

Pay Versus Performance is Here: What Compensation Committees Must Do Now

A Compensation Committee Series Webinar

Presented by NACD and Pearl Meyer

October 27, 2022

Presenters



Jill Smart (Moderator)
Director



Deb Lifshey
Managing Director, Pearl Meyer



Sharon Podstupka
Principal, Pearl Meyer

Housekeeping



- Submit a question and receive your answer directly from the presenters, either during today's webinar or as a follow-up. You will also be opted-in to receive future executive compensation thought leadership from Pearl Meyer.
- Presentation slides are available today at www.pearlmeier.com/pay-versus-performance and within the webinar console.
- The replay will be available early next week at www.nacdonline.org/webinars and www.pearlmeier.com/pay-versus-performance.

NACD Credentialing Information



Your participation in today's webinar earns you credit toward maintaining your NACD credentials.

NACD Board Leadership *Fellowship*®

If you're working toward maintaining your NACD *Fellowship*® credential, you will receive **1 credit**.



NACD Directorship Certification®

If you're working toward maintaining your NACD Directorship Certification® credential, you will receive **1 credit**.



- Why We're Here Today (Background)
- Major Decision Points
 - Considerations, Unintended Consequences and Unanticipated Issues
 - Peer Group Selection
 - CSM Selection
 - Tabular Measures Selection
- Calculating “Compensation Actually Paid” (CAP)
 - Considerations, Unintended Consequences and Unanticipated Issues
- Required Narrative: Format
 - Current Thinking
 - Bringing the PvP Table to Life: An Example
- Next Steps

Why We're Here Today



Context

- More than a decade after mandating the disclosure of pay versus performance (“PvP”) under the Dodd-Frank Act, the SEC adopted and released the final PvP disclosure rules on August 25, 2022
 - “Compensation Actually Paid” (CAP) compared to “financial performance” (stock price/dividends considered)
- Companies must comply with the new disclosure rules in proxy statements for fiscal years ending after December 15, 2022

What must be disclosed?

- Companies must now include a new proxy table with five years of data (initially three years and then a two-year phase-in to five years) disclosing executive “CAP” in relation to the company’s financial and Total Shareholder Return (TSR) performance

Compensation Disclosure

1. Summary Compensation Table (SCT) total compensation for CEO, and average of other NEOs
2. CAP of CEO and average of other NEOs
 - Reflects SCT-disclosed compensation with adjustments for pension and equity values
 - Replaces SCT grant-date fair value of equity with “fair value” of equity compensation based on vesting or year-end values

Performance Disclosure

1. TSR for the company and its peer group
2. Company Net Income
3. The most important financial metric used to determine CAP in the most recent fiscal year
4. Three to seven additional metrics that the company deems most important in linking executive pay to performance

The Required Tabular Disclosures



- The table below shows the required items to be disclosed, with a phase-in which only requires three years of data in the first year, followed by four years of data in the next year, and five years of data in the third year (SRCs report three years; two years initially)

Year	SCT Total for CEO	“Compensation Actually Paid” to CEO	Average SCT Total for Other NEOs	Average “Compensation Actually Paid” to Other NEOs	Value of \$100 Initial Fixed Investment Based on Company TSR	Value of \$100 Initial Fixed Investment Based on Peer Group TSR	Net Income	Company Selected Measure
Year 1								
Year 2								
Year 3								
Year 4								
Year 5								

- In addition to the table below, the company must also include a list of three to seven performance measures that it determines are its most important for linking executive compensation actually paid to company performance

Most Important Performance Measures
Measure 1
Measure 2
Measure 3
Measure 4
Measure 5
Measure 6
Measure 7

Polling Question #1



Has your management team started working on this yet?

- Yes
- No
- I don't know

Regardless of your answer, you should expect to be briefed on this topic during your November and/or December committee meeting(s).

