Pearl Meyer

On Point

TIMELY, ACCURATE, INSIGHTFUL

Looking Ahead to Executive Pay Practices in 2021

Executive Summary

Table of Contents

Introduction

Our annual survey *Pearl Meyer On Point: Looking Ahead to Executive Pay Practices* is designed to provide organizations with an annual perspective on how their peers are responding to the latest changes in the environment for decision-making around executive pay and governance.

This year's survey was conducted in late August and September of 2020, with total participation of 273 companies, including 165 publicly traded, 81 private for-profit, and 27 not-for-profit (NFP) organizations. As with prior surveys, responses are broken out separately by respondent role (board member versus employee), ownership type, industry, and company revenue size.

This year's survey addresses key topics associated with the current environment, including compensation actions taken or contemplated in response to the COVID-19 pandemic and use of diversity & inclusion (D&I) metrics within executive compensation programs. It also covers subjects such as compensation philosophy, peer group development, expected pay outcomes for Fiscal 2020, projected pay opportunities for 2021, recent or anticipated incentive plan design changes, and prevalence of and emphasis on environmental, social & governance (ESG) incentive plan metrics.

Introduction (continued)

This year's survey includes the following seven industry groups:

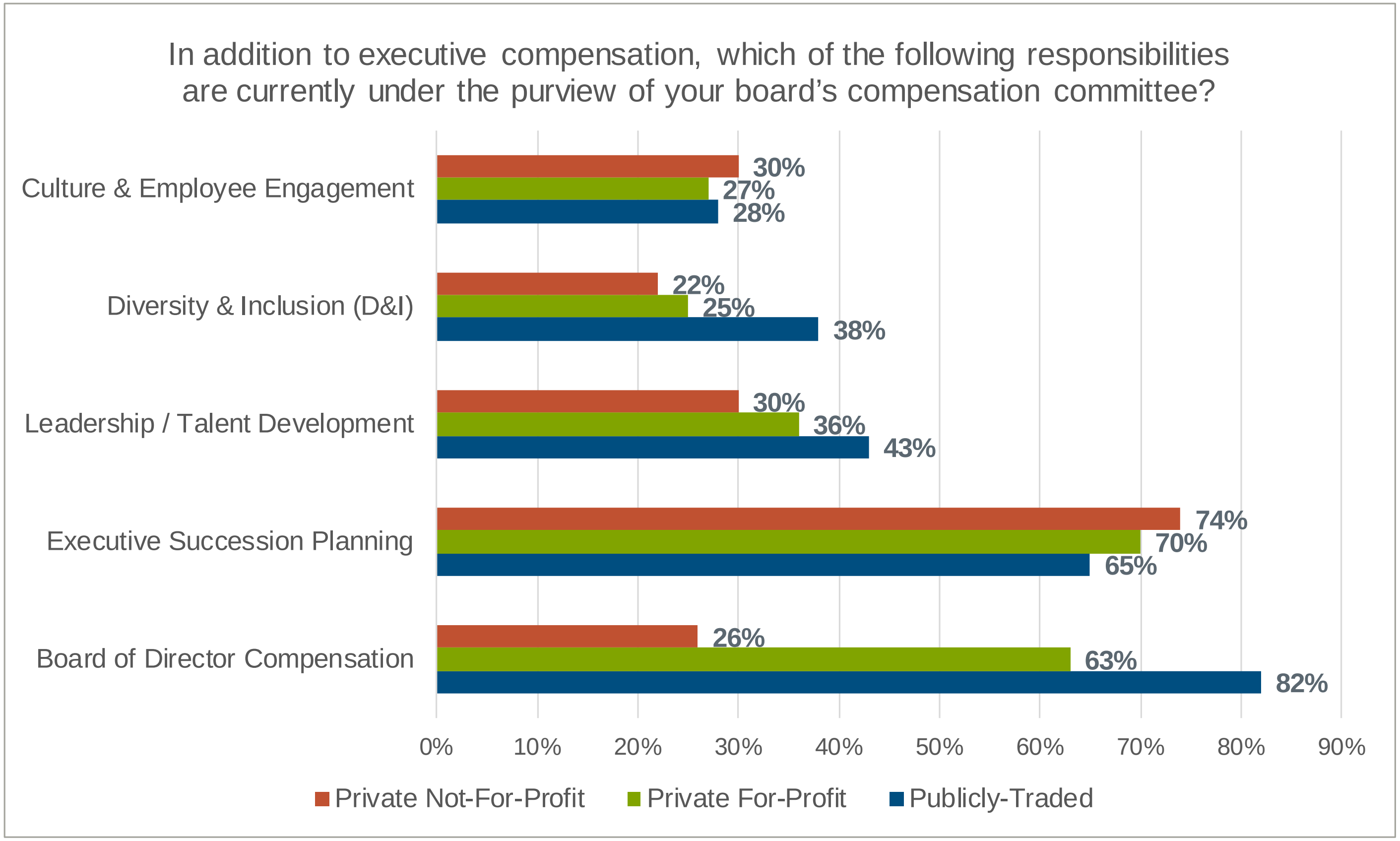
- Business/Other Services
- Consumer Staples/Discretionary
- Energy/Utilities
- Financial/Real Estate
- Healthcare/Life Sciences
- Industrials/Materials/Transportation
- Technology

We hope you find this information useful as you make compensation-related decisions for the coming year. If you have any questions or are interested in discussing these findings, please contact:

Bill Reilly
Managing Director
bill.reilly@pearlmeyer.com
770-261-4082

The Expanding Role of the Compensation Committee

- Compensation committee oversight roles continue to expand, with most for-profit respondents (both public and private) responsible for non-employee director pay and executive succession planning and a growing number also overseeing leadership/talent development and diversity & inclusion (D&I), especially among publicly traded companies.
  - The biggest study-over-study prevalence increase was for D&I (+5% for publicly traded companies), which we expect to become even more of an oversight priority going forward.



