

# The Proxies Are Done: Putting Pay vs Performance in Perspective

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*A Compensation Committee Series Webinar*

Presented by NACD and Pearl Meyer

June 29, 2023

# Presenters



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# 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.pearlmeyster.com/pvp-in-perspective](http://www.pearlmeyster.com/pvp-in-perspective) and within the webinar console.
- The replay will be available early next week at [www.nacdonline.org/webinars](http://www.nacdonline.org/webinars) and [www.pearlmeyster.com/pvp-in-perspective](http://www.pearlmeyster.com/pvp-in-perspective).

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## Pay versus performance: what does it all mean?

- SEC Pay vs. Performance rules: a refresher
  - What have been some of the biggest challenges?
- What are the trends?
  - Data findings among the Russell 3000
  - What are some guiding principles in PvP disclosure?
- How do I make sense of my company's PvP results?
  - Analyses and insights vs. peers
  - Emerging practices
- What questions should I prepare for?
  - Anticipated FAQs
  - Talking points

# SEC Pay vs. Performance Rules

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A refresher

# SEC Pay vs. Performance rules: a refresher



- **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**
- **Companies must comply with the new disclosure rules in proxy statements for fiscal years ending after December 15, 2022** (generally, proxies filed in 2023)

## What is required to be disclosed?

Companies must now include a new proxy table with 5 years of data (initially 3 years and then a 2-year phase-in to 5 years) disclosing executive “compensation actually paid” 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. Compensation Actually Paid (CAP) to 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 equity compensation actually paid based on the fair value at end of fiscal year (similar to “realizable pay”)

### Performance Disclosure

1. Total Shareholder Return (TSR) for the company and its peer group
2. Company Net Income
3. The most important financial metric used to determine compensation actually paid in the most recent fiscal year
4. New tabular disclosure including 3-7 most important measures driving NEO compensation

#### ***Smaller Reporting Companies (“SRCs”) have reduced reporting requirements:***

- *Only two years of data in initial year (with up to 3 years in subsequent years)*
- *Only company TSR and Net Income reported; peer TSR, CSM, and list of other measures not required*

# PvP tabular disclosure details



## Pay versus Performance Tabular Disclosure

- The new table includes the elements below with phase in starting at three years of data in 2023
- In addition to the table below, the company must also include a list of three to seven financial performance measures that it determines are its most important performance measures for linking executive compensation actually paid to company performance

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 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]								

## Highlights

- Peer Group is either CD&A benchmarking peers or 10-K performance graph industry index
- CAP Takes SCT totals and adjusts so that equity includes fair value of awards in progress or that vest during the year, and pension includes only amounts attributable to service cost for the year
- Details required either in text or graphical format to explain relationships between CAP vs. Net Income, TSR and Company Selected Measure, as well as company TSR vs. peer group TSR



# What is included in “Compensation Actually Paid”?



CAP starts with SCT total compensation and makes the following adjustments:

Category	Adjustment Type	Details
Pension	- Pension Benefits	Change in the actuarial present value of DB and pension plans from the SCT
	+ Service Cost	Service cost and prior service cost
Deferred Compensation	+ Deferred Compensation	Deferred comp above-market earnings that are not tax-qualified
Equity Compensation	- Grant Date Fair Value	Grant date fair values for all equity awards from SCT
	+ Change in Vested Value	Fair value of equity awards on vest date minus fair value of equity awards as of the prior FYE (full amount is included for new grants during FY)
	+ Change in Value of Outstanding and Unvested	Fair value of equity awards as of the end of the FY minus fair value of equity awards as of the prior FYE (full amount is included for new grants during FY)
	- Forfeitures	Fair value at prior FYE for awards forfeited/cancelled
	+ Dividends	Dividends or dividend equivalents not otherwise included in total compensation

**Key takeaway: “Compensation Actually Paid” isn’t “Compensation Actually Paid” - it contains a blend of realized and unrealized compensation values**

# Examples of PvP footnote reconciliation: horizontal



Calculation of Compensation "Actually Paid"	Calculation for Current PEO			Calculation for Former PEO			Calculation for Average of Non-PEO NEOs		
	Year 2020 (\$)	Year 2021 (\$)	Year 2022 (\$)	Year 2020 (\$)	Year 2021 (\$)	Year 2022 (\$)	Year 2020 (\$)	Year 2021 (\$)	Year 2022 (\$)
Summary Compensation Table Total	N/A	N/A	8,348,517	15,306,715	20,006,806	19,536,434	3,586,272	4,076,812	4,856,562
Less Stock Award Value Reported in Summary Compensation Table for the Covered Year	N/A	N/A	(7,000,026)	(11,996,569)	(12,192,859)	(12,893,118)	(2,590,164)	(2,359,343)	(3,121,007)
Plus Fair Value for Awards Granted in the Covered Year	N/A	N/A	7,953,183	15,823,776	17,440,890	11,220,663	3,505,606	3,329,128	2,736,407
Change in Fair Value of Awards from Prior Years that Vested in the Covered Year	N/A	N/A	-	1,040,047	(137,809)	(960,026)	(160,466)	(15,856)	(108,100)
Change in Fair Value of Outstanding Unvested Awards from Prior Years	N/A	N/A	-	8,607,449	7,942,001	(6,885,373)	1,833,620	1,799,713	(876,674)
Less Fair Value of Awards Forfeited during the Covered Year	N/A	N/A	-	-	-	-	-	-	-
Plus Fair Value of Incremental Dividends of Earnings Paid on Stock Awards	N/A	N/A	-	-	-	-	-	-	-
Less Aggregate Change in Actuarial Present Value of Accumulated Benefit Under Pension Plans	N/A	N/A	-	(338,576)	(798,423)	(704,454)	(93,643)	(168,385)	(125,379)
Plus Aggregate Service Cost and Prior Service Cost for Pension Plans	N/A	N/A	-	293,972	295,638	380,660	82,057	75,725	60,434
Compensation "Actually Paid"	N/A	N/A	9,301,674	28,736,814	32,556,244	9,694,786	6,163,283	6,737,795	3,422,243