Three Major Decision Points

1 Choosing the Peer Group for TSR

2 Choosing the Company Selected Measure (CSM)

3 Choosing the “Tabular List” of Measures

Year	Value of \$100 Initial Fixed Investment Based on Company TSR	Value of \$100 Initial Fixed Investment Based on Peer Group TSR
2022		
2021		
2020		

Year	Company Selected Measure
2022	
2021	
2020	

Most Important Performance Measures
Measure 1
Measure 2
Measure 3
Measure 4
Measure 5
Measure 6
Measure 7

Polling Question #2



Have you chosen the peer group that will be used?

- Yes
- No
- I don't know

Considerations, Unintended Consequences, and Unanticipated Issues

“Peer group used for compensation benchmarking in the CD&A”

- Likely aligns better with CD&A story
- Can only be peer group relied upon for benchmarking; not a performance group and not a “market reference” group
- Must be market weighted each year
- Changes in peer group result in detailed footnote disclosure explaining change and reporting old and new comparison
- Looks less like a compliance exercise

“Peer group used in the 10K in the Performance Graph”

- Easy and looks like compliance exercise
- Won’t have to report year-over-year changes
- Cannot use broad index
- Must use published industry or line of business index from performance graph
- If company does not already use industry index in 10-K, it may to consider adding new index to performance graph in 10-K

Polling Question #3



Have you chosen the Company Selected Measure (CSM) yet?

- Yes
- No
- I don't know

Considerations, Unintended Consequences, and Unanticipated Issues

- CSM must be a “financial performance measure”
 - If non-GAAP, include description of how derived from financial statements
 - Must be listed in the Tabular List of Measures
- Should be the most important thing that drives compensation and align with CD&A
 - Based on philosophy or formula?
- May have more than one, but would result in additional PVP explanation
 - Conglomerate measures
- May have none, but footnote!
- Unclear if stock price and/or rTSR may be used

Polling Question #4



If the CSM has been decided upon, is it prevalent in one of your incentive plans?

- Short-term incentive plan
- Long-term incentive plan
- Neither

“Tabular Measures” Selection



Considerations, Unintended Consequences, and Unanticipated Issues

- It's an unranked list
- Must include the CSM
- May include Net Income and TSR
- Three to seven measures should be provided, of which three should be “financial”
 - But if you don't have three financial and you don't have seven total, don't try to populate just to populate
- Should align with CD&A disclosure — this is your chance to make some sense of rule
- May provide multiple lists if vastly different goals between NEOs

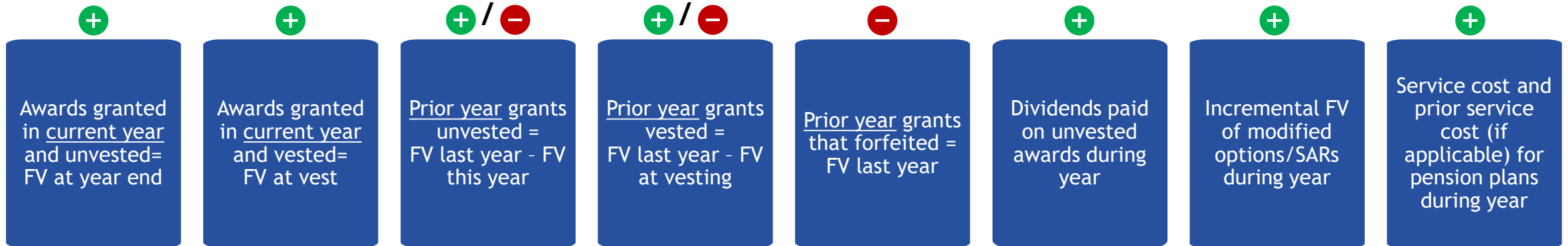
Compensation Actually Paid (CAP)



Compensation "actually paid" means the total compensation for each NEO as reported in the SCT, adjusted as follows (which adjustments must be disclosed by footnote to the PVP table):

Step 1: Deduct from the SCT total the total grant date fair value (FV) of all equity awards and change in pension value, each as reported in the SCT

Step 2: Add in (or deduct out) a "marked to market" equity value based on year-over-year or vest date and pension service cost



