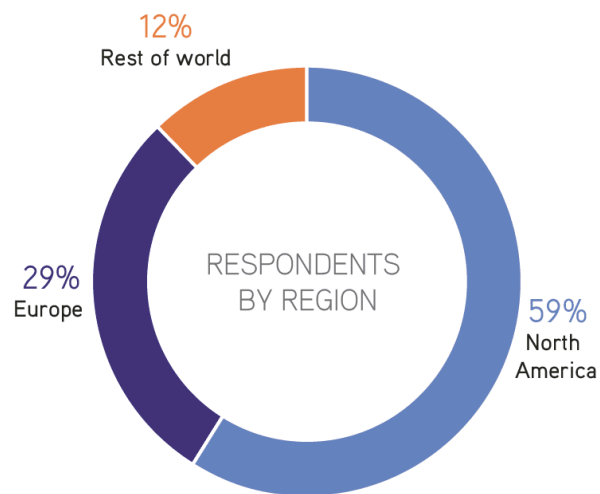
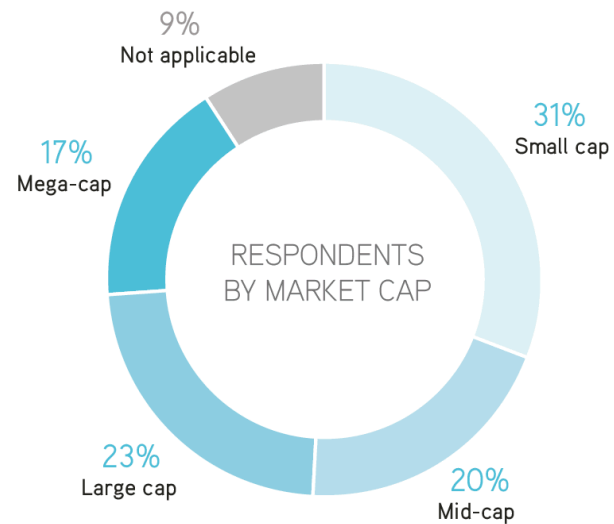
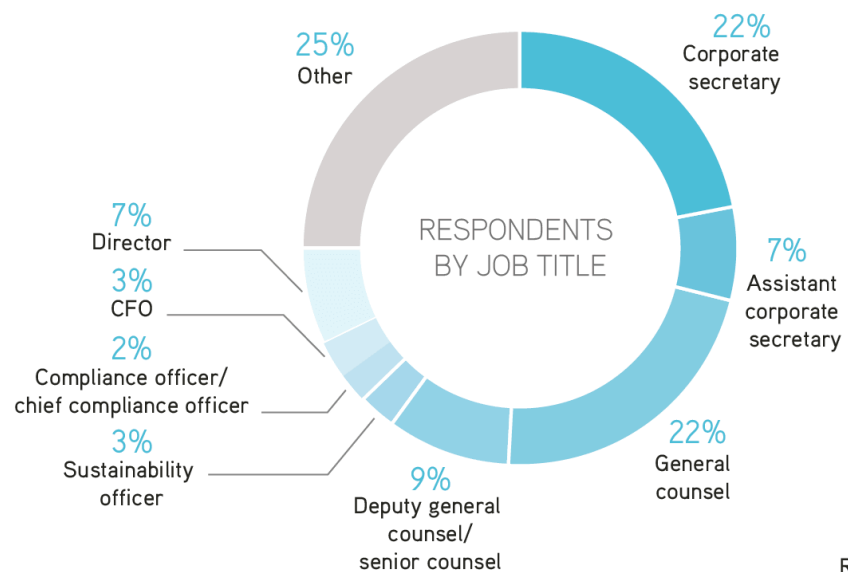
- Sixty percent of respondents at small-cap companies say the compensation committee has primary oversight of executive compensation. By comparison, 90 percent of those at mid-cap companies say their compensation committee is in charge.
- Globally, 75 percent of respondents say their board uses an outside adviser or advisers on executive compensation matters.
- Only around a quarter (27 percent) of

respondents at mega-caps say their board's main discussions on compensation take place in the first three months of the calendar year.

- A significant number – 21 percent – of respondents globally say their board has revised its approach to executive compensation planning as a result of the Covid-19 pandemic.
- Globally, more than half (56 percent) of respondents report that investors have asked questions around executive compensation at least occasionally over the past 12 months.
- Sixty percent of respondents in Europe say their board links executive compensation to ESG metrics, compared with 37 percent of those in North America.

Survey demographics

This report is based on the findings from an online survey conducted between December 2021 and February 2022. A total of 153 respondents took part.



Assigning roles

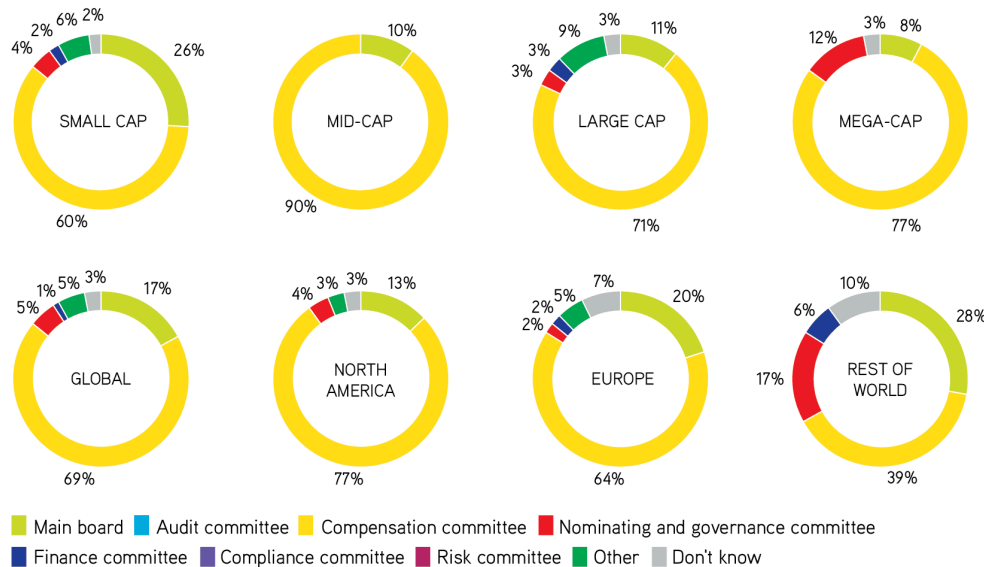
Who is involved?



