Pearl Meyer

On Point

TIMELY, ACCURATE, INSIGHTFUL

Looking Ahead to Executive Pay Practices in 2023

Executive Summary

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Introduction

Pearl Meyer’s “Looking Ahead to Executive Pay Practices” is an annual, online survey and valuable compensation planning tool. This year’s survey was conducted in August and September of 2022, with total participation of 301 companies, including 161 publicly traded, 104 private-for-profit, and 36 not-for-profit (NFP) organizations. As with prior surveys, responses are broken out separately by respondent role (board member vs. employee), ownership type, industry, and company revenue size.

This year’s survey addresses key topics associated with the current environment, including perceived impact of various macroeconomic factors on businesses and their executive compensation programs, current/anticipated status of in-office vs. remote work requirements and any actions taken to encourage a return to the office, and use of retention awards. It also covers subjects such as compensation philosophy, compensation committee oversight, expected award funding outcomes and use of discretion for incentive cycles ending in Fiscal 2022, projected base salary increases for 2023, recent or anticipated incentive plan design changes, and long-term incentive award prevalence and participation.

Introduction (cont.)

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

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

Certain industry categories in the online questionnaire were combined to allow for more meaningful sample sizes. Statistics are based on the number of responses for each question, and sample sizes vary. We believe this information will serve as a useful tool as your organization prepares for year-end pay determinations and Fiscal 2023 compensation planning.

Please feel free to contact me with any questions.

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Key Highlights

Many expected somewhat of a return to “normal” (or at last “semi-normal”) in 2022 following pandemic-related challenges in 2020 and 2021. As prevalence of COVID-19-related serious illnesses continued to decline, more employees began returning to the office (at least on a hybrid basis), and many companies experienced a strong start in terms of financial results. Most respondents still expect overall company performance for 2022 to be at or above last year’s results, with slightly more than half projecting year-over-year improvements. Most also expect incentive payouts for performance cycles ending in 2022 to be at or above target. However, macroeconomic conditions continue to evolve rapidly, especially with regard to inflationary pressures and market volatility, and it will be interesting to see how these factors impact actual performance and incentive award funding outcomes.

Hybrid work policies have become the new normal for the majority of respondents, with many requiring or suggesting two to three days in the office per week, although practices vary with a fair amount of flexibility for employees. Similar to last year’s findings, most companies have not taken or anticipate taking any action to encourage a return to the office. Most also do not use or plan to add geographic pay differentials.

In response to rising wage inflation and tight labor markets, slightly more than one-third of respondents provided higher than normal merit increases in 2022, with approximately 20% providing off-cycle adjustments. Most respondents expect to increase base salaries in 2023, with median projections equal to 4.0% across all employee categories, and 40% of companies planning to provide higher percentages than in 2022.

Key Highlights (cont.)

Most respondents do not currently plan on exercising discretion for incentive award cycles ending in 2022, although many are taking a “wait and see” approach. Anticipated use of discretion, when applicable, is more likely to apply for short-term incentives vs. long-term incentives. Most have not made any changes to metrics or goals for in-process cycles. Slightly more than half of all respondents expect similar degrees of stretch, compared with 2022, for 2023 performance goals, with nearly 40% anticipating more aggressive hurdles.

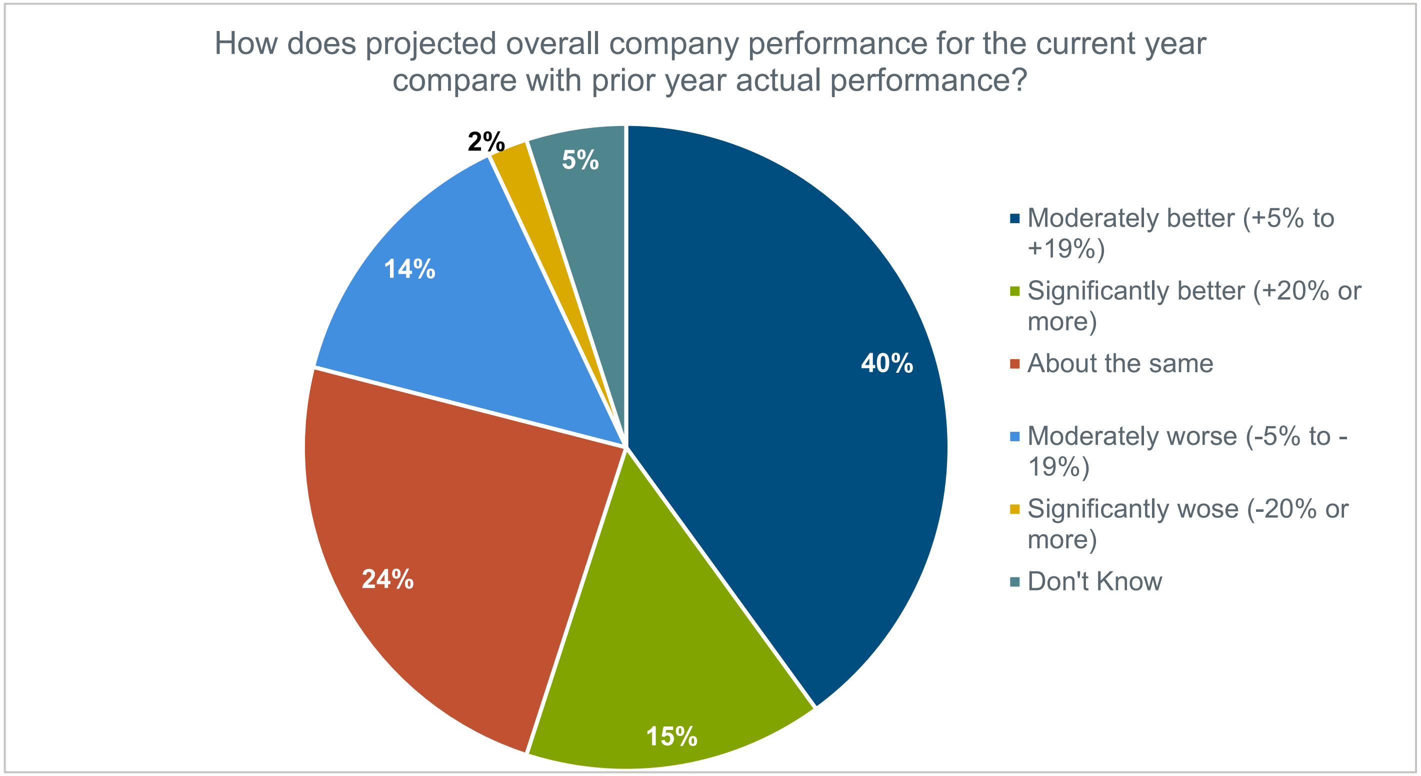
Approximately 60% of all respondents do not anticipate making changes to short-term and long-term incentive designs for 2023. Among those that do, the most commonly cited change is to add new performance metrics, with 12% of respondents planning to add new environmental, social, and/or governance (ESG) metrics within short-term incentive plans.