[Source: CSX Corp. 2023 Proxy](#)

# Examples of PvP footnote reconciliation: vertical



## Reconciliation of SCT total compensation to CAP for CEO

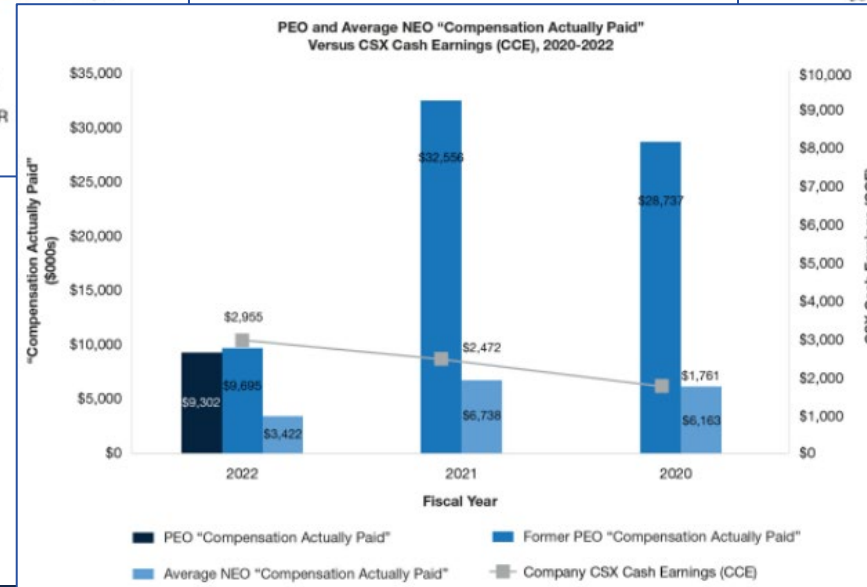
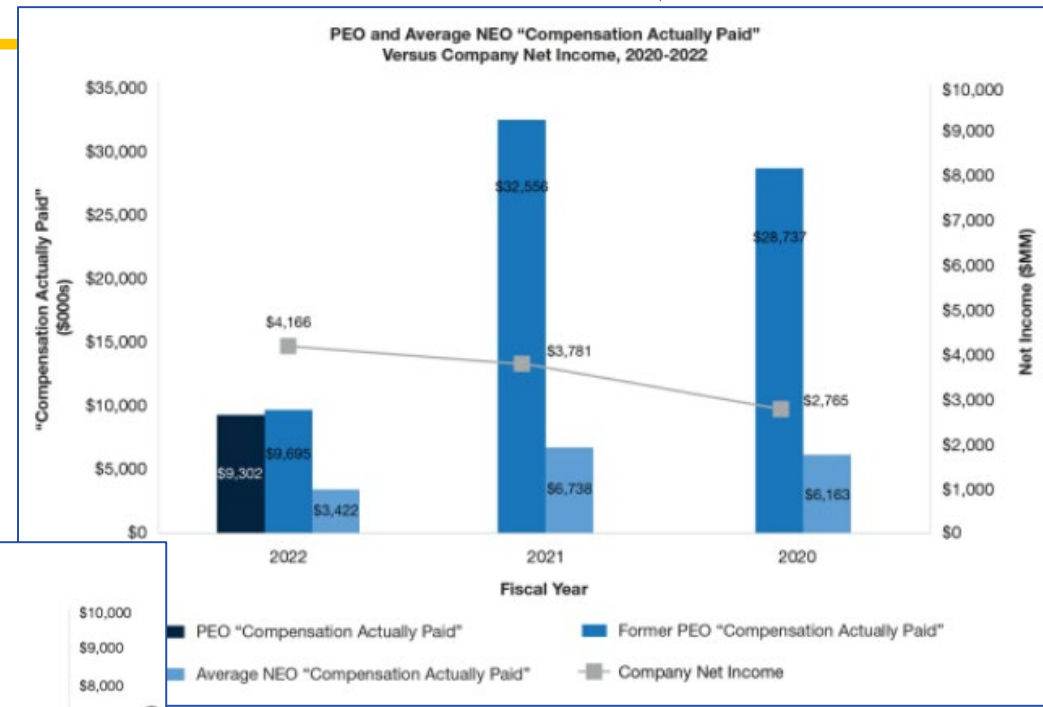
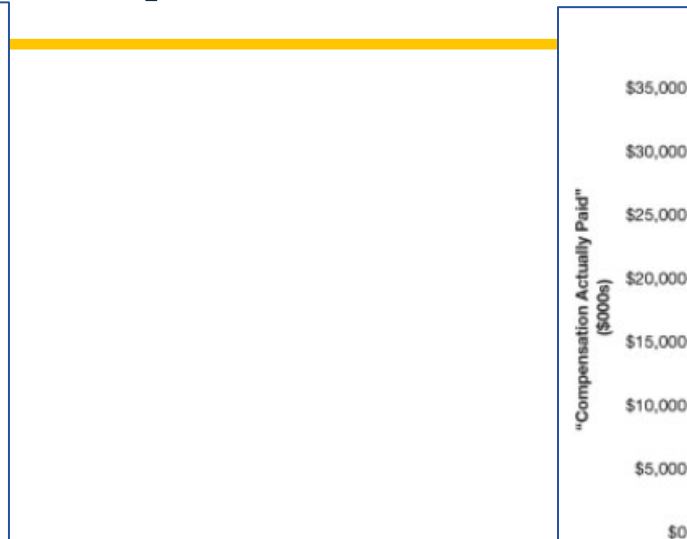
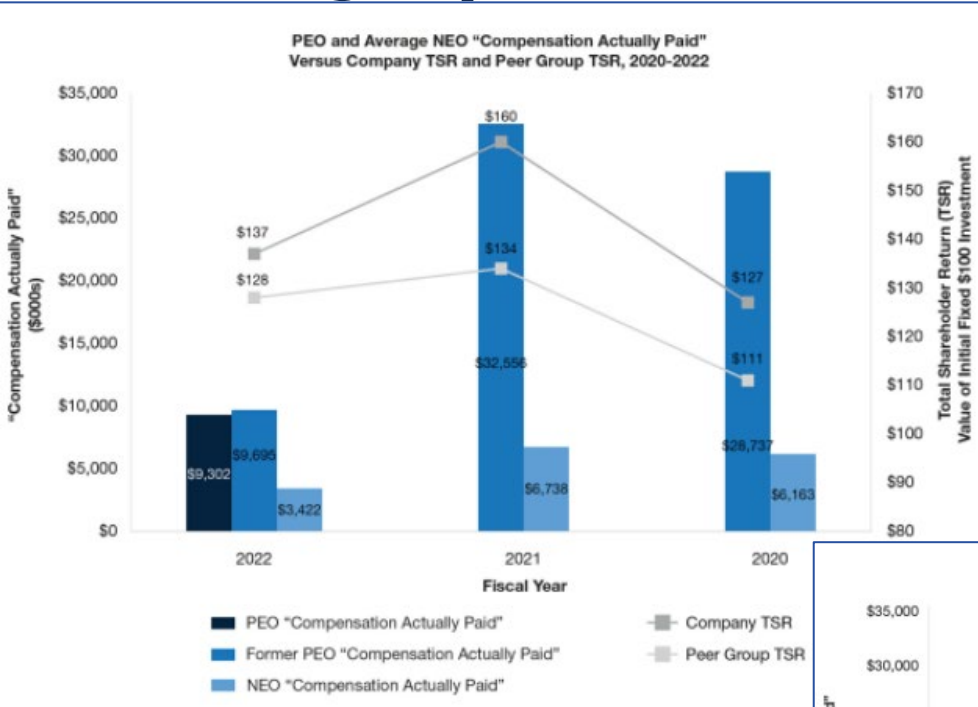
All amounts in U.S. dollars