Assigning roles

Who is involved?

On your company's board, which of the following has primary oversight of executive compensation?



It is no surprise to observe that compensation committees are most frequently in charge of executive compensation matters at the board level. Globally, a clear majority (69 percent) of respondents say their compensation committee has primary oversight in this area.

A further 17 percent say the main board has primary oversight, while a handful point to the nominating and governance committee (5 percent) or finance committee (1 percent).

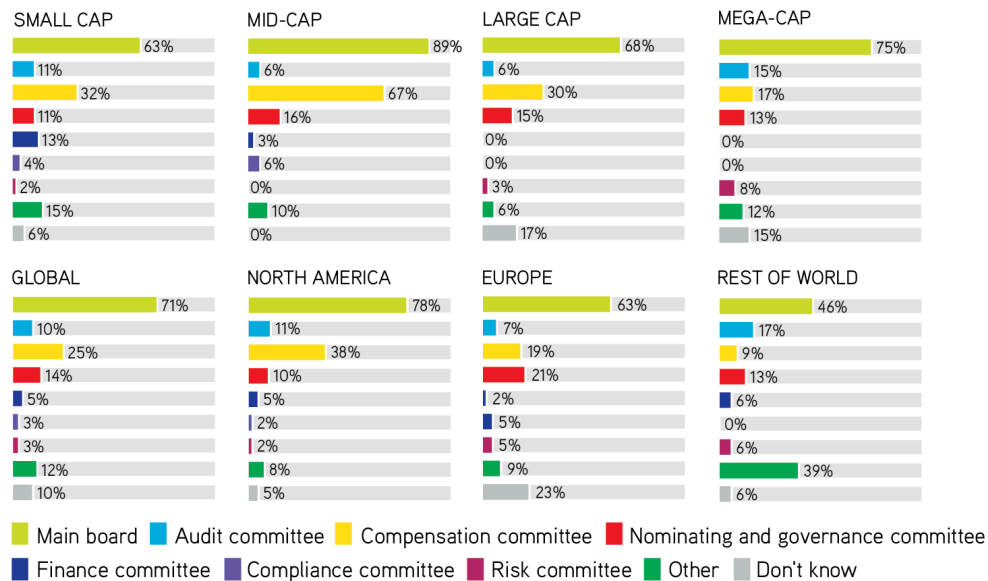
There are, however, variations in the focus on the compensation committee depending on company size or region. More than a quarter (26 percent) of respondents at small-cap firms say their main board is in charge of executive compensation matters, with 60 percent pointing to the

compensation committee. By comparison, 90 percent of those at mid-cap companies say their compensation committee is in charge, while the corresponding figures for those at large caps (71 percent) and mega-caps (77 percent) fall in between.

Those at mega-caps are least likely to say the main board is in charge (8 percent) and the most likely to say the nominating and governance committee (12 percent) has primary oversight.

Regionally, respondents in North America (77 percent) are more likely than those in Europe (64 percent) to cite the compensation committee as having primary oversight.

On your company's board, which of the following also has some oversight of executive compensation?



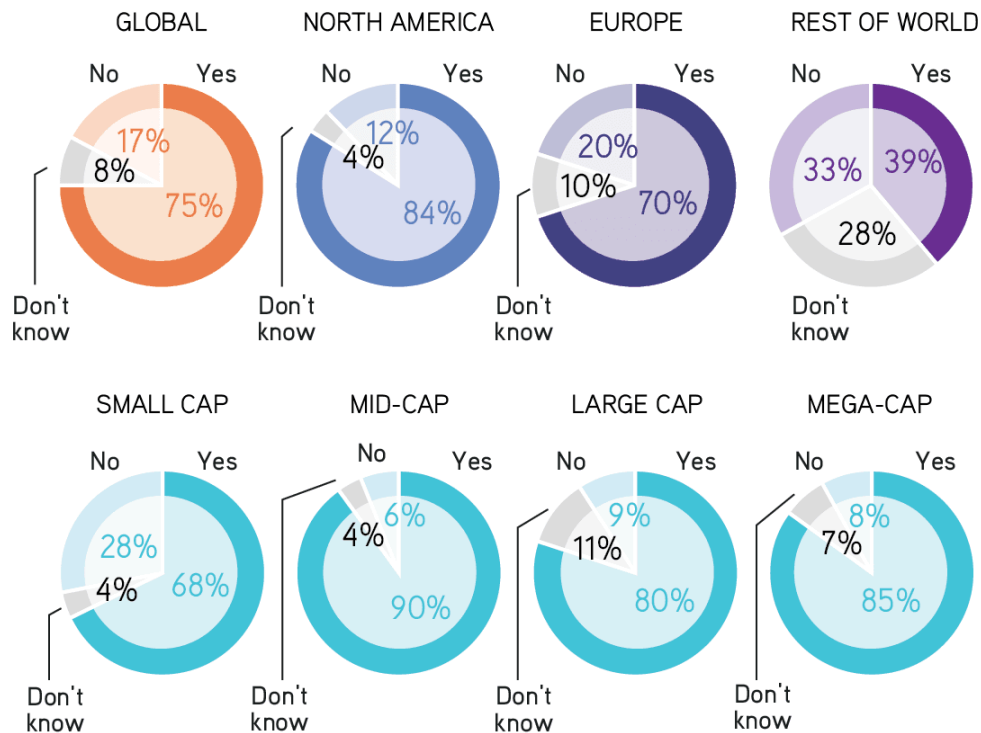
When asked which parts of the board have *some* oversight of executive compensation, the most frequently cited globally are the main board (71 percent of respondents), compensation committee (25 percent) nominating and governance committee (14 percent) and audit committee (10 percent).

The main board is cited most frequently by those at mid-cap companies (89 percent), compared with 75 percent of those at mega-caps, 68 percent of those at large-cap firms and 63 percent of those at small caps. Thirteen percent of small caps say the finance committee plays a role, compared with just 3 percent of those at mid-caps and none of those at large or mega-cap companies.