Nearly 15% of respondents increased long-term incentive participation levels in 2022, with approximately 10% anticipating increases in 2023. Similar to last year’s survey, publicly traded companies make awards deeper within the organization than other ownership types that typically limit grants to executives only. Virtually no respondents currently plan to modify equity grant practices in response to market volatility, although we anticipate this may change for some going forward due to the continued market downturn.

Most respondents have not provided (or currently plan to provide) retention awards to executives. When provided, recipients are typically determined on a selective basis, primarily with service-based vesting periods ranging from one to three years. These and other key survey findings are addressed in more detail on the following pages.

Overall Company Performance Projections vs. Prior Year

- Most respondents anticipate year-over-year (YOY) improvements in financial performance, with 40% projecting moderately better results (+5% to +19%) and 15% expecting significantly better outcomes (+20% or more); 16% expect YOY reductions.
  - Similar to last year's findings, outside (or non-employee) directors were generally more optimistic than employee respondents (approximately 71% vs. 52% expect YOY improvements), while sentiment was fairly evenly balanced by ownership type.
  - Half or more of respondents in all industry sectors other than healthcare/life sciences (35%) and consumer (42%) expect YOY improvement in financial performance.



Current Year Executive Pay Actions in Response to Macroeconomic Challenges

- Economic uncertainty, inflation, and a tight labor market were the most commonly-cited macroeconomic factors having the greatest impact on company performance and executive compensation programs.

- In response to these challenges, respondents made a variety of changes to executive pay practices, especially as relates to base salaries, to enhance retention and pay competitiveness, with the top three actions for each pay component shown below.

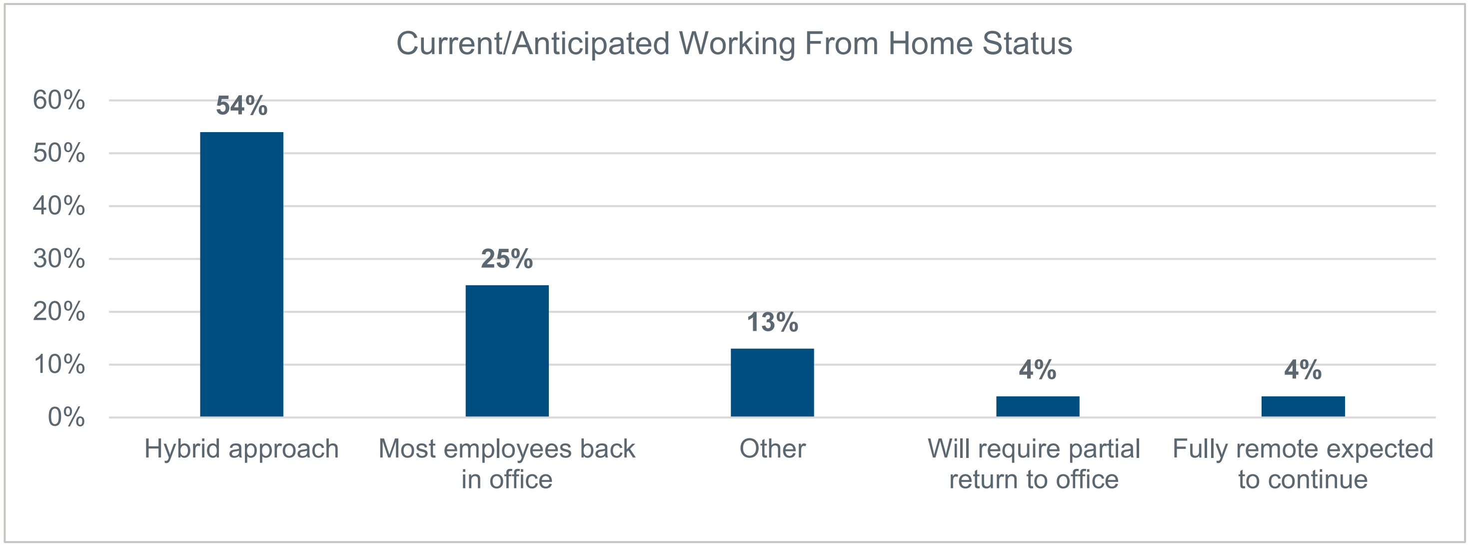
  - Prevalence of higher than normal merit increases was highest within the technology (59%) and business/other services (43%) sectors, while off-cycle salary adjustments were most common within the financial/insurance (27%) and healthcare/life sciences (21%) sectors.

  - Respondents in the largest size category (> $10B revenue or assets) were less likely than other respondents to take actions relating to base salaries and STI but most likely to provide retention awards and increase LTI awards.

Pay Component	Top Three Current Year Actions	Prevalence
Base Salary	• Higher than normal merit increases • Increase targeted pay positioning • Provide off-cycle salary adjustments	35% 20% 19%
Short-Term Incentives (STI)	• Increase award opportunities • Add/increase emphasis on relative metrics • Award cash retention bonuses	20% 10% 9%
Long-Term Incentives (LTI)	• Increase award opportunities • Expand executive participation levels • Provide one-time retention grants	16% 14% 11%

Working from Home

- Approximately 75% of respondents currently have hybrid or fully flexible working arrangements.
  - "Other" responses typically include either fully flexible arrangements or requirements that vary by employee category/function.
  - Among respondents with hybrid arrangements, employees are typically required (or encouraged) to be in the office two to three days per week (average requirement is 2.2 days).
- The large majority of respondents have not taken (or expect to take) any compensation or benefits-related actions to entice employees back to work.
  - The most commonly cited action was enhancing office perks (13% of all respondents, and 35% of those in the technology sector).
  - Most respondents have not modified any existing or established new base salary geographic pay differentials to account for working from home.