- FV is determined under ASC Topic 718
 - For options: Must use a model consistent with the FV methodology used to account for share-based payments in the financial statements under GAAP
 - For performance awards: Must consider the probable outcome of the performance conditions as of the measurement date

A Closer look at CAP

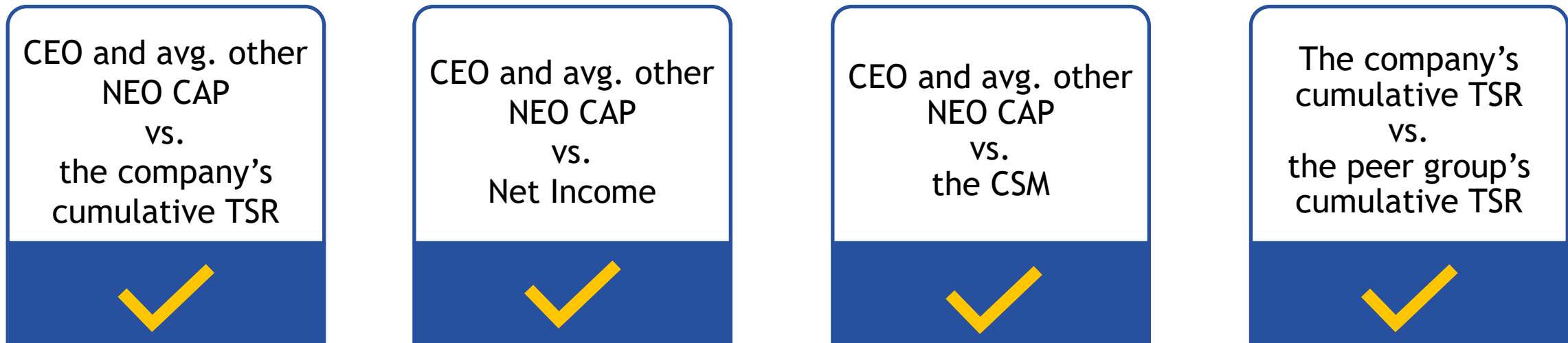


Considerations, Unintended Consequences, and Unanticipated Issues

- Time, expense, resources to collect data/create tables
 - SEC's estimate of time and cost is unrealistically conservative
- Performance-Based Awards
 - New disclosure about how awards are tracking
- Retirement
 - Eligible at grant = same value shown in SCT
 - Eligible during vesting period = equity valued as if it vests upon eligibility
 - Continued vesting upon eligible = confusion!
- Dividends
 - Cash Dividends on unvested stock (and any interest accumulating on deferred balance) included
 - Dividend Equivalents treated as new grants