Fifteen percent of those at mega-cap companies say the audit committee plays a role, considerably more than do those at large or mid-caps (both 6 percent) and small caps (11 percent).

Respondents in North America are more likely (78 percent) to see main board involvement in executive compensation than those in Europe (63 percent). At the same time, those in Europe are twice as likely (21 percent) to say the nominating and governance committee is involved as are those in North America (10 percent).

Does your board use an outside adviser/s on executive compensation?



The process of determining executive compensation is complex and evolving. It also faces increasing scrutiny from investors and other stakeholders. This perhaps helps explain why three quarters of all respondents say their board uses an outside adviser or advisers in this area.

The use of outside help is particularly pronounced among those at mid-cap companies, 90 percent of whom say their board gets third-party advice. By comparison, only 68 percent of those at small caps say their board uses outside advice, a figure that rises to 80 percent among large caps and 85 percent among mega-caps.

Respondents in North America more frequently (84 percent) state that their board uses outside help than do those in Europe (70 percent).

Making decisions

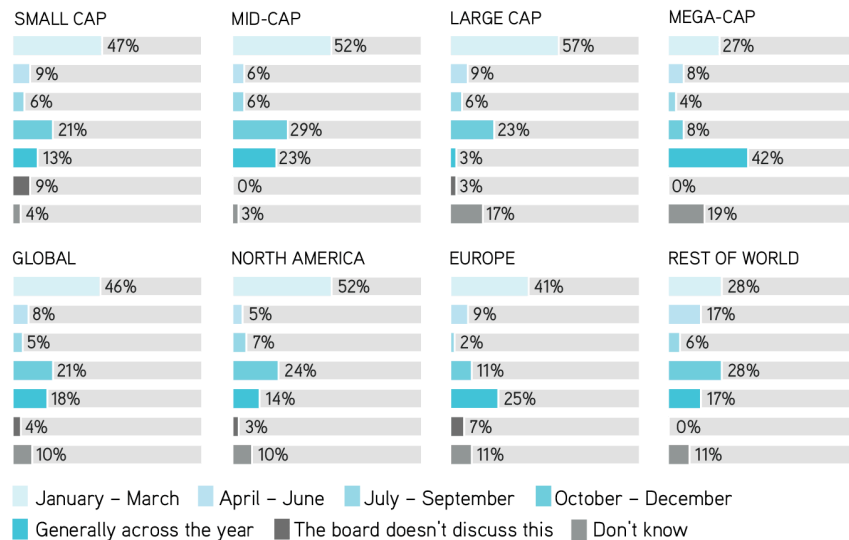
When to discuss – and did Covid-19 change things?



Making decisions

When to discuss – and did Covid-19 change things?

At your company, during what time of year do board discussions around executive compensation mainly take place?



Globally, January to March is the most common time when board discussions on executive compensation mainly take place, cited by 46 percent of respondents. That is followed by

October-December (21 percent) and generally across the year (18 percent). Few say boards focus their discussions on either April to June (8 percent) or July to September (5 percent).

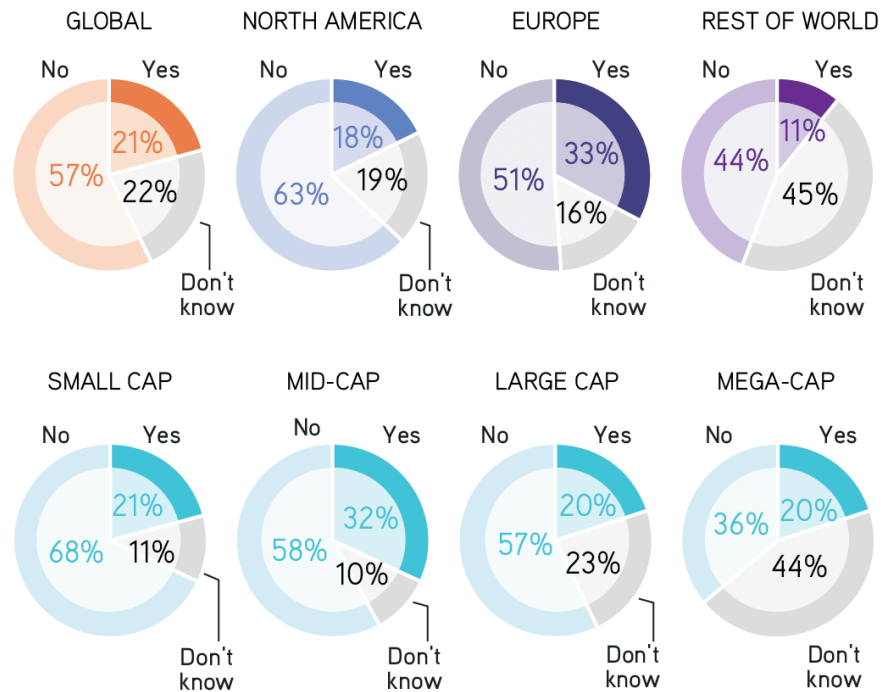
There are distinct variations in behavior based on company size. Only around a quarter (27 percent) of respondents at mega-caps say their board's main discussions take place in the first three months of the calendar year. By comparison, 57 percent of those at large caps, 52 percent of those at mid-caps and 47 percent of those at small-cap firms say January to March is the main period.

Around four in 10 (42 percent) of respondents at mega-caps say their board's discussions around executive compensation take place mainly across the year. That figure drops to just 3 percent among large caps and is still significantly lower at small caps (13 percent) and mid-cap companies (23 percent). On the flip side, significant numbers of those at small-cap

companies (21 percent), mid-caps (29 percent) and large-cap firms (23 percent) cite October to December as the main period for these discussions, while only 8 percent of those at mega-caps say the same.

Respondents in North America (52 percent) more frequently than those in Europe (41 percent) say the main period for discussions is January to March. October to December is cited by 24 percent of those in North America and 11 percent of those in Europe. The emphasis on year-round discussion is more commonly cited by those in Europe (25 percent) than by those in North America (14 percent).

Has your board revised its approach to executive compensation planning as a result of the Covid-19 pandemic?