Compensation Committee Oversight Roles

- Most compensation committees are responsible for executive succession planning across all ownership types and for non-employee director compensation at for-profit organizations.
  - Approximately 10% of all respondents increased compensation committee oversight within the past year, typically as relates to DE&I and other human capital-related topics.
  - Employee engagement oversight had the biggest YOY increase in prevalence (28% vs. 20% last year), which is not surprising given the tight labor market and focus on retention.

Oversight Category	Compensation Committee Oversight Prevalence		
	Publicly Traded	Private (For-Profit)	Private (NFP)
Board of Director Pay	79%	62%	41%
Executive Succession Planning	74%	76%	81%
Diversity & Inclusion (D&I)	49%	31%	16%
Leadership/Talent Development	43%	37%	22%
Employee Engagement	32%	27%	9%
Culture	30%	28%	16%

- Compensation oversight responsibilities vary by ownership type; approximately 80% of NFP and 60% of private for-profit respondents do not review pay below the CEO direct report level, while nearly half of public company respondents go further down within the organization (but typically not below the corporate officer level).

Targeted Executive Pay Positioning

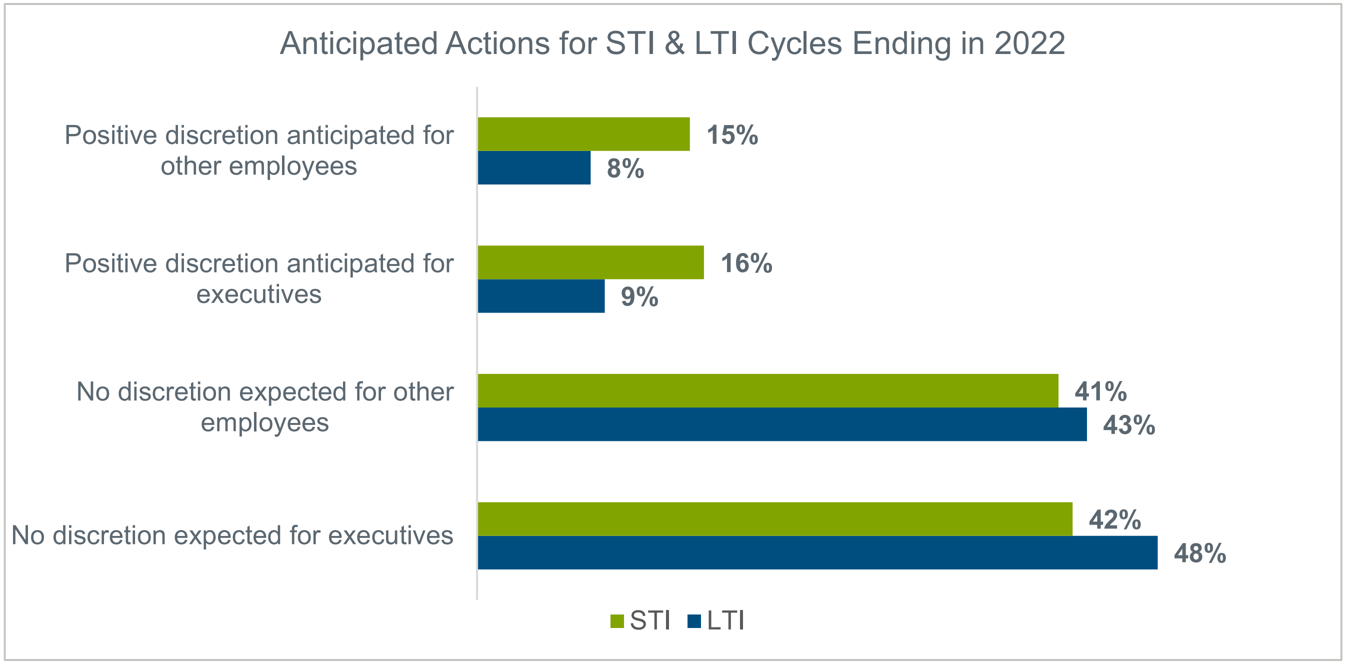
- Approximately half of all respondents target executive compensation at the market 50th percentile, with prevalence higher for base salary than variable pay (STI and LTI).
  - Public company respondents and those in the largest size category (revenues or assets > $10B) are much more likely to target executive pay at the 50th percentile (or median) compared with private organizations, reflecting the impact of greater external scrutiny.
  - Slightly more than 40% of private and NFP respondents (vs. 32% of public companies) target total direct compensation above the 50th percentile (typically between the 50th and 75th percentile); however, some of these organizations may not be factoring LTI into their evaluation of total compensation.

Pay Component	Targeted Pay Positioning (% of All Respondents)		
	Below 50th Percentile	At 50th Percentile	Above 50th Percentile
Base Salary	12%	55%	27%
Short-Term Incentives (STI)	9%	44%	29%
Long-Term Incentives (LTI)	5%	40%	33%
Total Direct Compensation	7%	45%	37%

- Approximately two-thirds of all respondents have not changed (or plan to change) targeted executive pay positioning, with 15% increasing pay positioning vs. market and 12% increasing the emphasis on variable pay (STI and/or LTI).
  - By industry, prevalence of increased targeted pay positioning was highest for the business/other services sector (27% of respondents) and lowest for energy/utilities (0%).

Anticipated Use of Discretion for Incentive Cycles Ending in 2022

- Most respondents do not currently expect to exercise positive discretion for incentive cycles ending in 2022, although many are taking a “wait and see” approach.
  - Virtually no respondents currently expect to apply negative discretion, and many (approximately 33% for STI and 25% for LTI) say its too early to tell whether discretion will be applied for cycles ending in 2022.
  - Anticipated use of positive discretion is lower for publicly traded and larger-size respondents vs. others, and highest for those in the healthcare/life sciences (21% STI, 17% LTI) and technology (25% STI, 13% LTI) sectors.