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k) = (b)-(c)+ (d)-(e)+(f)+ (g)+(h)+ (i)-(j)
Fiscal Year	SCT Total for CEO	Minus SCT Change in Pension Value for CEO	Plus Pension Value Service Cost <sup>(1)</sup>	Minus SCT Equity for CEO	Plus EOY Fair Value of Equity Awards Granted During Fiscal Year that are Outstanding and Unvested at EOY <sup>(2)</sup>	Plus Change from BOY to EOY in Fair Value of Awards Granted in Any Prior Fiscal Year that are Outstanding and Unvested at EOY <sup>(3)</sup>	Plus Fair Value at Vesting Date of Awards Granted and Vested During the Fiscal Year <sup>(4)</sup>	Plus Change in Fair Value from BOY to Vesting Date of Awards Granted in Any Prior Fiscal Year that Vested During the Fiscal Year <sup>(5)</sup>	Minus Fair Value at BOY of Awards Granted in Prior Year that were Forfeited During the Fiscal Year <sup>(6)</sup>	CEO CAP
2022	14,031,387	—	742,142	11,000,949	5,780,110	(5,795,900)	—	(3,604,307)	—	152,482
2021	18,200,584	2,978,538	756,691	10,501,098	11,644,213	756,097	—	560,744	—	18,438,692
2020	20,700,347	7,709,350	512,179	10,001,635	13,484,523	(559,922)	—	(721,377)	—	15,704,765

“EOY” = End of Year, “BOY” = Beginning of Year

[Source: 3M 2023 Proxy](#)

# PvP graphs of CAP vs. performance



[Source: CSX Corp. 2023 Proxy](#)

# What details must issuers footnote?



- List of Principal Executive Officers and Other NEOs
- Any materially new equity valuation assumptions
- Peer group composition (if using anything other than a published index)
- Changes to peer group composition in each year
- Detailed reconciliations from SCT to CAP (typically provided in a supplemental table)
- If using a non-GAAP measure as a CSM, provide reconciliation from GAAP (either in footnote or via reference)

# Preparation of PVP disclosures has been challenging, main issues include:



## Equity Valuation

- Detailed grant and vesting history data required for multiple years
- Complex vesting schedules (e.g., monthly vesting)
- Stock Option Black-Scholes valuations required for every tranche
- Dividends not otherwise included in grant date fair value
- Award modifications
- Forfeitures

## Performance-Based Equity

- Monte Carlo valuations required for PSUs with market-based metrics
- Probable award outcomes in each fiscal year
- Unique performance measurement periods
- PSUs with milestone-based goals