Executive Compensation Philosophy

- When asked to list and rank the top three executive compensation program objectives, the most commonly cited responses (rounded) were as follows:

Objective	% Most Important	% 2nd Most Important	% 3rd Most Important	% Within Top 3
Align pay with performance & value creation	41%	26%	12%	79%
Attract, retain, and motivate employees	14%	27%	24%	65%
Reinforce key business objectives	16%	16%	19%	51%

- "Align pay with performance and value creation" was the most commonly cited compensation program objective by for-profit respondents and most industry categories; it was also selected as the top priority by 62% of non-employee directors versus 34% of management respondents.
- "Attract, retain, and motivate employees" moved up from fourth place in last year's survey to second place this year, likely impacted by pandemic-related challenges.

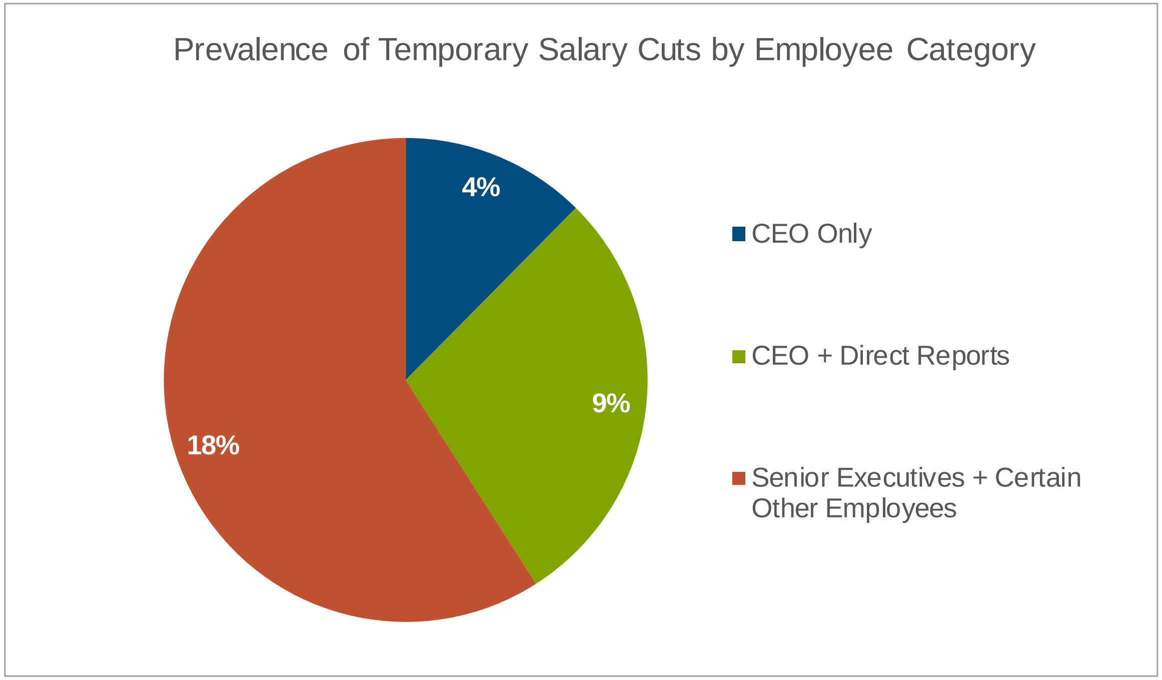
Targeted Pay Positioning

- Approximately half of all respondents (excluding "not applicable" responses) target total direct compensation (sum of base salary + short-term incentives + long-term incentives) at the 50th percentile, with prevalence slightly higher for base salary versus variable pay (STI + LTI).
  - Publicly traded companies are more likely to position pay at the 50th percentile than privately held respondents; they are likely impacted by greater external scrutiny and shareholder advisory group policies.

Pay Component	Targeted Pay Positioning (% of All Respondents)		
	Below 50th Percentile	At 50th Percentile	Above 50th Percentile
Base Salary	15%	55%	30%
Short-Term Incentives (STI)	10%	55%	35%
Long-Term Incentives (LTI)	11%	50%	39%
Total Direct Compensation	8%	51%	41%

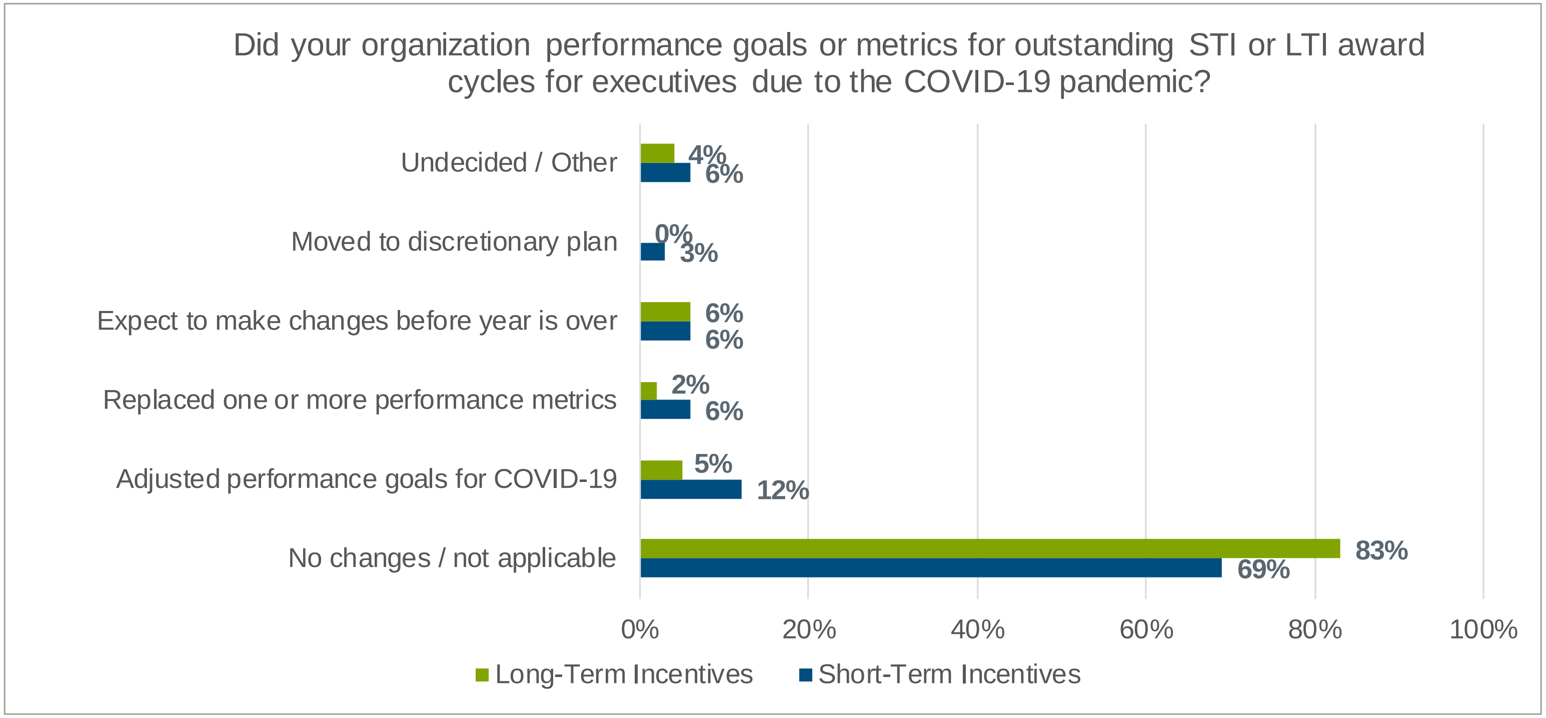
COVID-19 Pay Actions: Temporary Salary Reductions