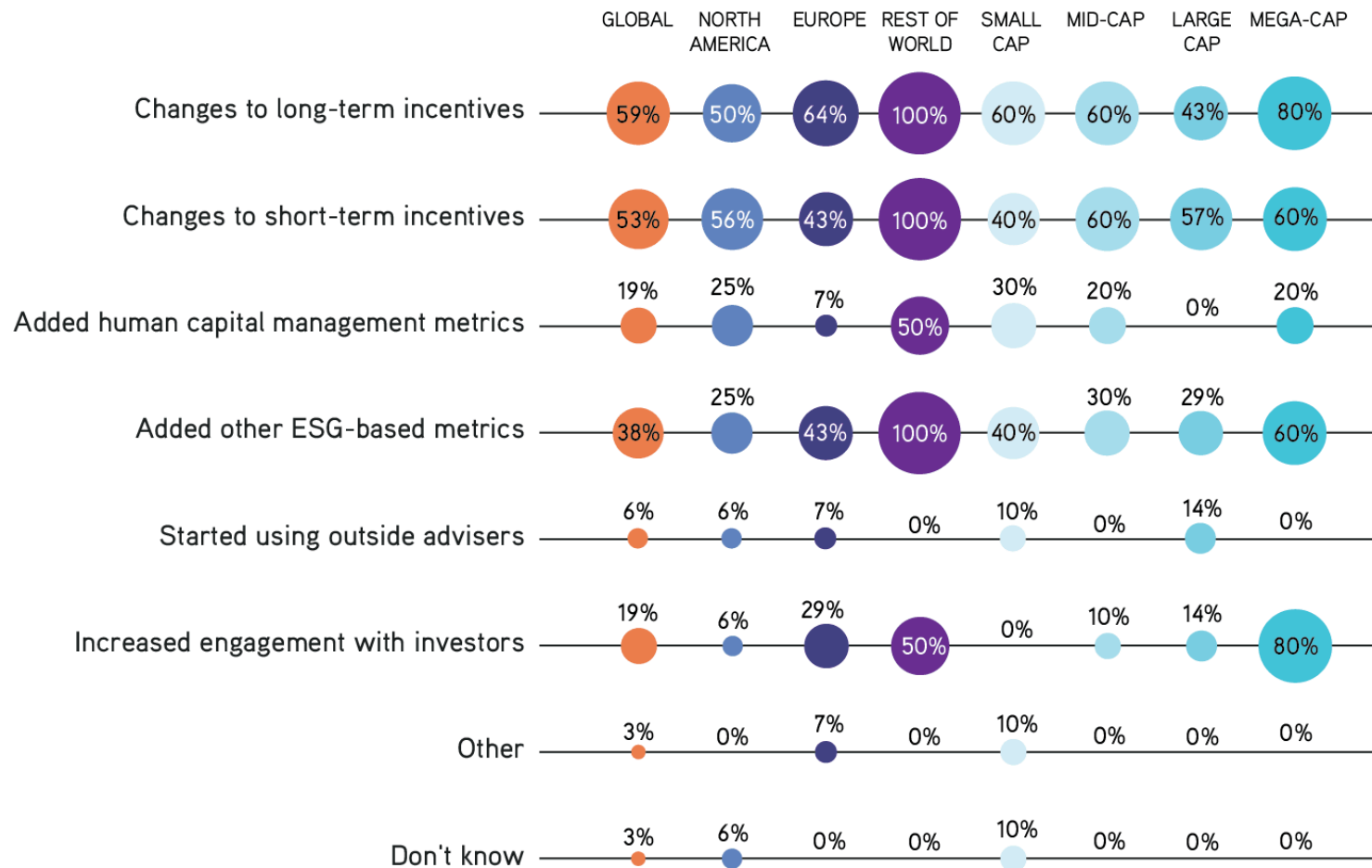
The experiences of the Covid-19 pandemic have given people pause for thought on many aspects of how they conduct their lives and businesses – including a renewed focus on a range of human capital management issues.

A significant number – 21 percent – of respondents globally say their board has revised its approach to executive compensation planning as a result of the pandemic. More than half (57 percent) say their board has not done so, though it is worth noting that more than a fifth (22 percent) of respondents do not know. The number who don't know is particularly notable (44 percent) at mega-caps.

Respondents at large caps and mega-caps (20 percent each) are the least likely to report a change in approach due to the pandemic, but almost a third (32 percent) of those at mid-cap companies say there has been a change in approach.

More respondents from Europe (33 percent) than in North America (18 percent) report a change in approach due to the pandemic.

What changes have been made?



Among those boards that have made changes to their executive compensation planning due to Covid-19, the most frequently cited alterations globally are changes to long-term incentives (59 percent of respondents) followed by changes to short-term incentives (53 percent), adding ESG-based metrics (38 percent) and adding human capital management metrics and increasing engagement with investors around compensation (19 percent each).

On the agenda

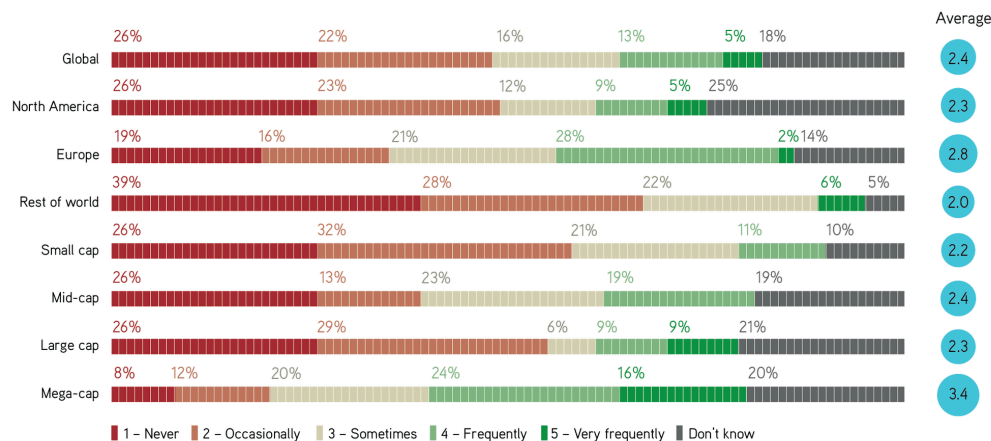
Investor interest in executive compensation



On the agenda

Investor interest in executive compensation

In the past 12 months, how would you describe the frequency with which investors have asked questions around executive compensation?