Required Narrative: Format

The Rule Requires “a Clear Description” of the Various PvP Relationships



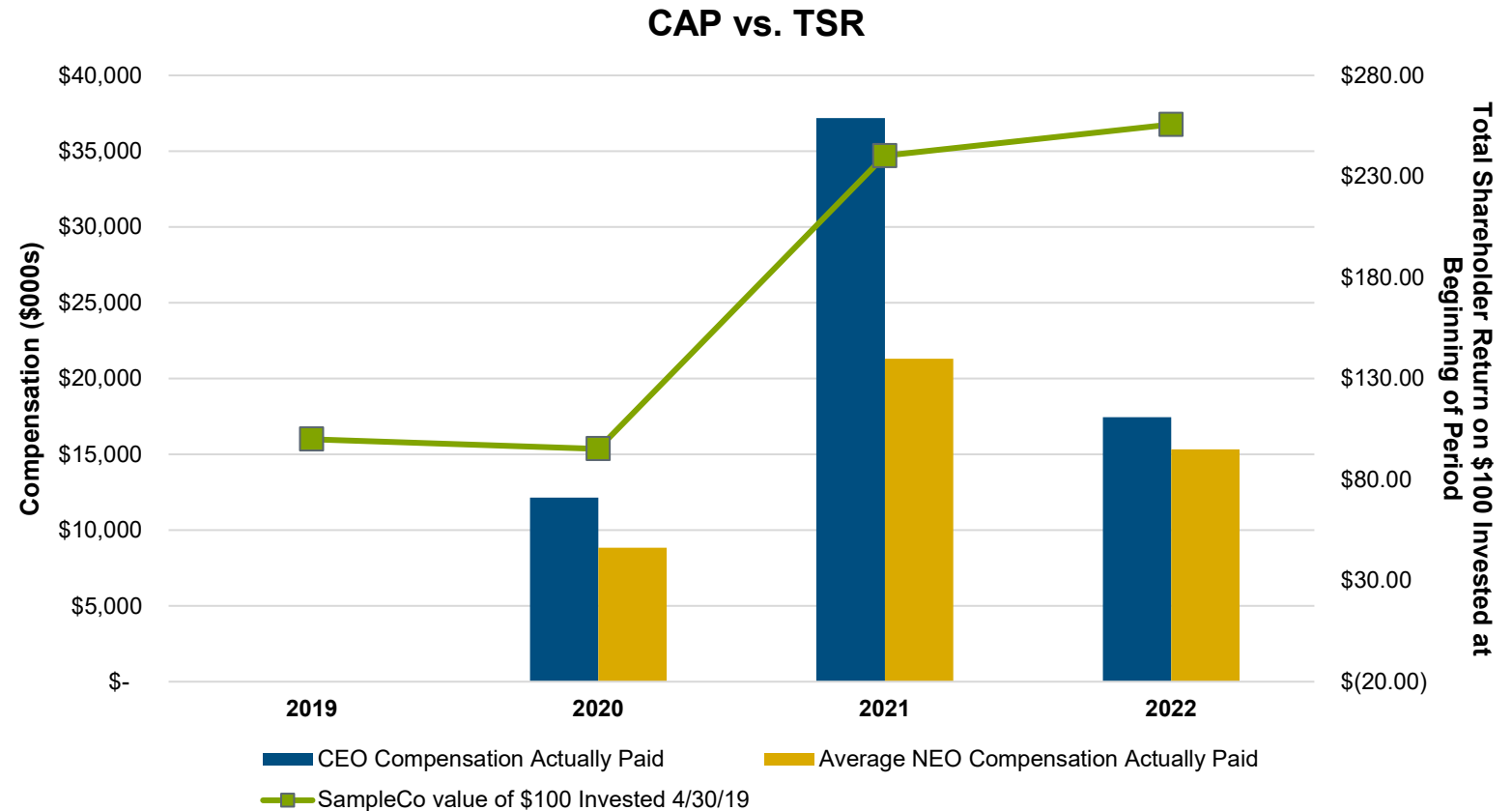
The rule does not provide specific guidance for understanding the mandate for a “clear description” – it is left to the company to decide how to interpret the SEC’s intent.

Using Visuals to Support the Table

CAP v. Company Cumulative TSR

The CEO's and other NEOs' CAP amounts are [aligned with] the company cumulative TSR. There are several reasons for this:

- [We have a long tenured CEO who holds a significant amount stock.]
- [The 2021 increase in stock price impacted the CEO's unvested shares.]
- [In 2022, the stock remained flat, and compensation levels are reflective of target opportunity.]