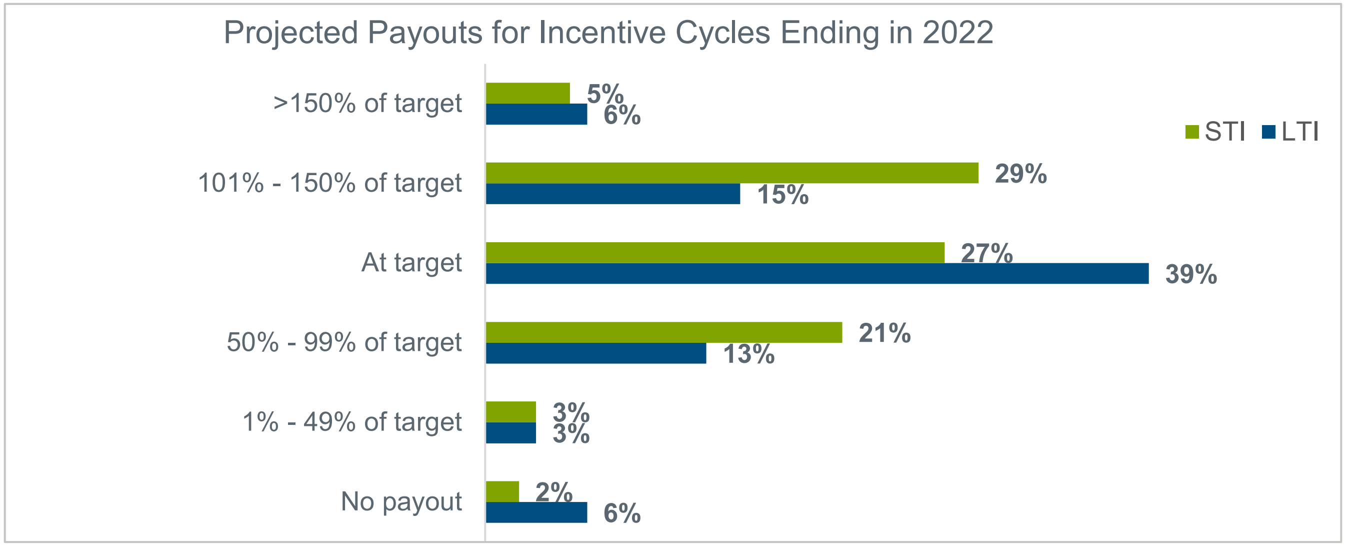
- Among respondents anticipating adjustments, the most commonly cited potential triggers include changes in business strategy/strategic priorities (37%), the ongoing COVID-19 pandemic (14%), supply chain challenges (12%), and non-recurring items/restructuring charges (10%).

Pay Projections

- Similar to 2022, salary increase projections for 2023 are above historical levels, with values across all employee categories equal to 4.0% at the 50th percentile and 5.0% at the 75th percentile.
  - 90% of all respondents expect increases for senior executives and 99% for other employees.
  - Average projections are generally lower for publicly traded respondents than for privately held organizations.

Employee Category	Average %	50th Percentile %	75th Percentile %
CEO	3.7%	4.0%	5.0%
CEO Direct Reports	3.9%	4.0%	5.0%
Other Employees	4.2%	4.0%	5.0%

- Most respondents with incentive cycles ending in 2022 expect payouts to be at or above target, with only 2% forecasting no payouts for STI and 3% for LTI.



  - By industry, projections are most favorable for the industrials/materials/transportation sector (53% expect above-target for STI and 44% for LTI) and least favorable for consumer (65% below target for STI and 25% for LTI).

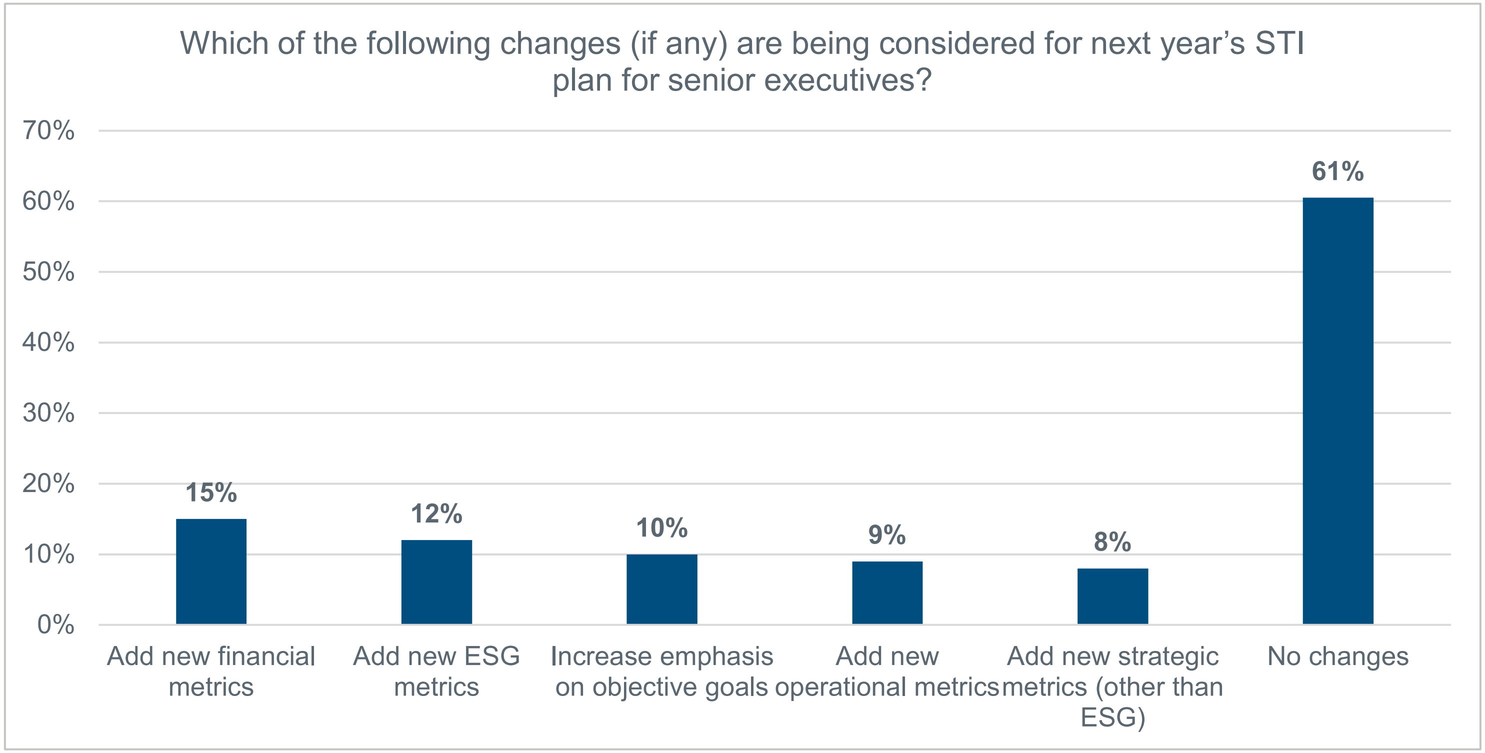
STI Performance Mix Projections for 2023

- Most respondents (72% of full sample and 85% of public companies) have formulaic STI plan designs, with pre-defined weightings for metrics and award opportunities.
- The anticipated performance mix for 2023 is very similar to 2022, with a primary emphasis on objective corporate/business unit financial goals; approximately 25% to 45% of respondents also plan to also use operational, ESG, strategic, and/or individual goals, with average weightings ranging from 13% to 38%.
  - Approximately three-fourths of respondents use multiple performance metric categories.
  - This year's survey includes a separate breakout for ESG goals, with prevalence of approximately 20% and average weightings, when used, equal to 13% of total target awards.
  - The focus on metric selection will likely increase going forward for public companies due to recent pay vs. performance and clawback rules approved by the SEC.

