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How boards should handle "involuntary retirement"in the C-Suite.

In the first quarter of 2019 alone, more than 20 CEOs of large public companies announced their resignations. This uptick in C-level departures, which included several "involuntary retirements," has compensation committees rethinking their approaches to officer-level severance pay. *CBM* recently spoke with Jonathan Szabo, lead consultant with Meridian Compensation Partners, about the conversations taking places in boardrooms today around this escalating issue.

What is driving the rising turnover we've seen in the C-Suite?

There certainly has been a large uptick in churn. Some are high-profile exits for inappropriate behavior or insensitive comments, but at other times it's a little bit less clear as to why an executive might be exiting the company. That typically happens during a period of poor performance or declining stock price. It may be apparent to the savvy shareholder that the executive is involuntarily being terminated, but because they've been with the company for a number of years and have reached a normal retirement age, they're being allowed to take their retirement. In essence, it's an involuntary retirement—a retirement that probably came a little sooner than they would have liked.

What concerns are you and your colleagues hearing from compensation committees with respect to involuntarily retirement as compared to termination or traditional retirement?

There are a number of differences. First, employment agreements, equity incentive plans, award agreements, all typically expressly address what happens in the event of a termination or a traditional retirement. But this area of involuntary retirement is a hybrid scenario they don't take into consideration. That's the first distinction.

The compensation related to those types of terminations is the next big difference. In a traditional retirement, typically, no cash severance is provided. Unvested equity might have some preferential treatment where it's allowed to either continue to vest or accelerate vesting. Conversely, in a conventional involuntary termination, often there is cash severance in exchange for restrictive covenants and execution of a release, but the unvested equity is forfeited completely.

So these involuntary retirement scenarios are kind of uncharted territory. You typically end up with a negotiated exit package that combines cash severance and maybe preferred or preferential equity treatments in exchange for restrictive covenants. That typically gets codified in a consulting agreement that requires that the outgoing officer remain available to the board and the management team for a certain period of time.

What considerations do boards need to take into account in that scenario?

Shareholders and proxy advisors are likely to take issue with exit pay associated with something that might have been described externally as a retirement. On top of that, now you've also set the precedent internally for future officer terminations inside the company and also a data point outside the company for other executives to point to in negotiating their own exits, so it becomes a slippery slope.

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Every executive termination has circumstances unique to the officer and the situation. It gets very challenging when there's an employment agreement in place that expressly describes what happens for involuntary termination or for retirement but doesn't address this hybrid involuntary retirement scenario, and frankly I've never seen one that does.

For boards trying to get ahead of this, what steps should they take?

The first step is for the board and the comp committee to get their story straight up front when they decide to terminate the executive. Because the clock starts ticking with an 8K requirement coming up and press releases to put out. And once you've described it as a retirement, you aren't able to go back and describe it as anything but what was originally stated in the 8K.

The second step is really getting their arms around the exit pay that would be associated with the termination. So, understanding in total what the exiting officer is getting in cash severance, any equity acceleration, any continuation of health and welfare benefits or any other perquisites. Understand also how that compares to the contractual involuntary termination that they might be entitled to under that termination scenario in their employment agreement or under a retirement scenario, as well as how it compares to market. Then model out what that will look like in the proxy disclosure.

If the quantum of that exceeds whatever is market typical or what they would have been entitled to in a traditional involuntary termination scenario, you're more likely to hear about it from shareholders and proxy advisors. So, understanding that total dollar value is important. If you're able to negotiate something less than what the involuntary termination would provide, now you have a much better story to tell in your proxy because you've saved the shareholders money by getting that exit pay down and still getting the restrictive covenants in place. And if there's a consulting agreement to help facilitate a smoother transition, all the better.

What can companies do to guard against this situation going forward?

Companies should consider incorporating an involuntary retirement provision in new employment agreements, new award agreements or long-term incentive plans going forward. Make it transparent, explicit up front, and set the expectation that if there's a termination that meets these qualifications, it might be handled a different way than an involuntary termination. It could involve lesser cash severance, and you could also treat the equity a little differently as well. Maybe it's prorated vesting on shares through the termination point or, potentially, there's a look-back period where any shares that were granted within the past year are forfeited, but shares granted prior to that are allowed to either continue vesting or accelerated vesting.

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