- Approximately 30% of all respondents temporarily reduced senior executive base salaries in response to COVID-19.
- Expressed as percentages of base salary, 50^{th} percentile temporary cuts were equal to 25% for the CEO, 20% for CEO direct reports, and 10% for other employees, with a 50^{th} percentile duration equal to six months.
  - Prevalence and pay cut magnitude were similar for public and private for-profit respondents; only 15% of private not-for-profit respondents temporarily cut CEO salaries, with a 7.5% reduction at the 50^{th} percentile.



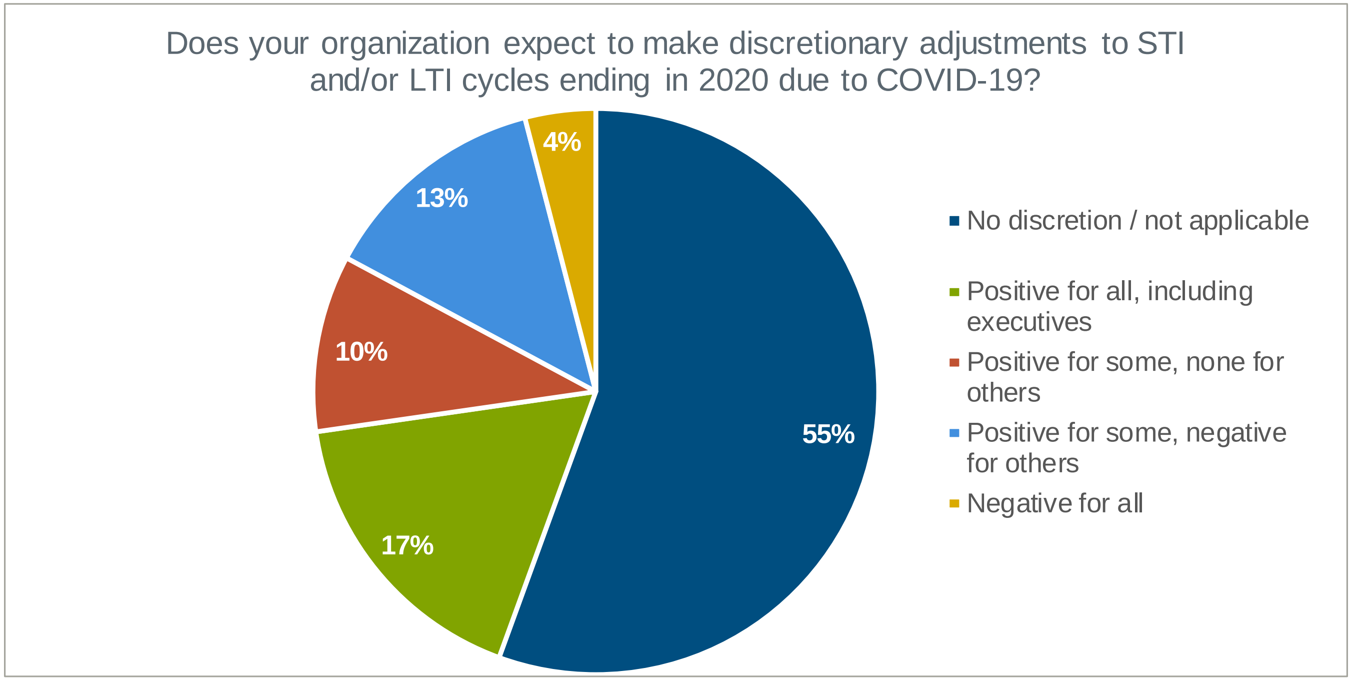
COVID-19 Pay Actions: Changes to STI/LTI Awards

- Most respondents have not made changes to outstanding short-term incentives (STI) or long-term incentives (LTI); those that did typically changed performance goals or metrics.
  - 21% of all respondents made one or more changes to STI awards versus only 7% for LTI.
- Among respondents making changes to STI or LTI awards, only 25% also made changes to award opportunities (to date). Public company respondents making changes were mixed in terms of disclosure timing: 35% have or will disclose changes prior to the next proxy, 27% will wait until the next proxy to disclose, and 38% were undecided.