Performance Metric Category	2023 STI Performance Mix: CEO		2023 STI Performance Mix: Direct Reports	
	Prevalence	Average Weighting (when provided)	Prevalence	Average Weighting (when provided)
Financial	96%	71%	96%	67%
Operational	36%	38%	45%	37%
Strategic	24%	20%	26%	19%
ESG	20%	13%	18%	13%
Individual	24%	27%	34%	27%
Discretionary	12%	30%	11%	21%

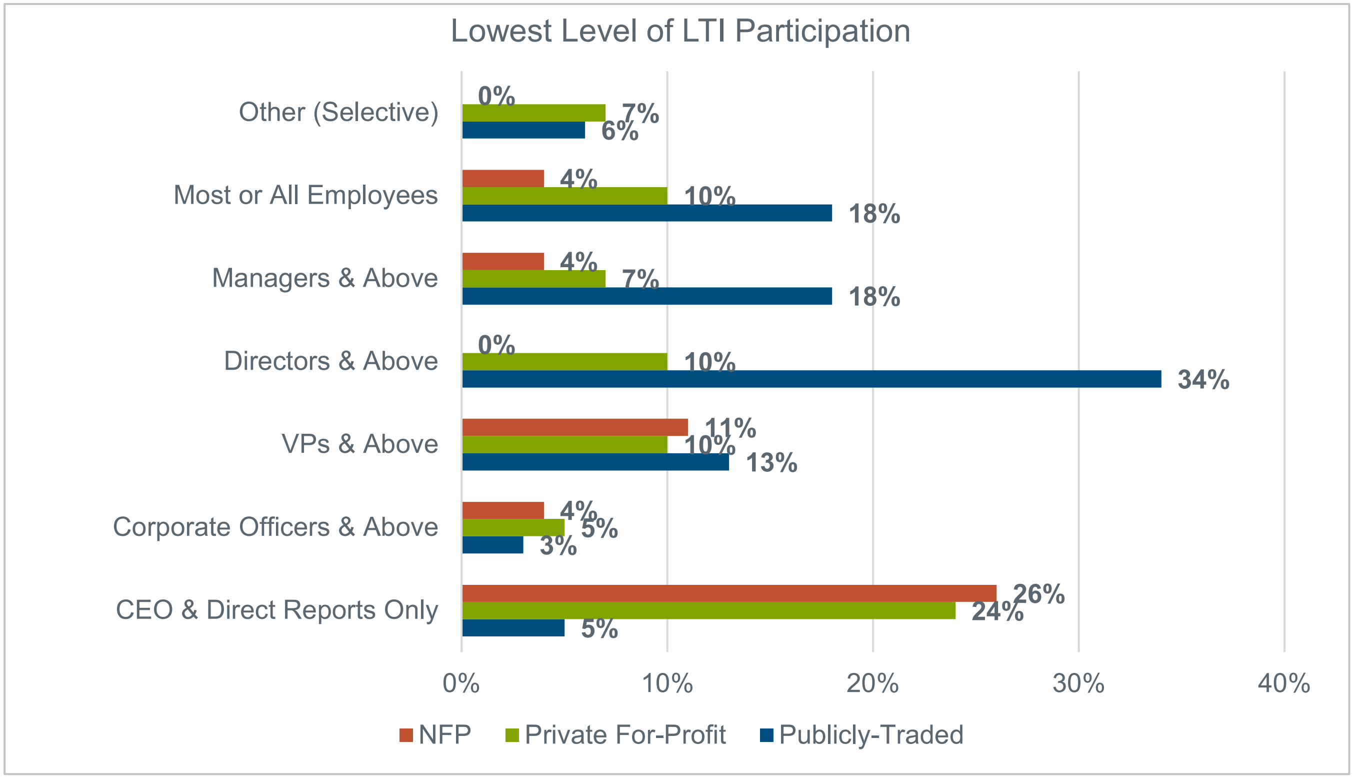
STI Plan Design Changes for 2023

- Approximately 40% of all respondents are considering making changes to senior executive STI designs for 2023, with the most common actions (expressed as a percentage of all responses, not just for those making changes) shown below.
  - 12% of all respondents, and 18% of public company respondents, plan to add new ESG metrics, with prevalence highest for those in the $100M-$300M (24%) and > $10B (21%) size categories and the energy/utilities sector (26%).
  - Prevalence of anticipated changes was lower than last year, when nearly half of all respondents were planning changes, especially for publicly traded companies (prevalence declined from 53% to 38%).