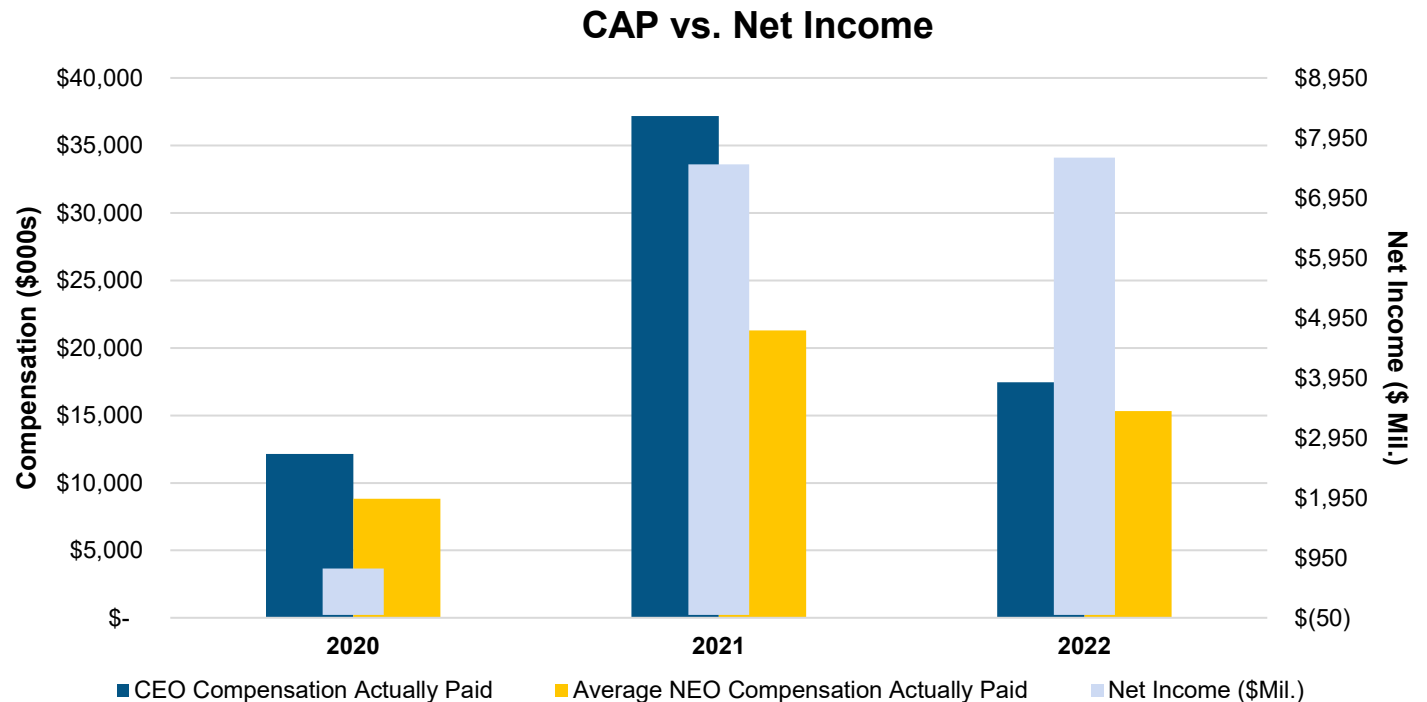


Using Visuals to Support the Table

CAP v. Net Income

The company's Net Income has [increased], while the CEO and other NEOs' CAP has [varied] each year. There are several reasons for this:

- [In 2021, the company rebounded from the pandemic, as reflected in its Net Income.]
- [The stock price also recovered, which drove increases to CEO and average NEO compensation.]
- [Net Income remained strong in 2022, and compensation levels returned to target opportunity levels given the direct correlation with stock price.]