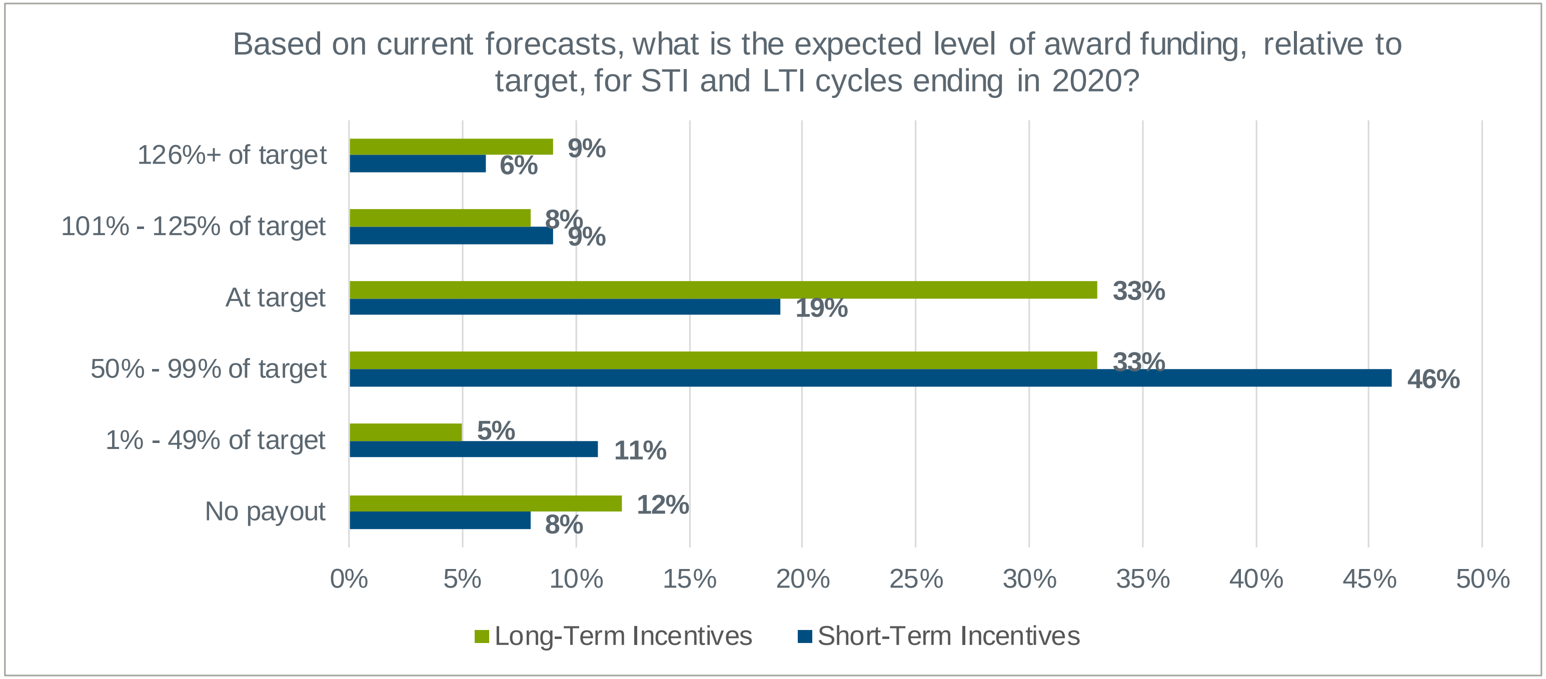
COVID-19 Pay Actions: Anticipated Use of Discretion

- Approximately 45% of respondents expect to make discretionary adjustments to STI and/or LTI awards for cycles ending in 2020 due to COVID-19, with a higher inclination towards positive versus negative discretion.
  - Anticipated use of discretion is higher for STI than for LTI awards (55% versus 36% of all respondents).
- Nearly one-third of respondents plan to implement some type of award cap along with discretion, typically either at target (10% of respondents), within +/- 25% of unadjusted outcomes (10%), or at threshold (5%).



Pay Projections for 2021

- Across the entire sample, average base salary increase projections for 2021 equal 2.3% for CEOs, 2.4% for direct reports, and 2.5% for other employees.
  - Salary freeze prevalence equals 41% for CEOs, 30% for direct reports, and 16% for other employees.
  - For the first time in many years, 50^{th} percentile projected increases fell below 3.0% for senior executives (2.5% for CEOs and 2.7% for direct reports) while remaining at 3.0% for non-executives.
- Among respondents disclosing expected outcomes for cycles ending in 2020, most (65%) expect below-target payouts for STI and 50% expect below-target LTI awards.
  - Average accounting accruals currently equal 73% of target for STI and 79% of target for LTI.
  - 54% of respondents expect lower STI awards for 2020 than 2019, with 17% higher and 25% similar.



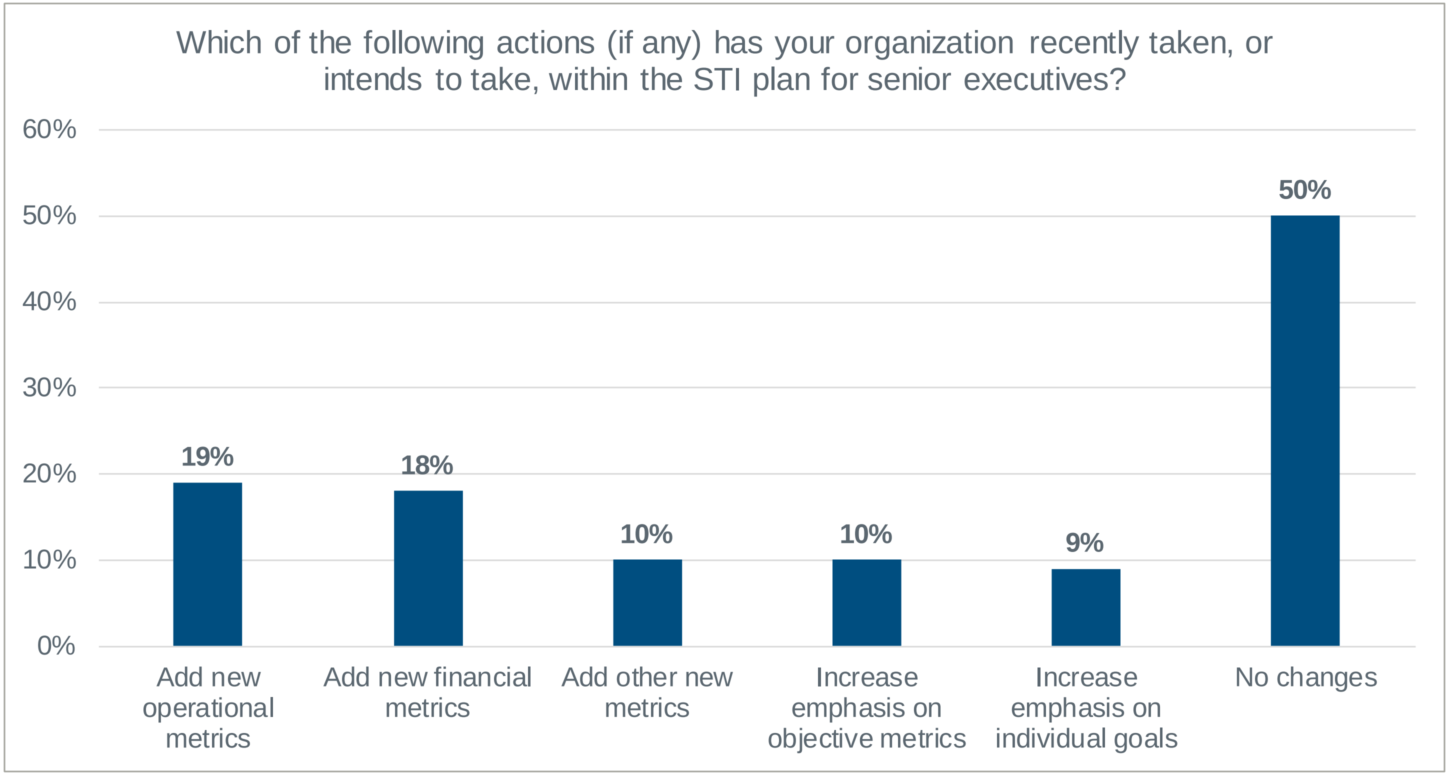
STI Performance Mix Projections for 2021

