tapestry NETWORKS

CTGN Summary of Themes

Dialogue with the EEOC's Keith Sonderling and discussion on executive compensation

November 2023

On October 17, 2023, members of the Compensation and Talent Governance Network (CTGN) met with Commissioner Keith Sonderling of the US Equal Employment Opportunity Commission (EEOC) to discuss the EEOC's current priorities and expectations for boards regarding human capital management. The conversation covered trends in discrimination claims, especially the rise in mental health claims; ongoing challenges around remote work; the transformative impact of new technologies; pay transparency; and diversity, equity, and inclusion (DEI) issues. Our afternoon peer discussion on executive compensation, featuring insights from Virginia Rhodes of Meridian Compensation Partners, highlighted trends in say on pay and effective responses to negative outcomes, as well as lessons from the first year of pay-versus-performance disclosures and thoughts on the expanding responsibilities compensation committees are handling.

This *Summary of Themes* highlights the following board priorities for human capital management and trends in executive compensation:

EEOC discrimination trends and priorities

Trends in executive compensation

The evolution of the compensation committee

For a list of meeting participants, see Appendix (page 7).

EEOC trends and priorities

Social catalysts like the #MeToo movement and the murder of George Floyd elevated discrimination, harassment, and equity to board priorities. The added visibility from hyper transparency through a very social and public discourse on claims of discrimination has only increased the pressure on boards to address these issues. *"Now with social media and an increase in cases coming out, these issues are making it onto board agendas,"* said Commissioner Sonderling. In this context, he shared key issues and emerging trends that the EEOC urges corporations to consider.

- **Shifting discrimination claims.** Retaliation for complaints has consistently been the most frequent reason for employment-related complaints to the EEOC, followed by claims of harassment and discrimination based on disability, race, and religion. COVID-19 generated distinct challenges. The EEOC allowed companies to set their own vaccine policies, but any vaccination mandate was required to include exceptions for religion, pregnancy, and disability, leading to a spike in employees seeking religious exceptions and bringing religious discrimination claims to the EEOC. Noting that many employees' religious claims may have been less than genuine, Commissioner Sonderling said, *"Companies were being put into the position of questioning employees' faith, which they did not have to do before."* Organizations wrestled with how to accommodate workers in different states with different laws and political climates. For at least one member, the desire to avoid controversy over vaccinations *"accelerated the company's strategy to be remote first, which wasn't the company's initial goal."*

- **The rise in mental health claims.** *"Mental health is the number one health issue raised,"* a director said. Last year, the EEOC saw a 20% increase in mental health claims, specifically anxiety, depression, and post-traumatic stress disorder, and mental health issues are complicating many companies' return-to-office plans. *"Employees are saying that they're disabled and can no longer meet return-to-office requirements [because of anxiety or for other mental health reasons],"* said Commissioner Sonderling, who noted, *"The law requires an interactive process to engage each employee as a different claim and level."* He said that companies have the legal right to mandate that people return to the office but risk losing talent if they can't make mental health exemptions: *"There is no federally protected right to work from home, but mental health claims are in effect creating a federal protection to work from home."* He described special accommodations that companies can make to ease employees' transition back into the office, such as noise-cancelling headphones and dim office lights.

  Generational differences of opinion regarding mental health issues in the workplace, particularly regarding anxiety about workload and performance reviews, are causing difficulties. The workforce spans five generations, and several years of remote work mean there have been fewer opportunities to discuss assumptions and create shared expectations. Commissioner Sonderling warned participants that failure to understand these generational shifts in attitudes and approaches to mental health creates a risk of increased mental health claims. *"Companies need training and awareness of issues that lead to discrimination to prevent claims from turning into a federal investigation,"* he said. Directors cited examples of younger workers refusing assignments or refusing to work on weekends due to anxiety or stress, which would have been unthinkable for earlier generations.

Younger generations' anxieties around performance reviews have led some companies to eliminate or scale them back—but then the lack of performance data creates challenges when it comes to making promotion or separation decisions. *"There needs to be data on performance to know if people are failing or succeeding,"* one director said, adding that feedback on performance gives people *"a chance to rectify the situation."*

- **Equity concerns around artificial intelligence (AI) and other technological advances.** Rapid advances in generative AI technologies may eventually reduce the need for workers and lead to workforce reductions. Commissioner Sonderling warned of the possibility of a rise in age and race discrimination claims, as job eliminations tend to disproportionately affect older workers, who may adapt less quickly to new technology, and recently hired younger workers, who tend to be more diverse. *"If AI causes loss of jobs, organizations must conduct those eliminations with a diversity perspective that considers vulnerable groups,"* he advised. AI has also raised concerns about potential bias arising from how the technology is trained and used. In discussing bias in recruiting, Commissioner Sonderling warned participants, *"If you're using AI in any part of the organization and something goes wrong, the AI vendors have zero liability,"* reminding them that *"the EEOC is only looking at the organization."* On a more positive note, Commissioner Sonderling noted that advances in adaptive technology make it possible to accommodate disabled workers and thereby reduce potential disability discrimination claims.
- **Pay transparency.** Commissioner Sonderling noted that while no federal law requires the disclosure of wages, currently 10 states, including California, New York, Connecticut, and Washington, mandate transparency in salary. The patchwork of laws raises challenges for large companies, which need to decide whether to disclose only in states with transparency laws or to do so across the nation. Commissioner Sonderling noted that, beyond compliance with laws, the decision to show pay range when advertising a position as *"important business decision in terms of attracting talent."* He encouraged companies to prepare for enhanced pay disclosure requirements in coming years: *"The federal government will require more granular pay data, with a focus on types of jobs and salary, not just race and gender. Now is the time to invest in pay equity audits."*
- **The growing politicization of HR.** Commissioner Sonderling encouraged companies to manage corporate DEI programs with an *"extra layer of care"* as the politicization of