Globally, more than half (56 percent) of respondents report that investors have asked questions around executive compensation at least occasionally over the past 12 months.

Just over a quarter (26 percent) say investors have not asked about the topic during the past year. It is also notable that 18 percent of respondents do not know whether such questions have been asked.

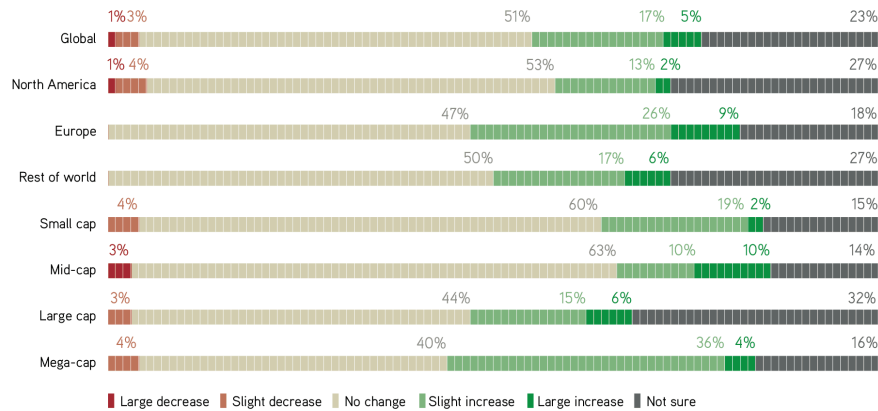
Among those at mega-caps, just 8 percent report investors never having asked questions in the past 12 months, while 40 percent say investors have asked questions either frequently or very frequently. Indeed, respondents at mega-caps report the most-frequent inquiries, with an average score of 3.4 based on a scale where one is 'never' and five is 'very frequently'.

Globally, respondents on average report a frequency score of 2.4 – between 'occasionally' and 'sometimes' – for the previous 12 months. Those at small-cap companies report the least-frequent investor questions (average score 2.2), though their peers at mid-caps (2.4) and large-cap companies (2.3) report similar scores.

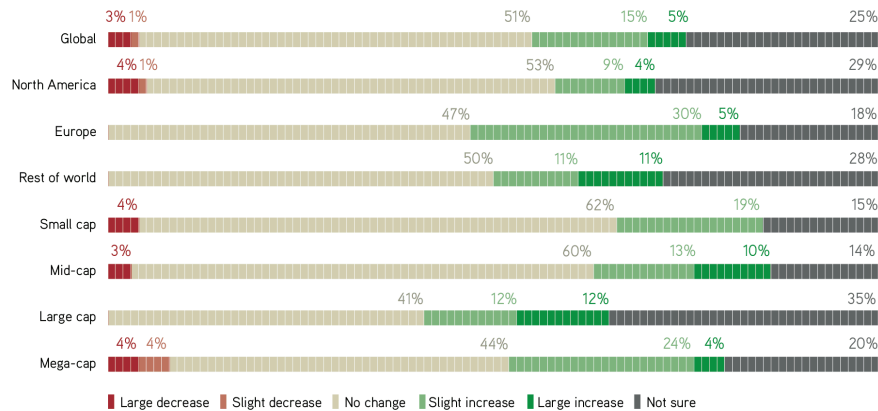
Respondents in Europe (2.8) on average report more frequent questions than those in North America (2.3).

How has the frequency with which investors ask about executive compensation plans changed compared with...

Two years ago?



Three years ago?



The trend on balance is toward more frequent questioning from investors about executive compensation plans. Globally, 22 percent of respondents say there has been a slight or large increase compared with two years ago, against 4 percent who report a slight or large decrease, leaving a net 18 percent seeing an increase. The equivalent figures (20 percent reporting an increase, 4 percent a decrease) are very similar over a three-year period.

The trend is more marked at the very largest companies: 40 percent of those at mega-caps report a slight or large increase in questions over the past two years, with 4 percent having seen a slight decrease, leaving a net 36 percent reporting an increase in frequency. That net figure of increased frequency of questions is 17 percent among those at both small and mid-caps and 18 percent among those at large-cap companies.

Among respondents in Europe, 35 percent say the frequency of investor questions is up and none report a decrease. By comparison, just 15 percent of those in North America report increases and 4 percent decreases.

Comments

Respondents were asked what questions investors ask about their company's executive compensation plans. Their comments include:

- “Details of proposal to exercise discretion following the chair of the [remuneration committee] reaching out to major investors ”
- “It varies, but mainly about the components (short term vs long term, time-based vs performance-based) and any special awards ”
- “Cost of short-term incentive plan ”
- “Disclosure of CEO compensation, CEO-to-employee pay ratio ”
- “What the increase will be for the upcoming year ”
- “Pension for CEO ”
- “How does the company ensure compensation governance practices while remunerating executive management? ”
- “What is the role of ESG? ”
- “Long-term vs short-term incentives, components/factors/determinants of short-term incentives and ESG's role in compensation decisions, particularly evaluations of immediate past performance ”
- “Alignment to strategy and shareholder return ”
- “Structure, performance metrics, target-setting process, compensation philosophy ”
- “Limited inquiries after bankruptcy, as executive compensation was brought down across the board ”
- “How much will CEO make and is that proportionate? ”
- “We have put a lot of effort into aligning with best practice so in reality there is no negative feedback ”
- “Investors are keen to ensure they are aligned with shareholders' interests ”
- “Disclosure plus [short-term] and [long-term] incentives plans ”
- “They want to understand the strategy behind the compensation plan. Europe-based investors frequently advocate for very long stock-holding periods and suggest we adopt them ”
- “Process for setting compensation and assessing out-turns ”
- “ESG metrics in executive compensation ”
- “Mainly about the impact of Covid-19 ”
- “Goal-setting for performance pay plans, extent of pay considerations ”
- “Performance compensation ”