- Most respondents (78% of the full sample and 88% of public companies) have formulaic STI plan designs, with pre-defined weightings for metrics and award opportunities.
- The anticipated performance mix for 2021 is very similar to 2020, with a primary emphasis on objective corporate/business unit financial goals; approximately one-third of respondents plan to also use operational, strategic, and/or individual goals, with 50th percentile (median) weightings ranging from 20% to 25% when used.
  - Nearly three-fourths of respondents (73%) use multiple performance metric categories.

Performance Metric Category	2021 STI Performance Mix: CEO		2021 STI Performance Mix: Direct Reports	
	Prevalence	Median Weighting (when provided)	Prevalence	Median Weighting (when provided)
Financial	97%	75%	96%	70%
Operational	32%	25%	35%	30%
Strategic	37%	20%	36%	20%
Individual	30%	20%	38%	25%
Discretionary	13%	20%	12%	20%

Recent or Expected STI Plan Changes for 2021

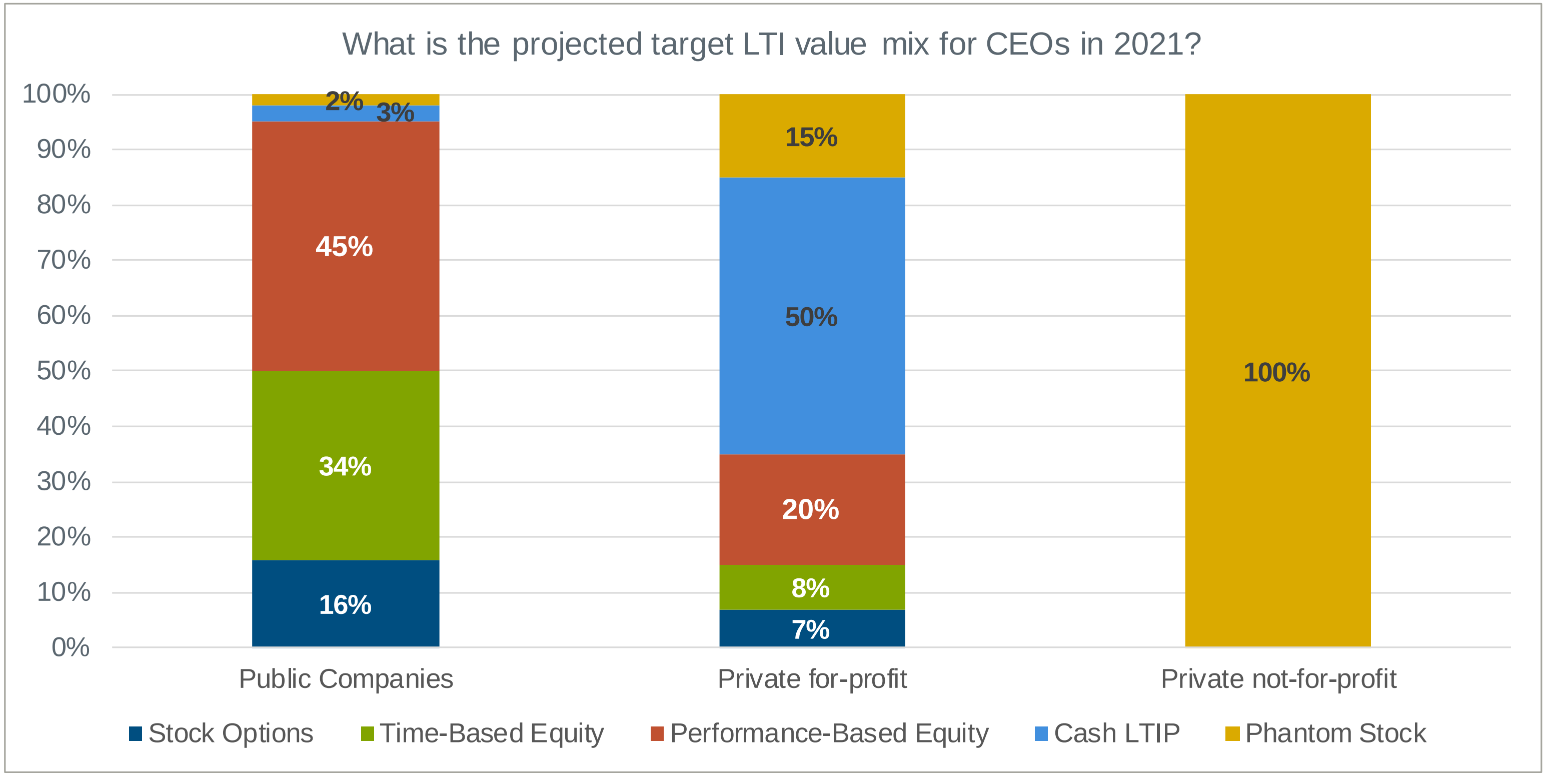
- Half of all respondents recently made or expect to make STI plan changes for 2021, most commonly involving performance metrics.
  - Changes were made or planned by half or more of respondents in all industry sectors other than industrials/materials and technology (40% made or plan changes in these sectors).