LTI Prevalence and Participation Levels

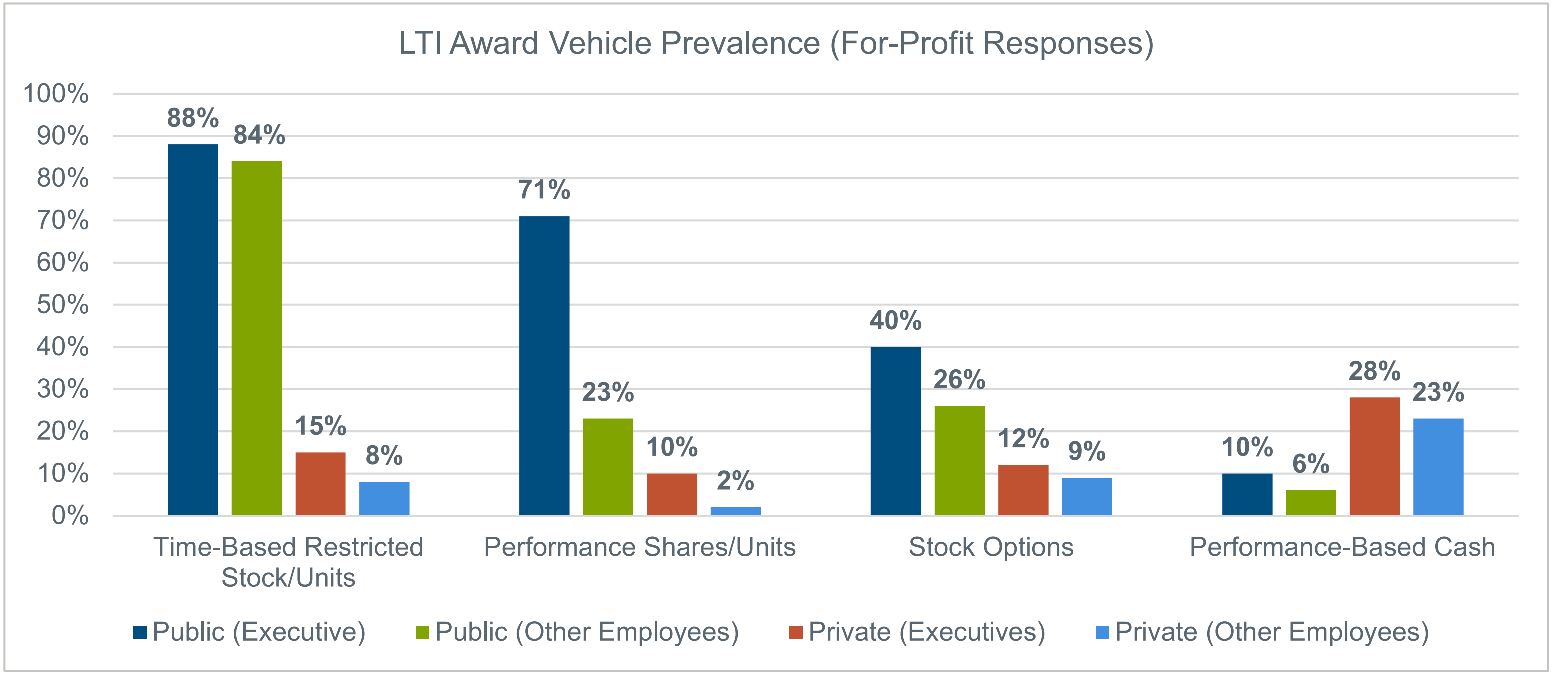
- Nearly all (98%) publicly traded and 72% of private for-profit respondents grant LTI awards to senior executives; 48% of NFP respondents grant LTI (prevalence may be impacted by low sample size).
- Most respondents do not grant LTI below the employee director level, with publicly traded companies having broader participation than privately held organizations.
  - Approximately 70% of public company respondents make at least some grants below the Vice President (VP) level vs. 27% of private for-profit and 8% of NFP organizations.
  - Broad-based grants to most or all employees were most prevalent for respondents in the healthcare/life sciences (50%) and technology (33%) sectors and lowest for real estate (0%) and financial/insurance (5%) sectors



Note: "Other" refers to other non-specified categories (e.g., SVPs and above, senior managers and above, or some other combination of roles

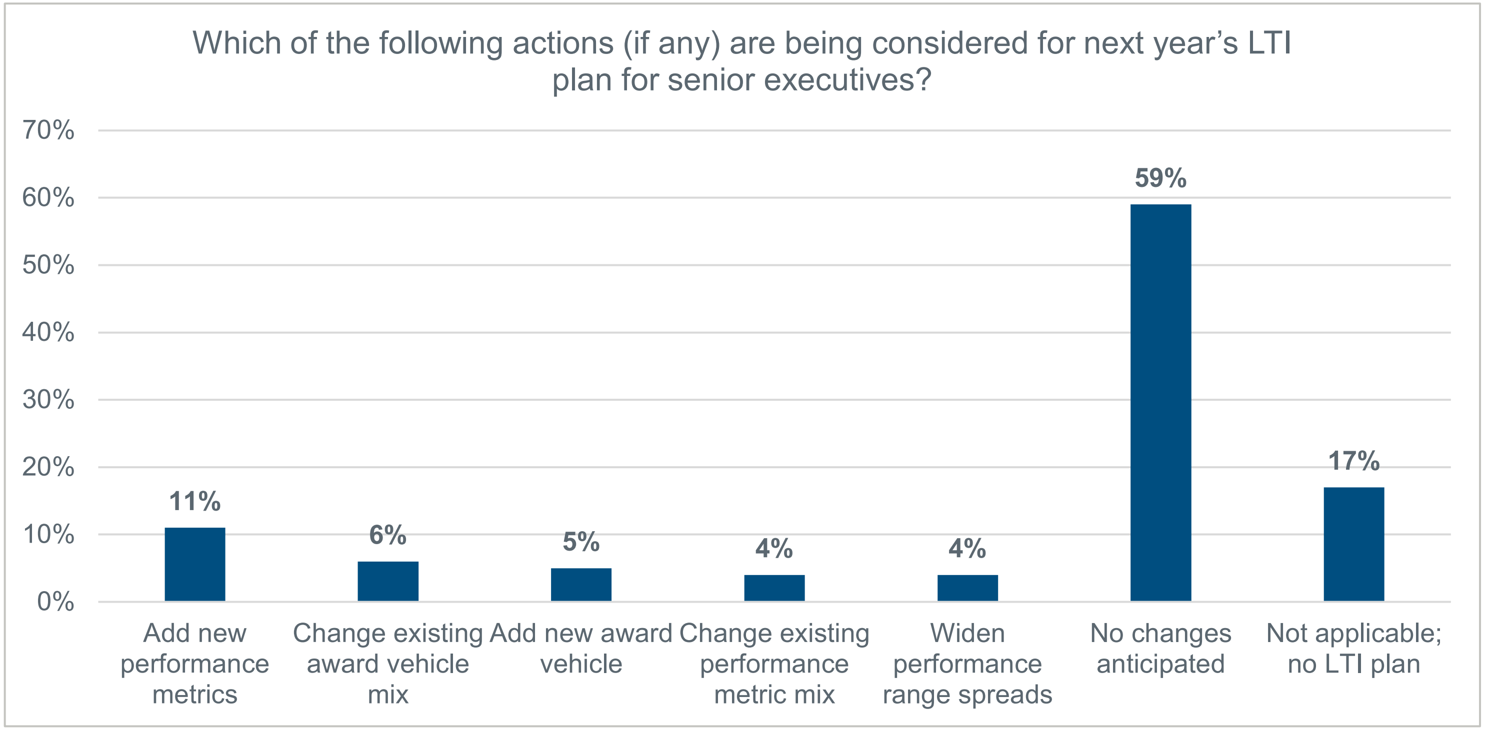
Target LTI Value Mix Projections for 2023