## Special Situations

- IPOs/de-SPACs
- Transactions (e.g., mergers, spin-offs)
- Multiple CEOs
- Changing NEOs
- NEO terminations/severance payments/equity acceleration
- Volatile stock price
- Pre-commercial companies not using financial goals in their incentive plans

# What are the trends?

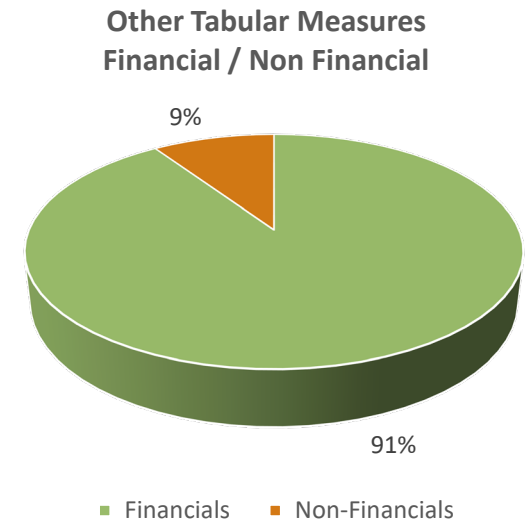
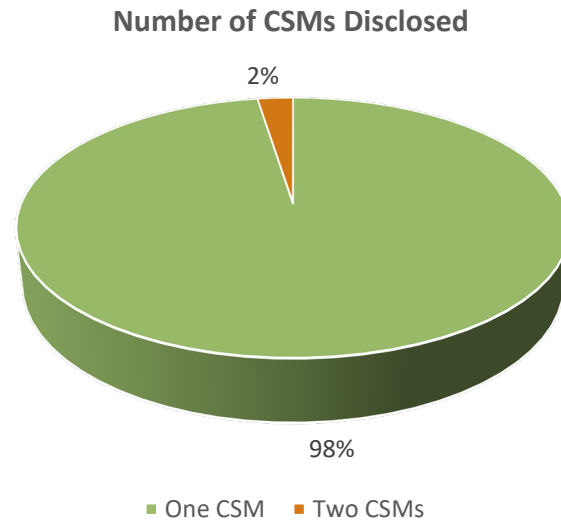
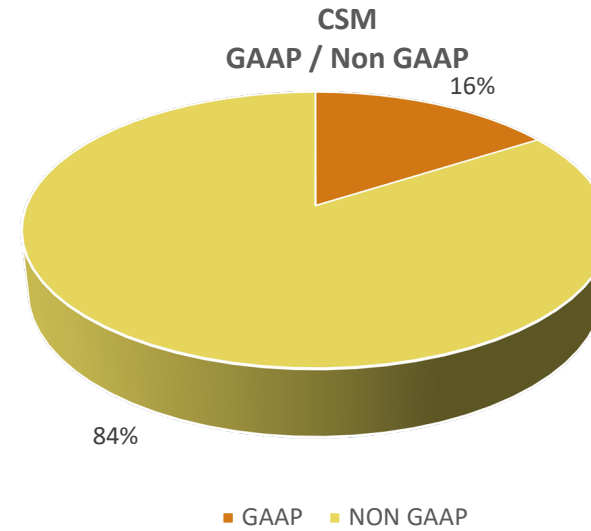
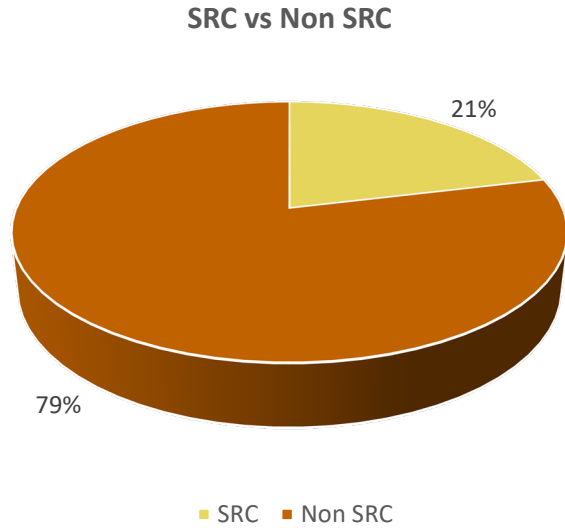
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Data findings and emerging practices