- Among respondents making changes, prevalence of those expecting to add D&I metrics in 2021 is twice as high as for those already using them (21% versus 11%).

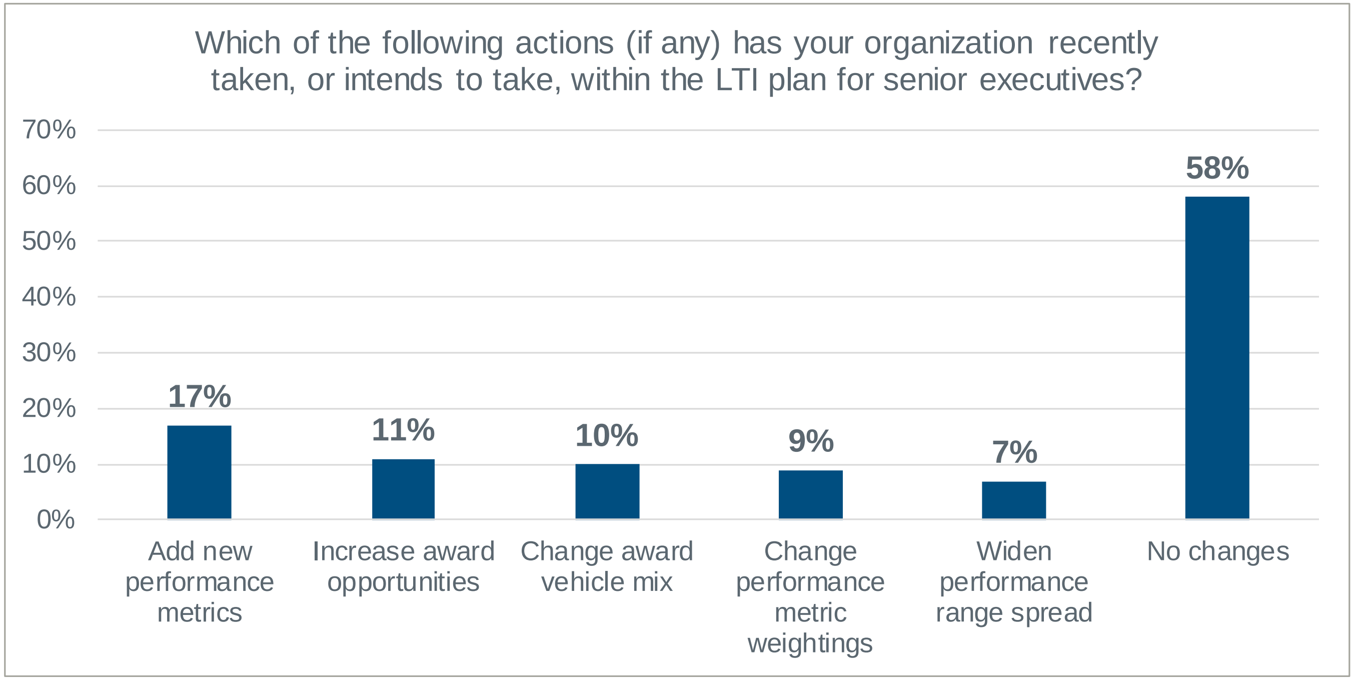
LTI Prevalence and Target Value Mix

- Nearly all public company responses (98%) and most private for-profit respondents (70%) grant LTI awards to senior executives.
  - 50% of private not-for-profit respondents grant LTI awards; prevalence may be skewed by the relatively low sample size (n=27).
- Most respondents with LTI plans express awards as a percentage of base salary or as a fixed dollar value. The average projected target value mix (including 0% values when an award vehicle is not used) in 2021 for CEOs is shown below.



Recent or Expected LTI Plan Changes for 2021

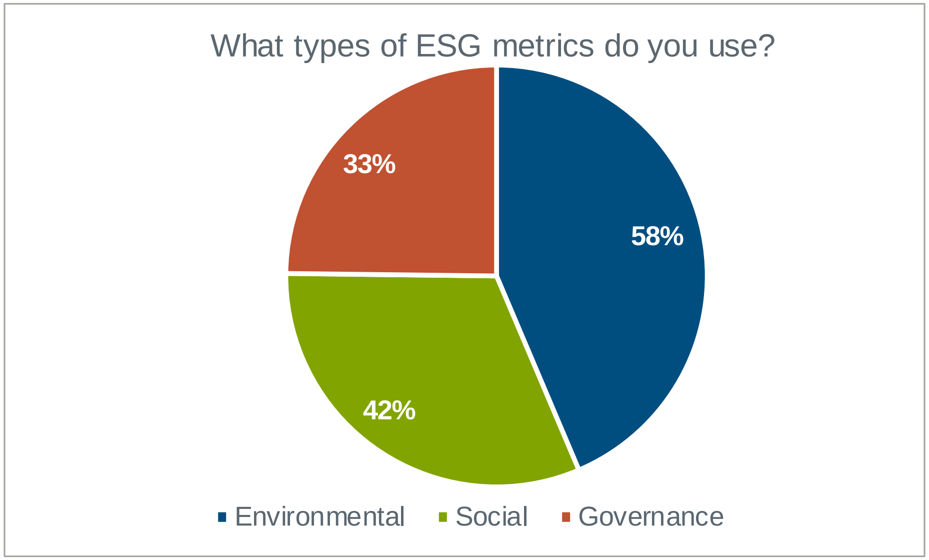
- Among respondents with LTI plans, 42% recently made or expect to make plan design changes for 2021 (prevalence excludes "not applicable" responses).
  - Nearly 60% of respondents making changes said they will continue beyond the pandemic while 41% said changes are temporary in response to COVID-19.