- Most publicly traded respondents grant time-based and performance-based equity to executives, while private companies rely more heavily on performance-based cash (cash LTIP).
  - Slightly more than one-third of private for-profit respondents (and nearly half when “not applicable” responses are excluded) grant equity awards to executives.
  - The average mix for NFP respondents (not shown below) is 100% cash LTIP.
  - Use of performance-based equity for executives increases with company size (~ 20% for respondents with revenues < $300 million and 81% for those with revenues > $10B).
  - Most publicly traded respondents (84%) express LTI award opportunities as percentages of salary or fixed target values; when provided, average weightings are 53% for performance shares and 46% for restricted stock.
  - For non-executives, public companies rely on time-based restricted stock (89% prevalence, 80% average weighting) with cash LTIP most common for private for-profit respondents (53% prevalence, 92% average weighting).



LTI Plan Design Changes for 2023

- Slightly less than 25% of all respondents currently anticipate making one or more LTI plan design changes for 2023, with the most common actions (expressed as a percentage of all responses including “not applicable”) shown below.
  - Across the entire sample, approximately 17% of all respondents do not currently have an LTI plan.
  - Prevalence of potentially adding new award vehicles was highest for the real estate sector (24%), the consumer sector was most likely to widen performance ranges (24%) and add new performance metrics (18%), and healthcare/life sciences sector respondents were most likely to change the existing award vehicle mix (13%).



- Virtually none (less than 5%) of respondents currently anticipate making any change in LTI grant practices for 2023; we expect actual prevalence may increase due to ongoing market volatility.

Executive Retention Awards

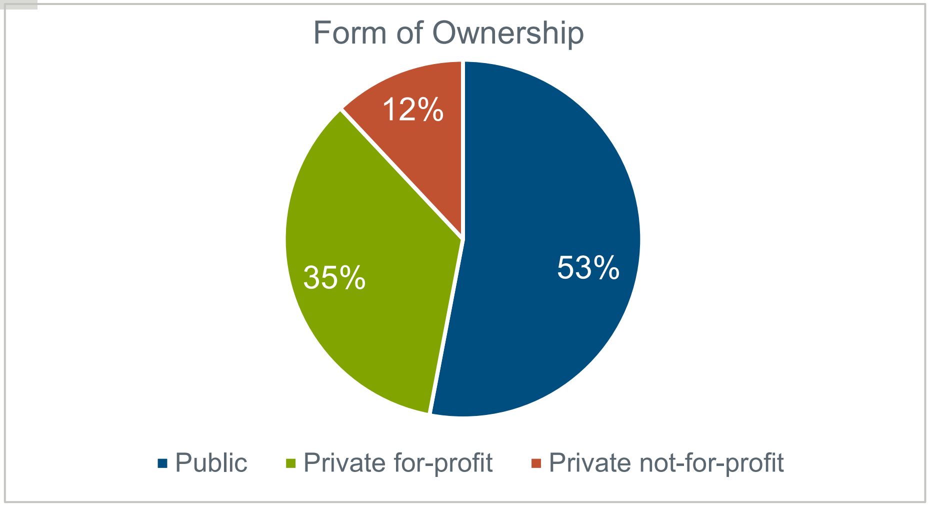
- Approximately 16% of all respondents have provided retention awards, typically on a selective basis, during the current year, with another 6% planning to provide them before the year is over.
  - Award prevalence was higher for publicly traded and NFP respondents (approximately 19% each) than for private for-profit companies (approximately 12%), and also highest within the technology (40%), consumer (35%), and healthcare/life sciences (22%) sectors.
  - Among respondents making or planning executive retention awards, most publicly traded companies provided at least a portion of awards in stock while most private for-profit organizations pay in cash.
  - Retention awards are typically tied to continued service (71% of all respondents providing awards), with vesting periods ranging from 1 to 5 years, and averaging 1.8 years.
  - Among respondents providing retention awards, publicly traded companies typically include half or more of senior executives other than the CEO and NFP organizations generally only including the CEO and direct reports, as shown in the following table.

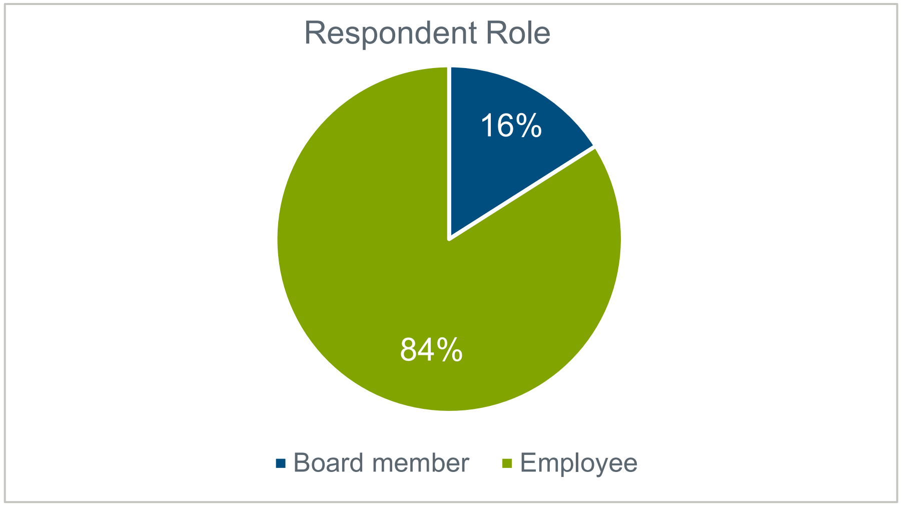
Executive Retention Award Recipients and Average Payout as % of Salary *