Informing the board

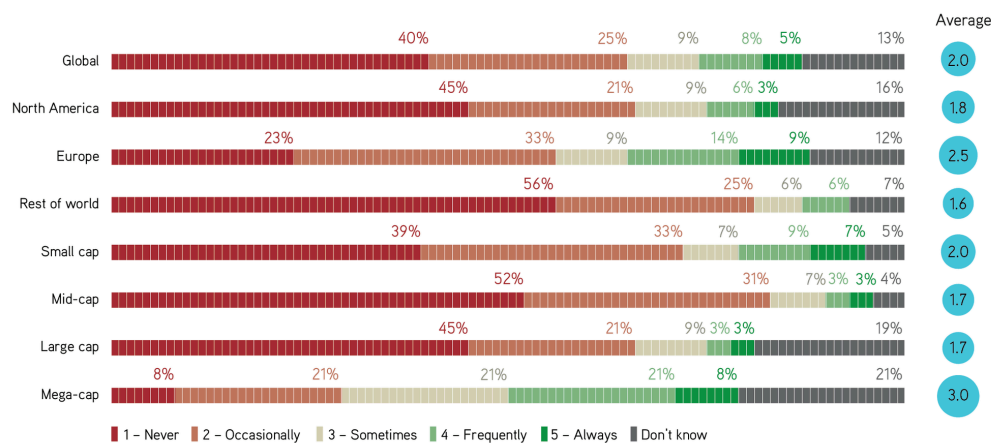
Engagement and education



Informing the board

Engagement and education

How frequently do members of your board get directly involved in investor engagement about your company's executive compensation plans?



Respondents were asked to rate how frequently members of their board get directly involved in investor engagement about the firm's executive compensation plans, using a scale where one is 'never' and five is 'always'. Globally, respondents report an average frequency of 2, or 'occasionally'. Those at mid-caps and large caps on average report the least-frequent director involvement, with a score of 1.7 each, while those at mega-caps report an average score of 3, or 'sometimes'.

These averages highlight that, despite widespread investor interest in talking with directors, overall they have relatively infrequent involvement in such discussions. Globally, almost two thirds (65 percent) of respondents say members of their board never or only

occasionally get directly involved in investor engagement about executive compensation. That figure rises to 72 percent among respondents at small caps and 83 percent among those at mid-caps. But just 8 percent of respondents at mega-caps say their directors are never involved. Half say their directors are involved sometimes, frequently or always.

More than four in 10 (45 percent) of respondents in North America say their board members are never directly involved in engagement on compensation matters. This compares with just under a quarter (23 percent) of those in Europe.

Comments

Respondents were asked how they make sure their board is informed about investor sentiment on executive compensation. Their comments include:

- “ Summary provided in [remuneration committee] report and governance report to the board ”
- “ Informing the head of the compensation committee ”
- “ The [remuneration committee] chair reports to the board at each meeting. [Remuneration] is covered in annual board training ”
- “ Via board discussion ”
- “ We report to the [compensation] committee and the full board on investor engagement ”
- “ Corporate secretary provides updates ”
- “ Engagement of outside advisers ”
- “ Through corporate governance roadshows ”
- “ Given verbal reports ”
- “ The investor relations department reports on this ”
- “ Compensation consultant, benchmarking ”
- “ Task of investor relations colleague ”
- “ Sharing summaries of engagement and outside proxy advisory reports ”
- “ Regular engagement led by the company secretary ”
- “ We have external remuneration advisers and we receive feedback from our brokers and investors ”
- “ Report during board meetings ”
- “ External consultants ”
- “ Quarterly IR report to board indicating investor questions and main themes/topics ”
- “ Consult with largest shareholders ”
- “ Reports by chairs of board and [compensation] committee to full board ”
- “ [Compensation] committee handles this ”
- “ Reports to compensation committee and [remuneration committee] reports to board ”
- “ CEO/CFO advise board ”
- “ Quarterly board meetings ”
- “ Meetings with investors, investor surveys, external advisers ”
- “ Legal and IR provide reports to the board on questions from investors regarding executive compensation ”

“ The board sees all communication from investors directed to the board members ”

“ Investor relations reports any conversations to corporate secretary. Most of the time these conversations are related to the proxy and annual meeting process ”

“ Formal reporting process through the nominating and corporate governance committee ”

“ Annual review of executive compensation ”

“ Annual meeting and proxy advisory firms ”

“ [Remuneration committee chair] meets with investors, updates provided to board, main shareholder and proxy adviser voting policies analyzed and key relevant items raised with the committee ”

“ Through our [compensation] committee chair as he participates in calls with investors regarding executive compensation ”

“ Governance updates at the board/committee meetings ”

“ Results of vote at annual meeting ”