# What CSMs and other tabular measures are companies using?



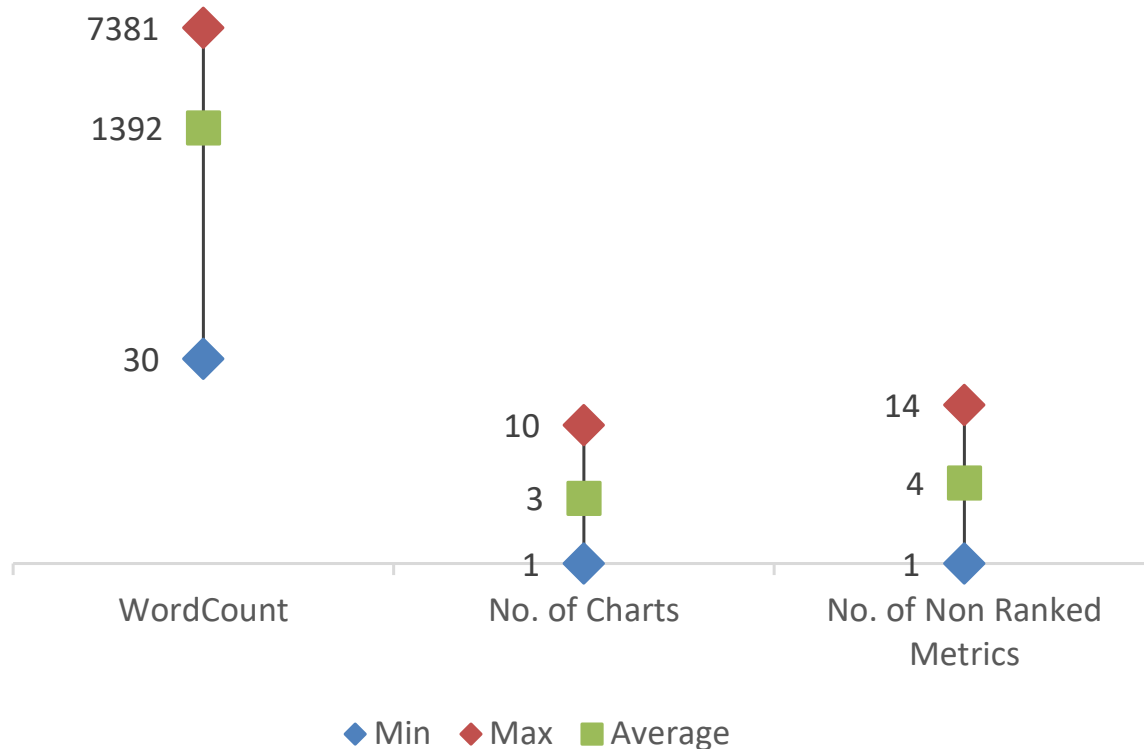
Pearl Meyer compiled data on PvP disclosed by 2,372 companies as of May 31, 2023



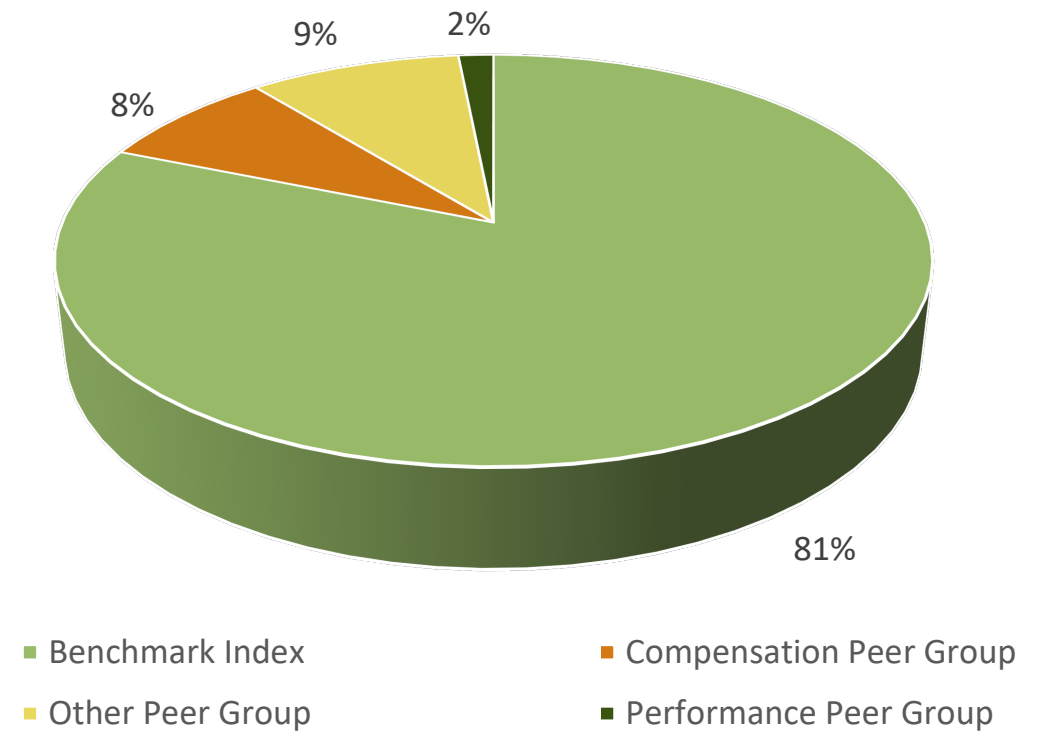


# What did the disclosures look like?

Word Count, Charts, Tabular Metrics



TSR Peer Group / Index



# What are common Company Selected Measures?

Most Common CSMs among the S&P 500\*



Category	CSM	Rank	Prevalence	Top CSM in Each Industry Sector
Revenue	Revenues / Sales	2	18.1%	Consumer Staples, Health Care, Info Tech
Profit	EPS	1	22.2%	Materials, Utilities
	EBITDA	3	10.6%	Industrials, Materials
	Op. Income / EBIT	4	10.3%	Communication Svcs., Consumer Discretionary
	Funds From Ops. Per Share	6	5.5%	Real Estate
	Net Income	9	3.3%	
	Pretax Income / EBT	10	2.5%	
	Operating / Profit Margin	11	2.3%	
	Gross Profit	15	0.3%	
	Op. Income Before Dep. & Am.	15	0.3%	
	Cash Flow	Free Cash Flow	9	3.3%
	Operating Cash Flow	12	1.8%	
Return / Ratios	Return on Equity	5	6.8%	Financials
	Return on Capital	10	2.5%	
	Return on Capital Employed	13	1.5%	Energy
	Return on Income	15	0.3%	
	Combined Ratio	14	0.5%	
TSR / SP	TSR / Stock Price	8	3.8%	
Other	Other Financial**	7	4.3%	

\*Source: MDG database as of June 1, 2023 (represents 397 S&P 500 companies that filed as of this date).