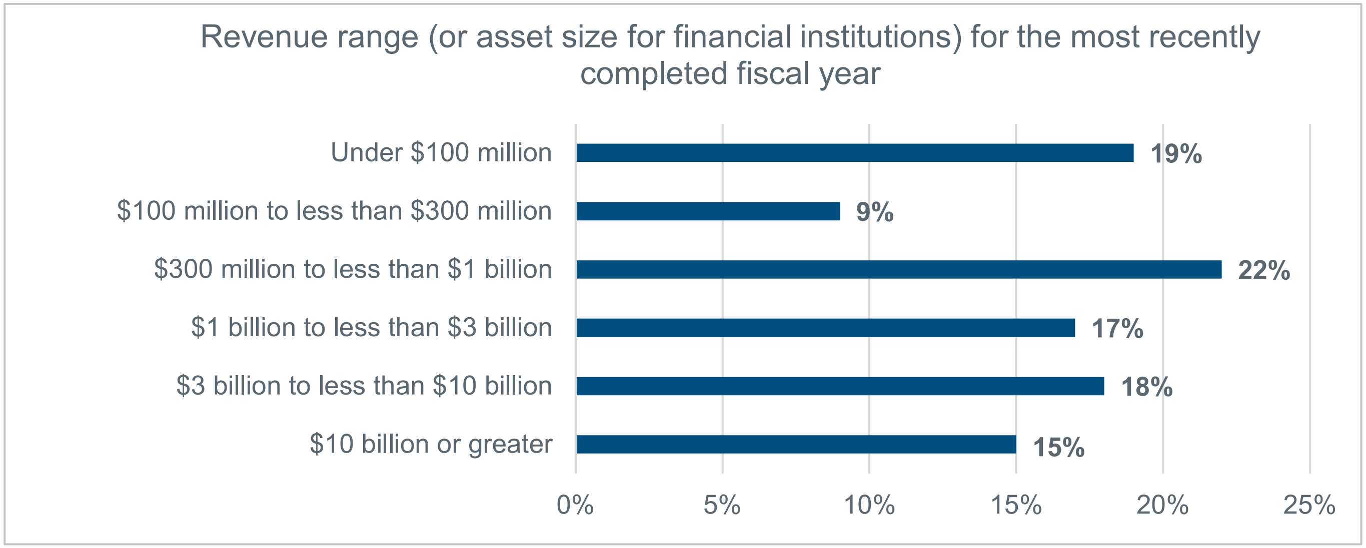
	Publicly Traded		Private For Profit		NFP	
	% Receiving	Award as % of Salary	% Receiving	Award as % of Salary	% Receiving	Award as % of Salary
CEO	39%	62%	29%	49%	86%	74%
CEO Direct Reports	55%	71%	36%	51%	71%	57%
SVPs	58%	39%	29%	25%	29%	10%
VPs	68%	46%	50%	34%	14%	0%

* Prevalence pertains to respondents that made or plan to make retention awards

Demographics







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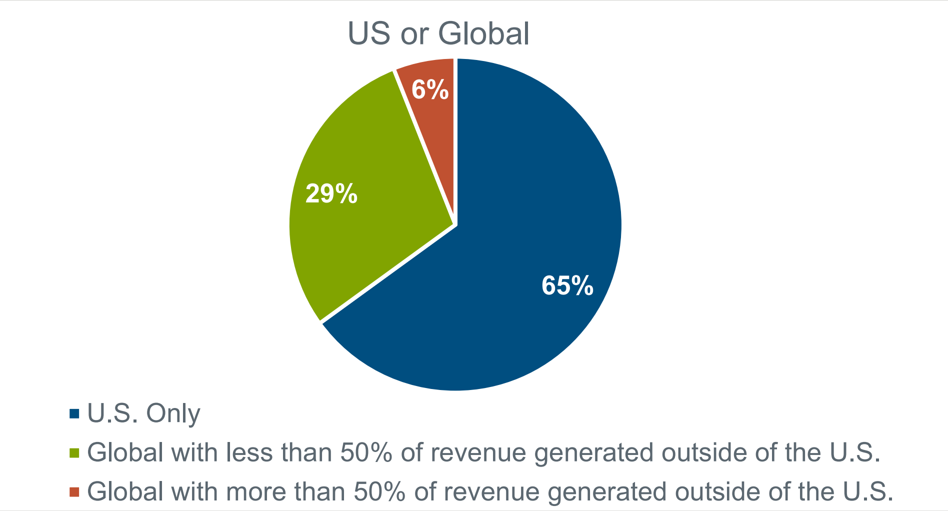

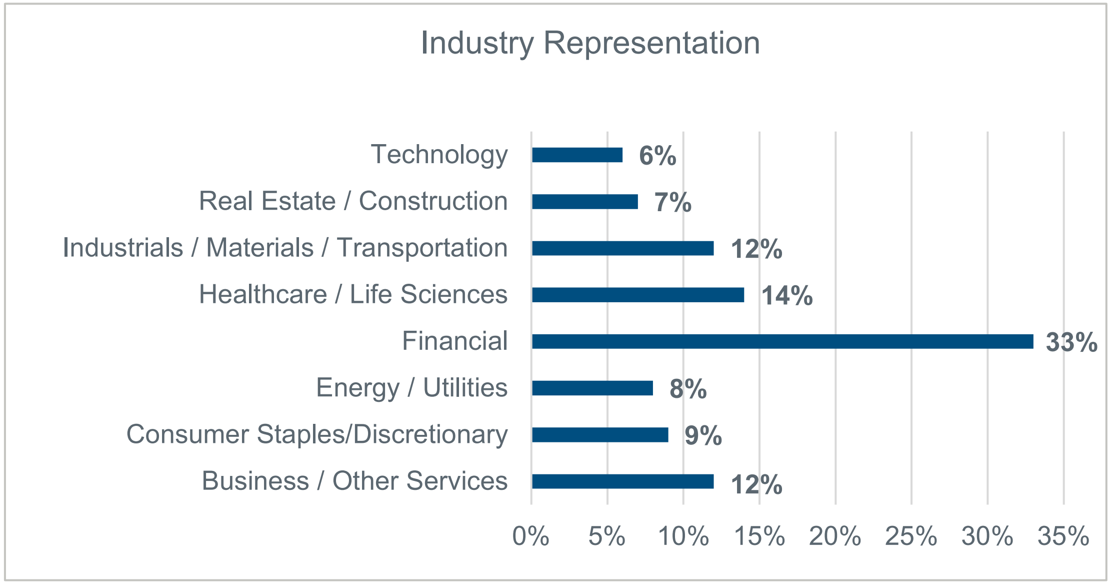

About Pearl Meyer

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, Boston, Charlotte, Chicago, Houston, Los Angeles, New York, and San Jose.