

# Compensation and Talent Governance Network

February 2023

CTGN

SUMMARY OF THEMES

## Compensation chairs discuss accomplishments and goals

Compensation committees have adapted to a rapidly evolving business and risk environment. As 2023 gets underway, committees continue to broaden their agendas into oversight of talent strategy and human-capital management issues even as turnover and competition for talent drives a renewed focus on retention. Stakeholders, particularly shareholders, are calling for further integration of environmental, social, and governance (ESG) metrics into compensation, and committees remain committed to advancing workforce diversity and inclusion.

On February 15, 2023, CTGN members reflected on their accomplishments in the past year and shared their priorities and ambitions for 2023. This *Summary of Themes* presents highlights from that discussion.

*For a full list of meeting participants, please see the appendix on page 5.*

### Increasing the rigor of nonfinancial goals, particularly diversity, equity, and inclusion

Members' committees are continuing to integrate nonfinancial metrics into incentive compensation in order to drive performance on environmental and social issues. One chair said, *"We include ESG, safety, and diversity as modifiers on our annual incentive plan. Last year, that was a negative, so it subtracted from executives' pay because we didn't like the results that we had seen on safety metrics. But it worked as intended: this year, we've seen a refocus on their safety metrics, which is the intent of having those in the plan."*

Diversity, equity, and inclusion are particular priorities, and committees are incorporating more quantitative data into the goals they are establishing for their management teams. For example, one member said they are assessing the percentage of diverse interview slates and establishing specific dollar targets for diverse suppliers as incentive compensation metrics. *"These are not modifiers; they are targets and those targets have to be hit,"* one chair said.

Companies are at different stages of integrating ESG metrics into compensation plans. One chair said that their company, despite *"becoming more sophisticated on ESG,"* remains cautious about integrating ESG metrics into incentive compensation: *"The ESG strategy is still pretty early days. We didn't want to get the cart before the horse, so there's a constant discussion: do we have the metrics and do we have clarity on what really counts for this company's strategy from an ESG standpoint? We're getting more clarity, which we need to link incentives to ESG."*

## Meeting the challenge of CEO and C-suite succession

A number of members reported that they had gone through recent CEO transitions or are anticipating CEO transitions in the near future, which is raising important considerations:

- **Identifying internal candidates requires a commitment to long-term planning.** Recent CEO hires at member companies have typically been internal candidates, which for most members is usually the preferred outcome. One member said that having multiple viable internal candidates *“made us feel pretty good about our succession planning process and gave us confidence that it was working.”* Members stressed the importance of a long-term approach to identifying potential candidates and establishing appropriate development programs. Boards are increasingly looking deeper into organizations for potential C-suite candidates and looking farther ahead to anticipate transitions. One member who had recently been through a CEO transition said the board and management team are now focusing not just on the next succession, but on the one after that: *“We have an idea of who could be ready five or seven years from now, but we are also looking to have insight into candidates that are 10–15 years out, so that you’re starting to really do career planning, development, and training so that they’re ready for two CEO transitions from now.”*
- **Engaging the current CEO in the development process is essential.** Sitting CEOs play a critical role in succession planning, but it can sometimes be a challenge to encourage the current CEO to prioritize leadership development, especially if that person has a long runway ahead. One member said, *“Our CEO has been in the role for a long time but is still relatively young, so getting him to think about succession and getting people ready and establishing really serious development actions and plans for CEO candidates and other C-suite succession is a huge challenge.”*
- **Effective CEO transitions require continued board engagement after the new CEO is in place.** The difficult work of CEO transition continues after a new CEO has been named. Members noted the challenge of properly setting expectations for the new CEO’s pay, as well as for the outgoing CEO when that person remains in an executive chair role for a period. One member noted that the question of compensation for the executive chair can be contentious if the outgoing CEO expects to maintain a similar level of compensation as they transition into the executive chair role; expectations need to be made clear from an early stage of the transition to avoid *“a situation where I’m going to be paying two CEOs.”* With internal hires, the board plays an important role in helping the new CEO manage relationships with other C-suite executives: *“One of the critical things we do is share not only the feedback from the board but the feedback from the CEO’s executive team, and we formalized that feedback. This was particularly important for an internal candidate, to ensure the transition from peer to CEO worked well.”*

## Aligning compensation and talent strategy with business objectives

For several members, a key objective is to better align compensation plans and talent strategies with overall corporate strategy, especially in light of continued market volatility and a potential global recession. One member noted that their company is *“pivoting to a growth strategy,”* with one of the goals for the compensation committee being *“to adjust the compensation strategy to fit with a new five-year plan for growth and becoming a service-driven organization.”* Another member’s committee is focused on *“refreshing the incentive compensation plan,”* partly by changing the company’s peer group to reflect the ways in which the business has changed in recent years.

Members’ committees are also working to ensure their organizations have a talent strategy that drives business outcomes. One chair noted that as their company has entered a rapid growth phase, *“the committee is making sure that the talent and organizational aspects are aligned with where the business is going as a high-growth company.”* Another member said, *“One thing we’re pleased with this year was that we spent a lot of time on the talent risk dashboard and taking talent analytics to the next level. It’s a work in progress, but given our long-term objectives, we want to see much more robustness in the way that the team is thinking about talent risk and the way that we’re using advanced analytics to predict where the issues are and where to focus.”* Another chair identified workforce planning as a key challenge: *“We’ve been pushing for a broad people strategy across the organization for a few years and [the company] has really made a lot of progress on that. The area where we have more work to do is on talent planning for the future. We don’t have a very sophisticated approach to planning around talent, and the committee is asking what the composition of the workforce is going to need to be in three to five years compared to today. The answer we get is very qualitative and people are just making a lot of assumptions, so we’d like to get more data oriented.”*

Members also stressed the need for sustained attention to address ongoing workforce needs. One said, *“You need a long pipeline and a sophisticated development program. It takes a lot of hands-on management to run that.”* The imperative to improve diversity compounds the challenge. One member noted that the approach to diverse talent management is evolving: *“The conversation has started to transition away from the acquisition of diverse talent because we’re all fighting for the same small group of people. The cost of acquisition is so high and turnover for that diverse talent is higher, so the question becomes, What are we doing to retain that talent? Are we making sure promotion slates are filled with diverse candidates? There are really substantial changes that organizations can make to do a better job of keeping women and minorities in the organization that they haven’t necessarily done yet because the focus has been on just the talent acquisition side.”*

## Understanding the impact of the new SEC clawback rules

Meridian Compensation Partners' Darren Moskovitz provided a brief update on the SEC's final clawback rules, adopted in October 2022. Mr. Moskovitz identified two key aspects of the rules: (1) contrary to most existing clawback policies, the new regulations include a no-fault provision that requires recouping incentive compensation in the case of financial restatement whether or not there was intentional misconduct or fraud that caused the need for restatement; (2) the recoupment is mandatory; the new rules limit committees' discretion and exceptions. As a result, he noted, *"Companies and committees will have to develop a formal process of recouping incentive compensation that was tied to a financial metric"* in the case of a restatement.

*Summary of Themes reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meeting are not attributed to individuals or corporations, except in cases where meeting guests or members have given explicit permission for their remarks to be attributed. Comments by guests and network members are shown in italics.*

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## Appendix: Meeting attendance



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