The new frontier

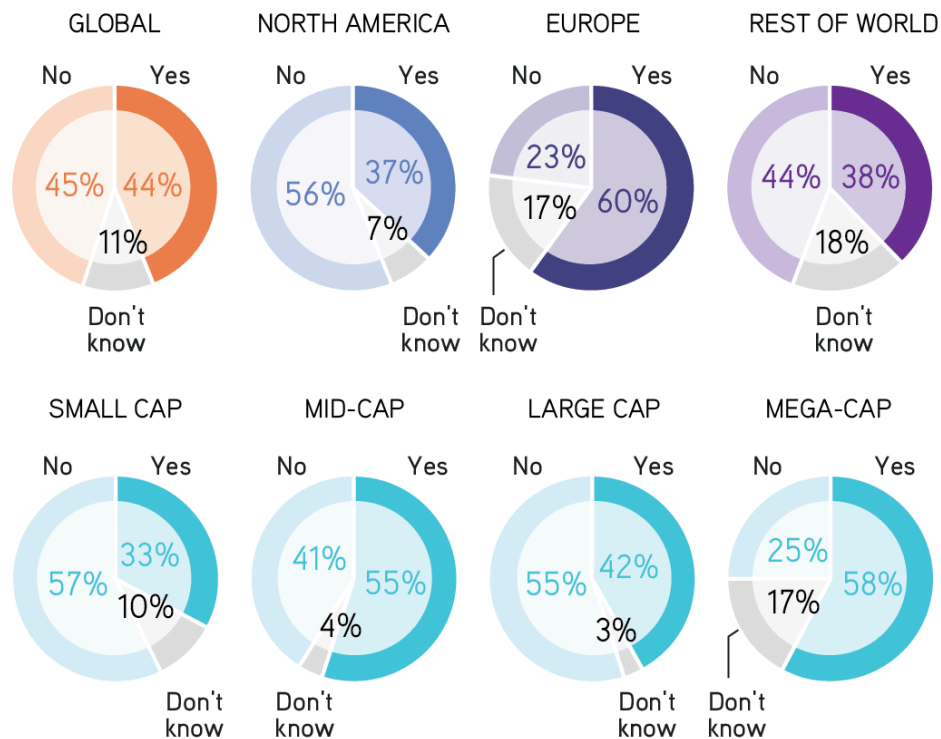
Linking compensation to ESG



The new frontier

Linking compensation to ESG

Does your board link executive compensation to ESG metrics?



Many investors are increasingly keen to see companies link executive compensation to ESG criteria as a means to incentivize management to reach goals such as enhancing diversity or reducing greenhouse gas emissions.

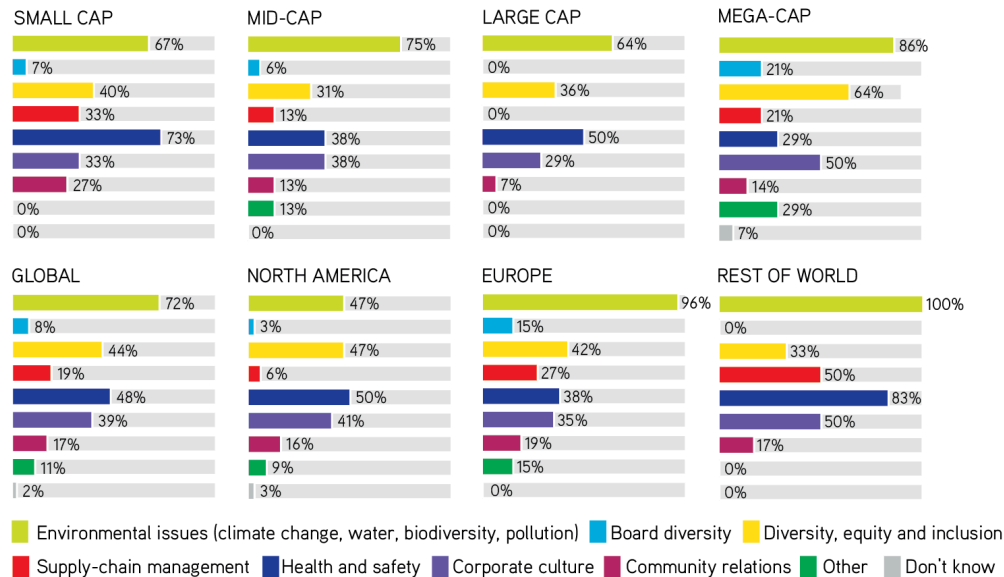
These goals are in turn considered to drive value for companies and other stakeholders. Making such links would have been generally unthinkable just a few years ago and companies are still developing the methods for implementing them. But our research suggests the idea has spread rapidly.

Globally, 44 percent of respondents say their board links executive compensation to ESG metrics, while 45 percent say their board does not. Just a third (33 percent) of respondents at

small caps and 42 percent of those at large caps say their board links compensation to ESG. But more than half of those at mid-caps (55 percent) and mega-caps (58 percent) report such links being used.

There is also a strong regional distinction in the degree to which this concept has been taken up: 60 percent of respondents in Europe say their board links executive compensation to ESG metrics, compared with just 37 percent of those in North America.

To which ESG issue/s is executive compensation linked?



Globally, among respondents who say executive pay is tied to ESG metrics, the most frequently cited metric is environmental issues such as climate change, water, biodiversity and pollution, cited by 72 percent.

mega-caps more frequently cite DE&I (64 percent) than do their counterparts at smaller issuers.

The next-most frequently cited issues are health and safety (48 percent of respondents), diversity, equity and inclusion (DE&I) (44 percent), corporate culture (39 percent), supply-chain management (19 percent) and community relations (17 percent).

Less than half (47 percent) of those in North America whose board links executive compensation to ESG metrics say they use environmental issues, compared with a decisive 96 percent of those in Europe.

Respondents at small-cap companies more frequently cite health and safety (73 percent) than do their peers at larger companies. Those at

Advertisement feature

Building an engagement program around compensation

Advice for governance teams



Building an engagement program around compensation

Advice for governance teams

Investors continue to articulate their own policies as opposed to relying solely on proxy advisers, leading to greater differentiation and a growing need for consistent shareholder engagement.

In the executive compensation area, firms typically engage shareholders in the context of one or more of the following scenarios:

- As part of the company's regular annual shareholder outreach program
- In order to pre-emptively address a potential pay-for-performance disconnect or a compensation decision that could be viewed negatively by

proxy advisers and/or investors

- To combat a negative say-on-pay vote recommendation by proxy advisers or the dissident view of activist investors
- To recover from a failed or challenged say-on-pay vote outcome.

The following provides an overview of the shareholder engagement process with respect to executive compensation and related governance issues.

When?

Timing is driven by the reason for engagement and varies depending on

each company's specific circumstances. In general, proxy advisory firms and institutional investors are most receptive to meetings during the proxy-off season – June to late fall – and may decline invitations during a company's proxy solicitation period.

With whom?

To determine which shareholders to engage, evaluate the company's ownership base – institutional, retail, insider – and say-on-pay voting patterns, such as an investor that typically votes based on an independent analysis or follows the recommendations of a specific proxy advisory firm.

Contact a meaningful number of shareholders – at least the top 20 holders. To the extent proxy advisory firm recommendations are influential with the company's institutional investor base, consider engaging directly with the proxy advisory firms.

By whom?

Who should represent the company in front of shareholders depends on the reason for the engagement, the subject matter to be discussed and the severity of the situation. If multiple participants are involved, messaging should be consistent and parties should speak with one voice.