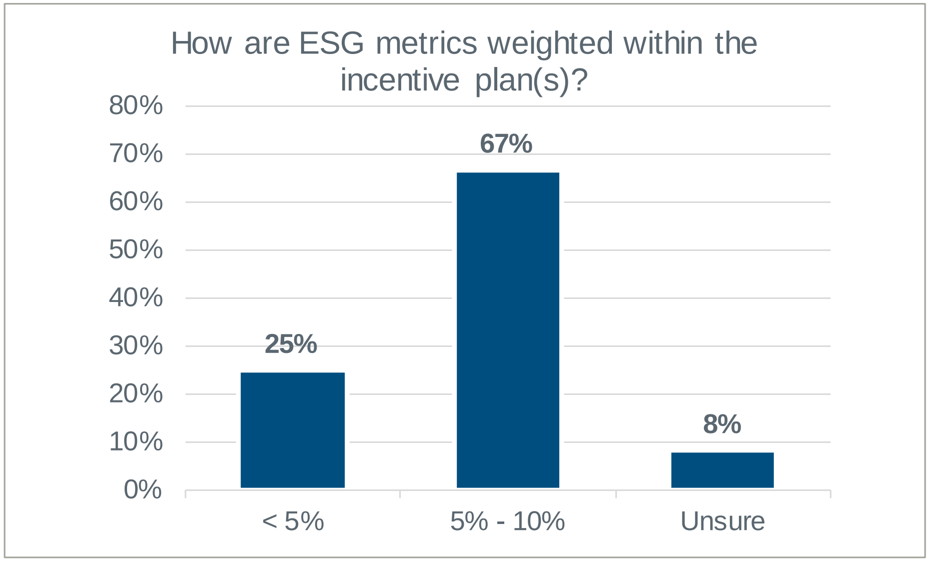


- Most respondents with LTI plans (79%) do not expect to change LTI grant practices in 2021, with 15% planning changes and 6% considering them.
  - The most commonly cited changes include using longer-term average stock prices to determine grant levels (6% of all respondents) and providing supplemental retention grants (5%).

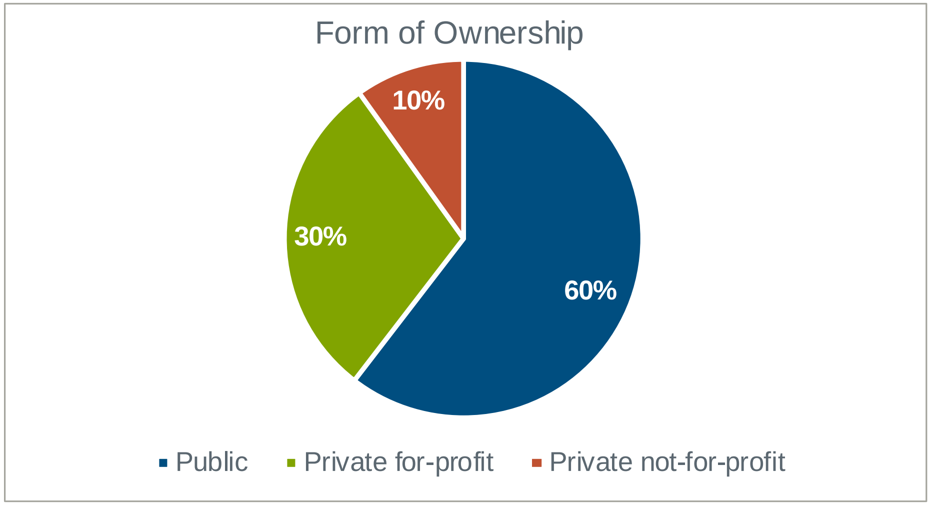
ESG Incentive Plan Metrics

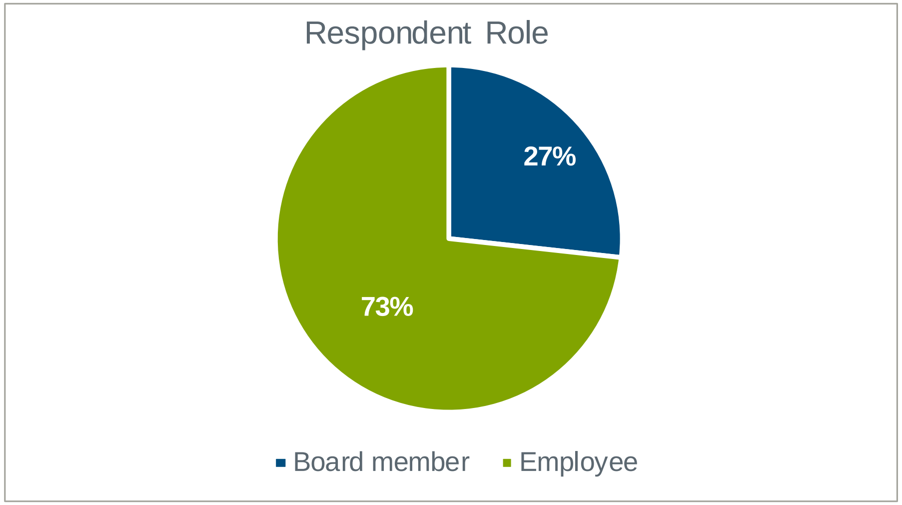
- Only 6% of all respondents currently include formal environmental, social, and governance (ESG) metrics within executive incentive plans, with another 9% planning to add one or more formal ESG metrics in 2021.
- Among respondents with ESG metrics, social goals are most common (58%) as compared with environmental (42%) and governance (33%); some use multiple types
  - Social goals are also most common among those considering adding ESG metrics (62%), followed by environmental (57%), and governance (43%).
- When used, ESG goals are typically weighted between 5% - 10% of total award opportunities (67% of respondents with formal metrics); 50% use quantitative goals, 33% qualitative, and 17% use both.