\*\*Reflects measures that were not categorizable as above and/or represented combinations of several categories of metrics.

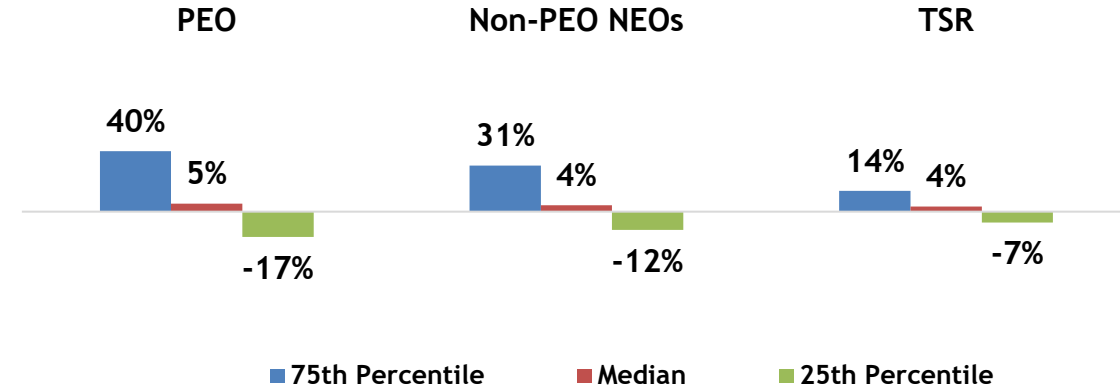
# Is there any relationship between CAP and TSR?



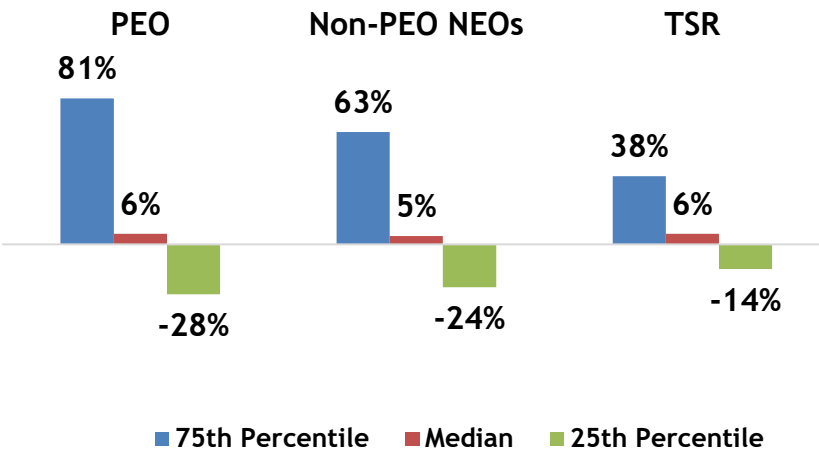
Yes! There is a strong relationship between CAP as a % of SCT and TSR in each year and on a 3-year cumulative basis

Based on sample of R3000 companies that filed as of May 31, 2023

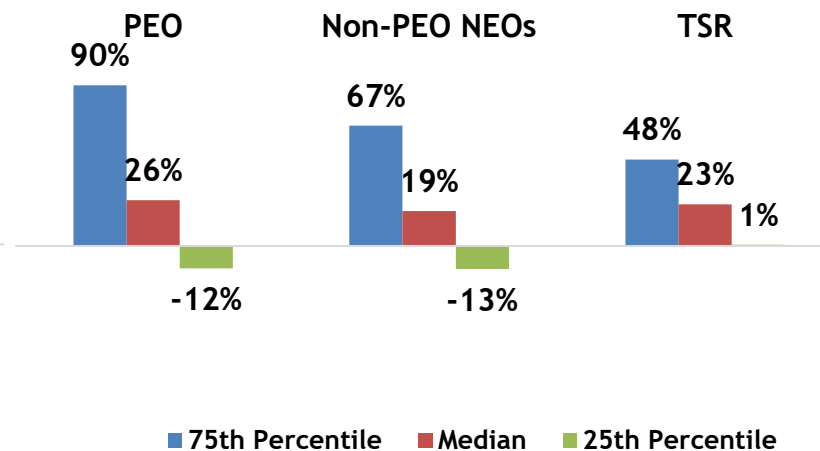
Cumulative (2020-2022) CAP as % of SCT and TSR