Participants should be well prepared. They should know the institutional investors' voting policies and prior feedback, how the company's compensation philosophy and pay design aligns with those policies, and who makes the say-on-pay voting decision. At some institutions the voting decision is made directly by the investment team, but at other institutions the voting decision is made by a separate governance team.

Directors should be used strategically: investors recognize that directors have limited time and

therefore value receiving direct attention from a member of the board.

How?

- Clearly state the objective of the meeting and the reason for pursuing that particular audience.
- Prepare a shareholder outreach presentation to facilitate conversation.
- Prepare to demonstrate knowledge of the compensation program, the behaviors it is designed to promote and elements that could potentially be perceived as controversial.
- Be prepared to address any ways in which compensation policies deviate from those policies favored by the shareholder.
- Communication with investor representatives is a two-way street. Be prepared to listen to investor issues and ready to discuss broader governance and social responsibility issues outside compensation.
- Be concise and sensitive regarding time allocation.

Post-engagement process

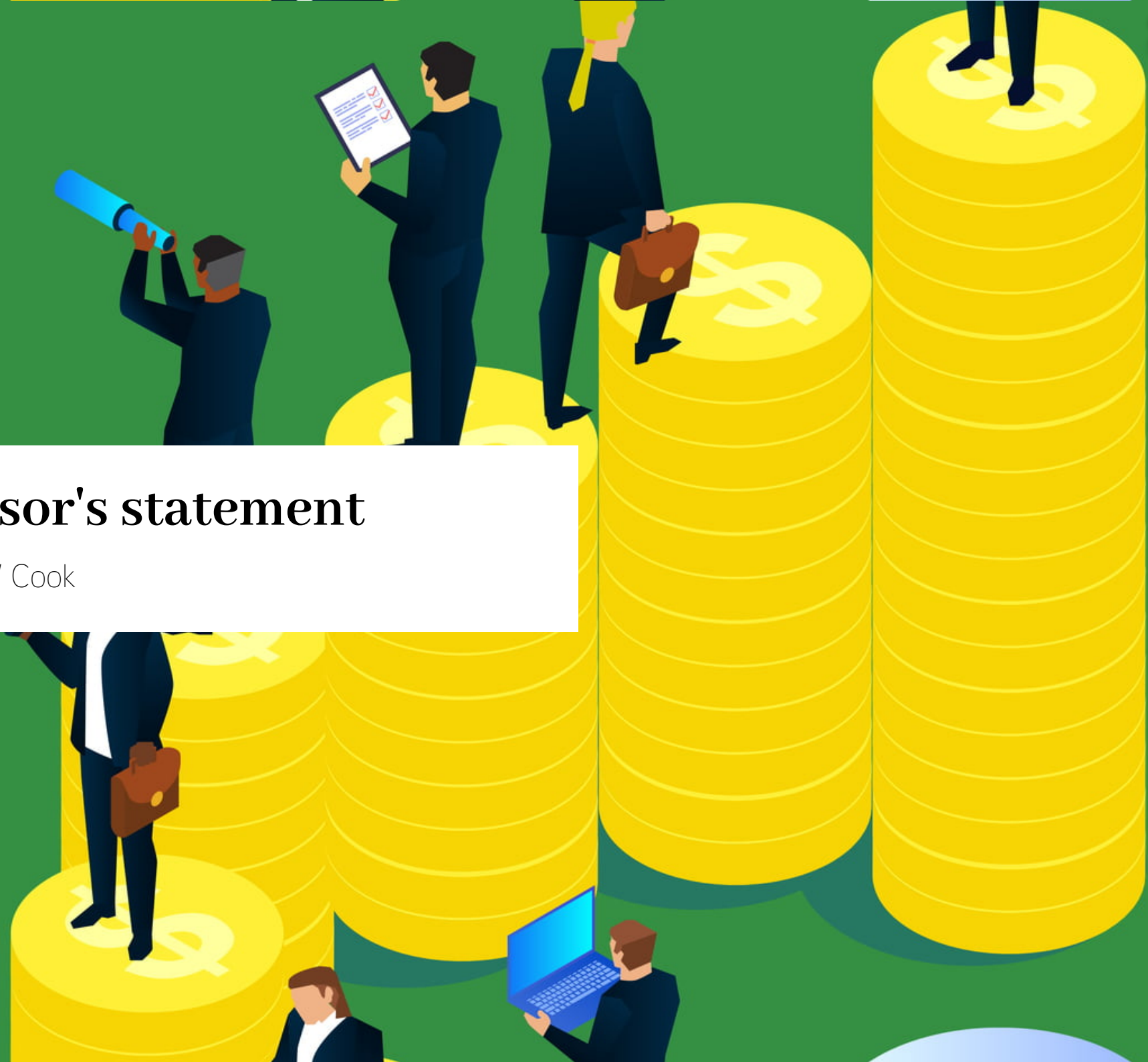
- Develop a summary of interviews and share with the entire board of directors.
- Assess opportunities for addressing key shareholder themes.
- Demonstrate responsiveness to shareholders by detailing shareholder outreach efforts in the next proxy statement. Disclosure will typically cover details of how many stockholders were contacted, who the company engaged with, what percentage of shares were represented, topics discussed and resulting changes to pay practices (if any).
- When substantive changes were made, present details in a table with ‘what we heard’ and ‘what we did’ columns.
- Use the compensation discussion & analysis as an effective medium for shareholder engagement to:
 - Create a shareholder communication document that tells

the company’s unique story

- Brings the reader inside the decision process
- Employs enhanced graphics and shorter, more concise text.

Sponsor's statement

About FW Cook



Sponsor's statement

About FW Cook

FW Cook is an independent executive compensation consulting firm that provides objective advice to boards and management of the world's leading companies. Our principal objective is to add value to the executive pay programs and processes of our clients, with whom we collaborate to solve complex problems and design programs that support their business strategy and successfully link executive pay to shareholder value.

Founded in 1973, we serve public, private and tax-exempt organizations across a broad spectrum of industries. We have the largest market share of board engagements among our competitors and

currently serve more than 750 clients. FW Cook has offices in New York, Chicago, Los Angeles, San Francisco, Atlanta, Houston and Boston. To learn more about us or to join our mail list, visit us on the web at www.fwcook.com.



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