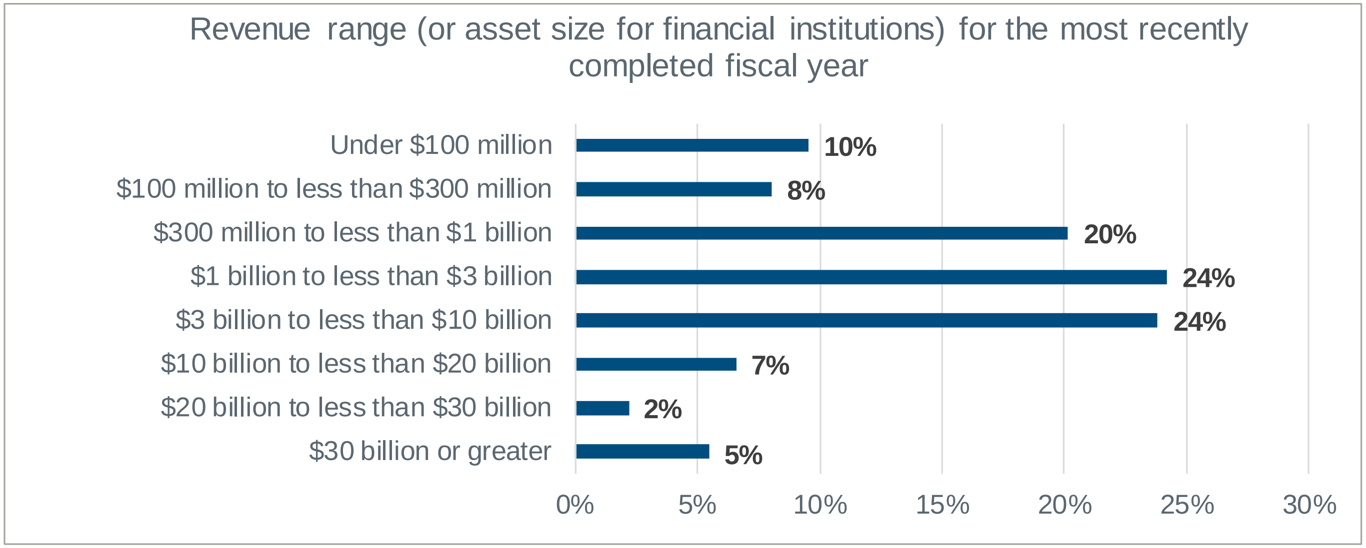




Demographics







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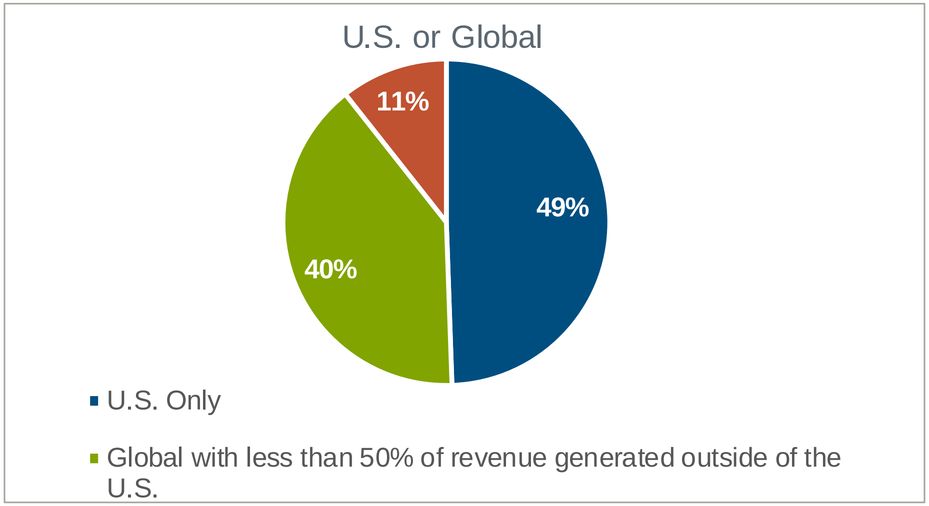

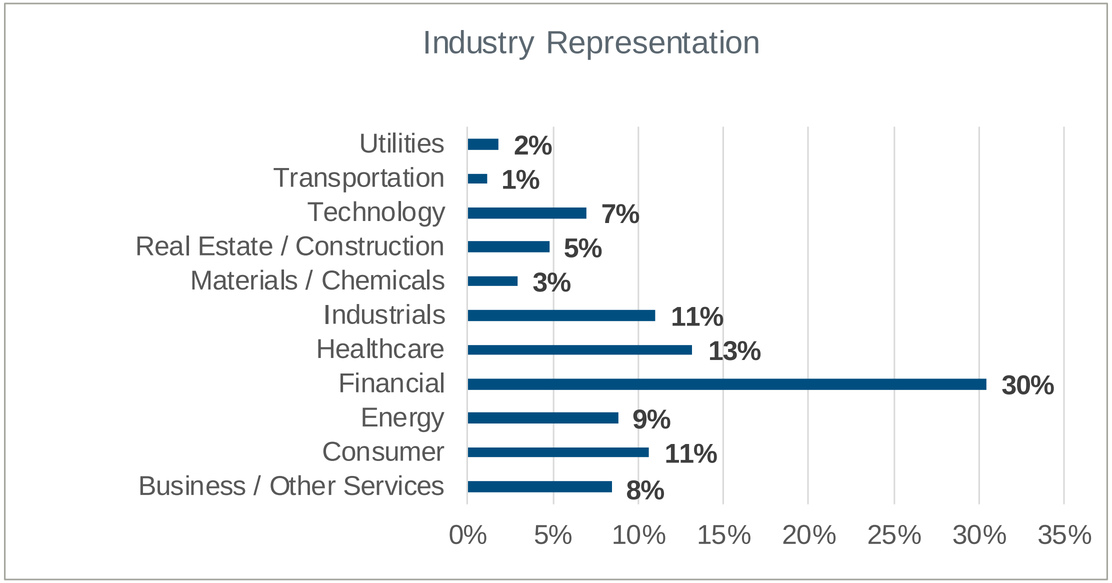

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Baltimore, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.

Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BALTIMORE
(410) 494-4100
baltimore@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

RALEIGH
(919) 644-6962
raleigh@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.