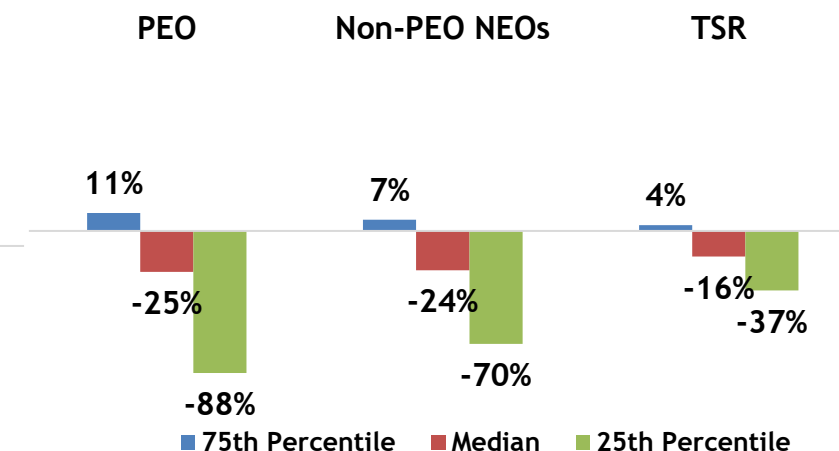
2020 CAP as % of SCT and TSR



2021 CAP as % of SCT and TSR



2022 CAP as % of SCT and TSR



# What are some guiding principles for PvP disclosures?



- **Less is more** - view this simply as a compliance exercise
- Encapsulate adjustments into as **few tables** as possible
- **Clearly footnote** all assumptions
- At a minimum, display the relationship between the following **graphically**:
  - CAP vs. Company Net Income
  - CAP vs. CSM
  - CAP vs. Company and Peer Group TSR
- **Minimize narrative on PvP alignment** - let the graphs speak for themselves
- CSM is typically the **most heavily weighted financial measure** in the annual incentive plan (most often Non-GAAP)
- **Industry index** as opposed to a compensation or performance peer group for TSR comparison
- To the extent your compensation committee uses **other tools/methodologies to evaluate pay-for-performance**, **clearly describe or illustrate the process in the CD&A**

# How do I make sense of my company's PVP results?

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Analyses and insights vs. peers  
Emerging practices

# Comparing client vs. peer group SCT, CAP, and TSR



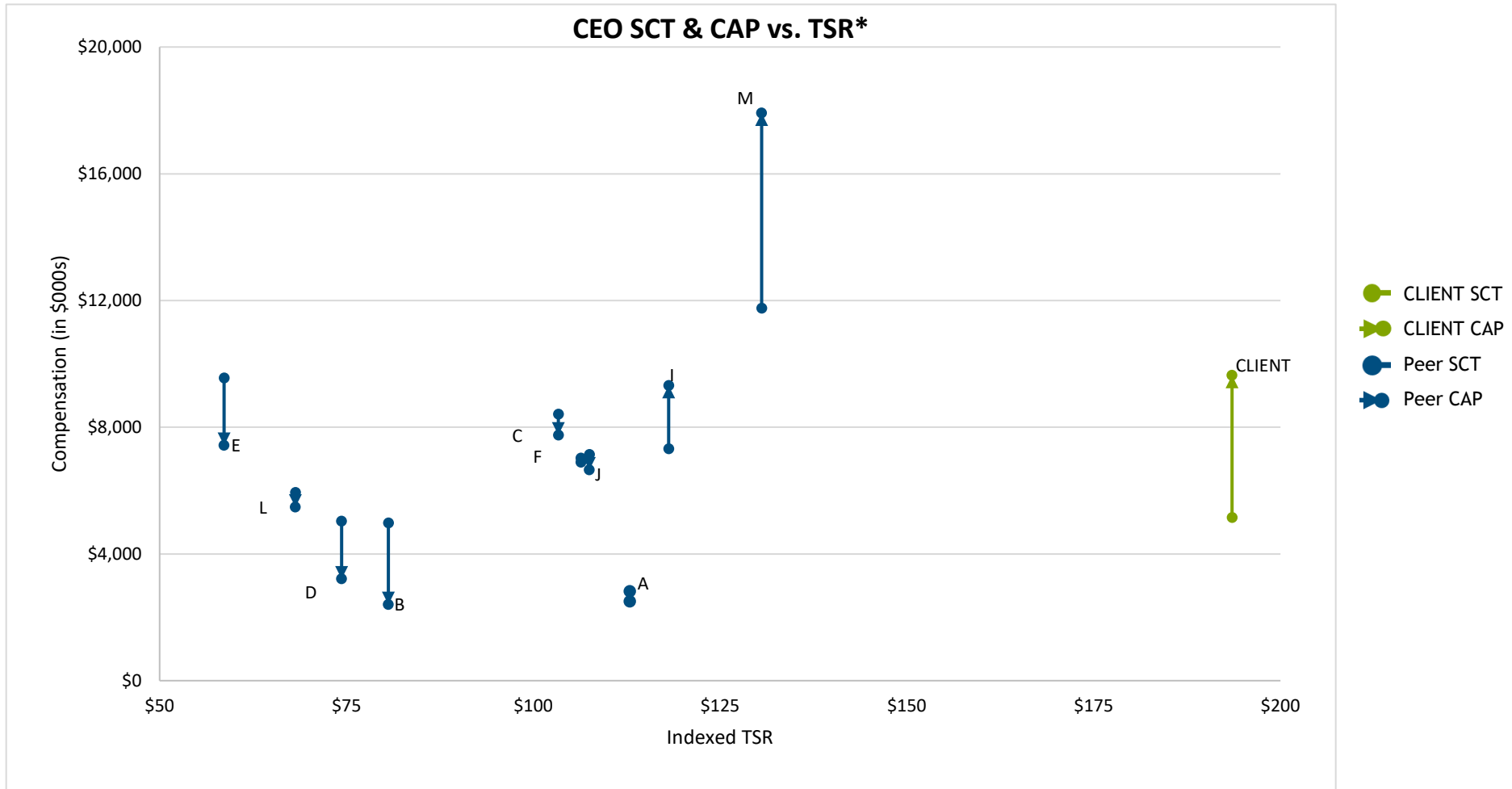
In this example, our client had the highest 3-year TSR vs. its peers, its CAP was not the highest (92<sup>nd</sup> percentile)