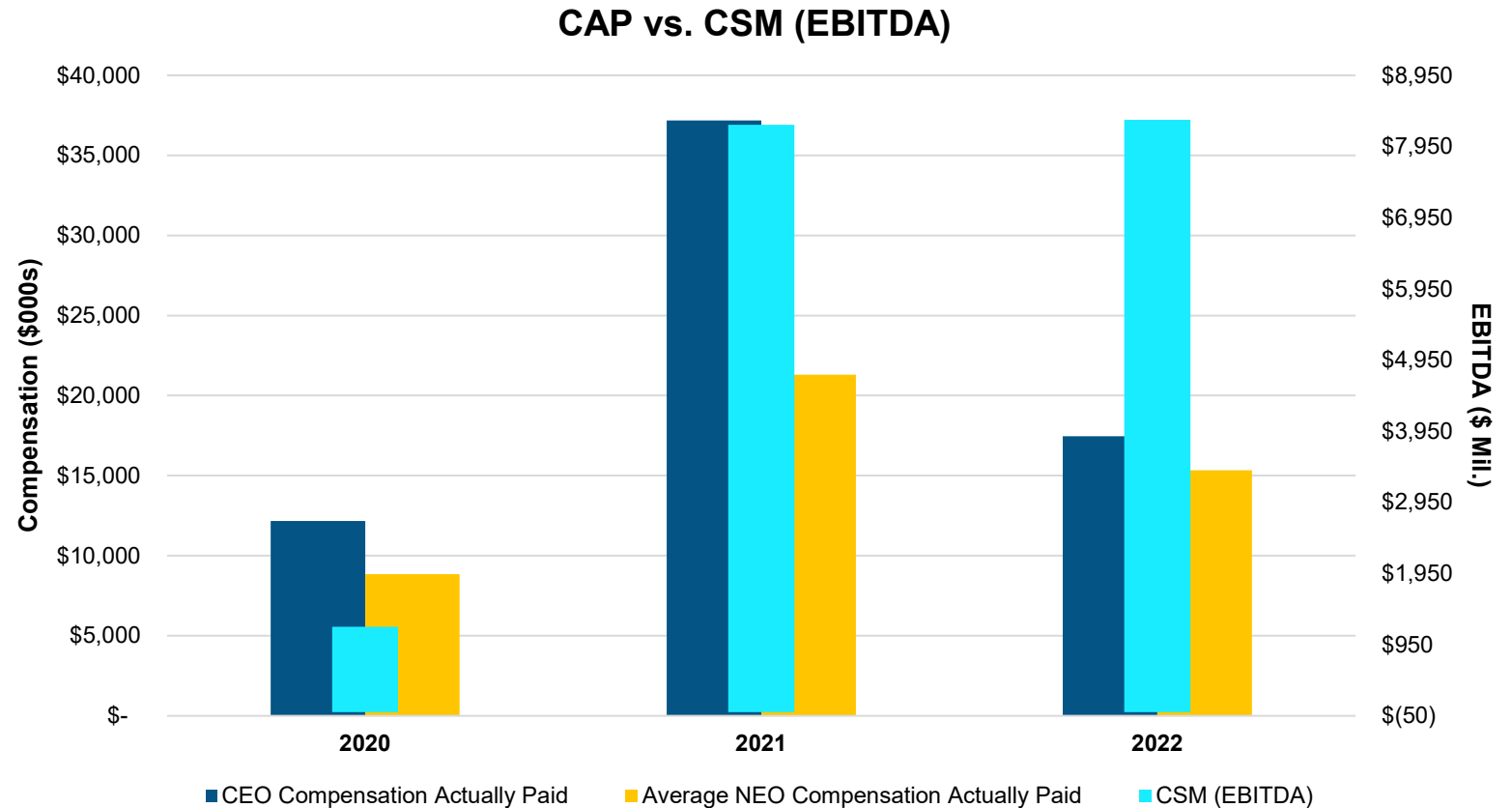


Using Visuals to Support the Table

CAP v. CSM (EBITDA)

This chart compares the CEO and other NEOs' CAP to our CSM, [EBITDA], which shows an [aligned] relationship. The definition of [EBIDTA] and how we calculate it is included in the CD&A of this proxy statement.

- [Like Net Income, EBITDA was strong in 2021, having a positive impact on stock price, which drove increases CEO and average NEO CAP.]
- [Although EBITDA remained strong in 2022, compensation levels returned to target opportunity levels given the direct correlation with stock price.]



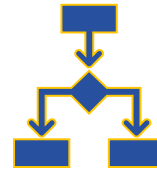
Next Steps



- Collect the data



- Identify valuation resources



- Make key decisions
 - Peer Group
 - CSM
 - Tabular Measures
 - Narrative Format



- Start traditional CD&A updates now



- Be prepared to respond to questions
 - Consider Talking Points and/or FAQs

Questions

Use the “Ask the Experts” box in your webinar console to submit a question for the presenters.

NACD Credentialing Information



Interested in NACD director credentials?



Certification.NACDonline.org
Credentialing@NACDonline.org



NACDonline.org/Fellowship
Credentialing@NACDonline.org

Thank You

Please take a moment to respond to our post-webinar evaluation.