MERIDIAN
COMPENSATION PARTNERS, LLC

VOLUME 10, ISSUE 15
SEPTEMBER 25, 2019

Meridian Client Update

Council of Institutional Investors (CII) Overhauls its Policy on Executive Compensation

On September 17, 2019, the Council of Institutional Investors (CII) announced an overhaul of its policy on executive compensation, urging public companies to reduce the complexity of their executive compensation plans and set longer service-based periods for time-based equity awards.

CII is an influential advocacy group for institutional investors. Its membership includes a wide range of asset managers with over $35 trillion in assets under management. To advance the interests of its members and reflect changes in the corporate governance environment, CII has developed (and periodically updates) a comprehensive body of corporate governance best practices on a variety of matters, including executive compensation. Last week, CII announced a major revision in its governance policies relating to executive compensation.

In its press release outlining the policy revision, CII Executive Director, Ken Bertsch, explained that the "revision reflects concerns on excessive complexity in U.S. executive pay plans, and questions on the effectiveness of some approaches to pay-for performance." In that regard, Mr. Bertsch noted that "steadily rising average [executive] pay, even when market performance is mediocre, suggests that pay-for-performance can be a mirage."

CII's new policy on executive compensation is less prescriptive and more principle-based than its former policy. The new policy recognizes that executive compensation should be tailored to meet a company's specific needs and circumstances, thereby avoiding a one-size-fits-all mentality. The new policy encourages companies to simplify their executive compensation programs and ensure that such programs are understandable, cost-effective and internally equitable.

Described below are the key changes to CII's policy on executive compensation:

- Companies should explore adopting simpler plans comprised of salary and restricted stock that vests over 5 years or more. For some companies, time-based restricted stock that begins to vest after 5 years and fully vests over 10 years (including beyond employment termination) may be appropriate.
- Companies should consider barring their highest level executives from selling stock awarded to them until after they depart to ensure management prioritizes the company's long-term success. However, some companies may determine that hold-until-departure or hold-beyond-departure from the company requirements are unnecessary because their stock-based awards include extended vesting periods.
- Boards and investors should increase their scrutiny of performance-vesting shares. This policy change appears to be in response to recent research that has raised doubts about the link between performance-vesting shares and long-term company performance. The need for increased scrutiny

also arises due to the use of “hard to understand” performance metrics and goals, which CII notes can be numerous, wide-ranging and adjustable.

- Companies should consider rank-and-file pay as a valid “reference point” for setting executive pay at appropriate levels. This policy change is in response to the widening gap between compensation for workers and executives.
- Companies should consider expanding their clawback policies to provide recovery upon not only financial restatements but also upon personal misconduct and ethical lapses that cause, or would cause, material reputational harm to the enterprise.

Meridian comment. CII’s revised policy reflects its goal of encouraging companies to simplify plan design, use defensible performance metrics that are linked to long-term company performance and clearly articulate the terms of their executive pay programs. These high-level objectives are generally consistent with the philosophy and views of many, if not most, public company boards, compensation committees and management, However, some of the suggested “solutions” will likely be viewed as a bridge too far that could put some companies at a competitive disadvantage in recruiting and retaining top talent.

In addition, CII’s suggested pay and governance designs relating to clawback policies and share ownership are already embraced by many public companies. For example, an emerging trend among large companies is the adoption of clawback policies that provide for the recoupment of compensation solely in the event of an executive’s misconduct (not related to a financial restatement). In addition, nearly all large and mid-size public companies maintain robust executive stock ownership requirements, some of which also maintain hold-until-ownership-guidelines-are-met requirements. Often, a company’s CEO and other executive officers significantly exceed ownership requirements. However, most companies are unlikely to require executive officers to hold all shares until retirement or beyond.

CII is also suggesting that companies consider (in appropriate circumstances) applying relatively lengthy vesting schedules to time-based restricted stock awards (e.g., 5 or more years) granted to the highest level executives, in lieu of performance-based compensation, due to concerns about the effectiveness, complexity and understandability of such arrangements. We do not anticipate that many companies will move away from performance-based compensation to restricted shares with long vesting periods at this time. We also note that, among large public companies, vesting periods greater than 3 or 4 years are rare.

Lastly, CII is encouraging boards and companies to consider rank and file pay when setting executive compensation to address the widening pay gap between workers and executives. Due to the advent of the CEO pay ratio disclosure and the continuing debate about perceived income inequalities, some corporate boards have begun to evaluate executive pay in a broader context. However, whether a broader evaluation of executive pay has a meaningful effect on pay levels remains to be seen.

* * * * *

The ***Client Update*** is prepared by Meridian Compensation Partners’ Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.