Name	Ticker	Three-Year Average SCT for CEO (in \$000s)	Three-Year Average CAP for CEO (in \$000s)	CAP/SCT Ratio	Indexed TSR	Is CSM GAAP or NON-GAAP?	Comparator group for TSR calculations	Company Selected Measure (Metric)	No. of Non-Ranked Metrics	No. of Financial Metrics	No. of Non-Financial Metrics
Company A	A	\$2,499	\$2,816	1.13	112.9	NON GAAP	Benchmark Index	FCF	4	4	0
Company B	B	\$4,977	\$2,403	0.48	80.6	NON GAAP	Benchmark Index	EBITDA	4	4	0
Company C	C	\$8,414	\$7,754	0.92	103.4	Not Disclosed	Benchmark Index	Sales	3	3	0
Company D	D	\$5,031	\$3,214	0.64	74.3	NON GAAP	Benchmark Index	EBITDA	7	3	4
Company E	E	\$9,553	\$7,429	0.78	58.6	NON GAAP	Compensation Peer Group	OI / EBIT	7	5	2
Company F	F	\$6,892	\$7,028	1.02	106.4	NON GAAP	Benchmark Index	EBITDA	4	3	1
Company G	G	\$4,491	\$4,884	1.09	92.9	NON GAAP	Benchmark Index	Net Income	5	3	2
Company H	H	\$5,819	\$5,881	1.01	104.1	NON GAAP	Benchmark Index	EBITDA	4	4	0
Company I	I	\$7,322	\$9,317	1.27	118.1	Not Disclosed	Benchmark Index	OI / EBIT	6	6	0
Company J	J	\$7,139	\$6,650	0.93	107.5	Not Disclosed	Benchmark Index	EBITDA	6	6	0
Company K	K	\$4,057	\$3,030	0.75	72.0	NON GAAP	Benchmark Index	EBITDA	3	3	0
Company L	L	\$5,944	\$5,479	0.92	68.2	NON GAAP	Benchmark Index	EBITDA	2	2	0
Company M	M	\$11,752	\$17,916	1.52	130.6	GAAP	Benchmark Index	EPS	3	3	0
Peer Average		\$6,453	\$6,446	0.96	94.6				4	4	1
25th Percentile		\$4,977	\$3,214	0.78	74.3				3	3	0
Median		\$5,944	\$5,881	0.93	103.4				4	3	0
75th Percentile		\$7,322	\$7,429	1.09	107.5				6	4	1
<b>CLIENT</b>	<b>CLIENT</b>	<b>\$5,152</b>	<b>\$9,636</b>	<b>1.87</b>	<b>193.5</b>	<b>NON GAAP</b>	<b>Benchmark Index</b>	<b>EBITDA</b>	<b>4</b>	<b>4</b>	<b>0</b>
<b>Percentile Rank</b>		<b>35th</b>	<b>92nd</b>	<b>ABOVE</b>	<b>ABOVE</b>						

# Comparing client vs. peer group SCT, CAP, and TSR



In this example, our client had the highest 3-year TSR vs. its peers; its CAP was not the highest (92<sup>nd</sup> percentile)



# What other methods of analyzing PVP results are emerging?



- Concept of CAP in excess of SCT compensation
- Relationship of CAP in excess of SCT to TSR, relative to peer group TSR
- “Sharing Ratio” showing the CAP in excess of SCT relative to key financial metrics (e.g., market cap, revenues, net income, etc.)



# What questions should I prepare for?

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Anticipated FAQs

Key points to highlight

# What questions from investors/media/employees might I receive?

Although PvP has garnered less attention than initially anticipated, be prepared to answer the following possible questions:

- 1) What is included in “Compensation Actually Paid”?
- 2) What is the additional supplemental table under the main PvP table with the detailed reconciliation?
- 3) Did the CEO really receive \$20M in [Fiscal Year X]?
- 4) Why are the CAP numbers so high in [Fiscal Year X]?
- 5) Why are there negative CAP numbers?
- 6) Does the compensation committee consider the results of the SEC Pay vs. Performance disclosure in making its annual compensation determinations for the Named Executive Officers (“NEOs”)?
- 7) What other pay-for-performance related analyses does the compensation committee consider in making compensation decisions for the CEO and other NEOs?
- 8) Do the results indicate a positive correlation between ABC performance and executive pay?
- 9) How do the company’s PvP results compare to peers?

# Key points to highlight



In discussing the results of PvP for the committees on which you sit, below are some talking points:

- This was the first year the PvP disclosure was required; the committee did not use the results in making annual compensation determinations, we will continue to evaluate our results relative to peers
- The committee uses a number of other tools/analyses in its annual evaluation and determination of NEO pay (e.g., including market benchmarking, performance assessments, realized and realizable compensation, level of risk in compensation plans vs. peers, etc.)
- CAP is not compensation “*actually paid*” - it is a complex concept that includes both realized and realizable compensation (that is, a significant proportion is still “at risk”)
- The CAP results were variable year-over-year primarily due to the changes in stock price over this 3-year period, and a significant proportion of that variability is from unvested/unrealized equity
- Relative to peers, our CAP results were [e.g., median], but our performance was well above [e.g., median], suggesting the company pays conservatively relative to peers
- Institutional shareholder advisors are not currently including PvP results in their voting recommendations, they use other methodologies (e.g., ISS CEO PFP test), which we consider and evaluate every year

# Questions

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