human resources, including the public discourse on the US Supreme Court's affirmative-action decision, has led to attacks from both left-wing and right-wing groups. *"It's getting more complex, and soon [talent pipeline programs and affinity and resource groups] will be under attack,"* he said. To counteract claims regarding DEI programs, he urged participants to remove any obligation or *"employee benefit"* from participation in them.

Trends in executive compensation

Say on pay, which has been a part of the corporate governance landscape for over a decade, continues to underscore the importance and challenge of effective communication with shareholders, while the SEC's new pay-versus-performance disclosures are highlighting the challenges of effectively linking executive pay with performance.

Say on pay

Failed say-on-pay votes remain rare: about 2.4% of S&P 500 companies failed say on pay last year, while the average support rate was 88.7%. Ms. Rhodes pointed out that because of the decline in proxy advisers' influence, *"getting medium or high concern [from a proxy adviser] doesn't mean you'll fail say on pay. However, you are likely to lose 25 to 30 percentage points of support."* One director recommended planning in advance for lack of proxy adviser support: *"Assume that you will be in those medium- and high-concern categories, and then prepare yourself to mitigate."* The discussion covered several factors that contribute to low support, such as large equity grants with limited performance criteria, excessive use of discretion, and perceived unresponsiveness to concerns raised in previous years. Ms. Rhodes also noted that investors and proxy advisers are increasingly leery of cash severance provided to retiring executives, and one member cited the lack of a clawback policy related to nonfinancial performance measures as a reason for opposition.

Participants agreed on the importance of responding meaningfully to pay concerns to avoid further trouble in subsequent years. They agreed that in-depth communication with proxy advisers and shareholders is essential. *"You have to communicate and add more details to the proxy*," said one director. Another director shared, *"We also used strong communication, and that helped get everyone back on our side. It wasn't just the compensation committee, but every single board member weighed in over months."* Ms. Rhodes encouraged participants to have regular compensation discussions with shareholders, not just when a problem arises: *"You want to already have developed relationships, so conversations are easier when needed*.*"*

Effective responses may also go beyond communications. One director said, *"We decided to go back and examine things top to bottom and to make corrections."* Ms. Rhodes pointed out that some companies have made explicit commitments not to repeat specific actions: *"A company might say, 'We will not provide a one-time grant to the current CEO again' or 'We will only apply one-time special grants under extraordinary circumstances.'"* In the end, there might be occasions when committees need to move ahead with compensation plans in the face of shareholder opposition: *"The bottom line is you have to do the right thing and be willing to take the risk."*

Pay versus performance

Early lessons from disclosures mandated by the SEC's pay-versus-performance requirements showed that compliance takes a lot of management's time and resources without producing clear outcomes. The SEC's goal is to create a common definition of pay for performance that would permit comparisons, but in conversation, participants suggested this is no easy task. *"Aligning pay with performance is a difficult concept to talk about. Every way you look at this analysis is flawed,"* said Ms. Rhodes. One director said that there is no clear answer even to the simple question of how much the CEO is paid: *"We did this analysis and came up with three different measures for CEO pay—realizable pay, net pay, and compensation actually paid [as] required by the disclosures."* While lack of data prevented assessment of real trends this year, one director said, *"If we can get through this, over time we may come up with data that can lead to more effective way of measuring pay and performance."*

Appropriate performance measures to link to compensation can vary by industry: in some cases, revenue growth is suitable; in others, income measures are more important. Companies are also facing the challenge of integrating nonfinancial performance metrics into incentive compensation. One director said, *"We did a balanced scorecard with 60% financial and 40% nonfinancial targets. Nonfinancial is the harder conversation to figure out."* Many companies refer to their peers for target setting based on a philosophy of median pay for median performance. Directors also noted the challenge of setting targets in the face of difficult economic conditions. *"The best plan that management put forward was significantly down,"* one director said. *"How can you target at 100% for a down plan? But if the plan represents the best efforts of the team, how can you not target at 100%? Do we believe this is as hard as the business can be pushed?"*

Participants also cautioned against setting targets that are not aggressive enough: "*If the team is consistently outperforming on the short-term incentive plan, then I'm not doing my job correctly."* Committees may need to use discretion on such cases. One director said, *"We're aggressive on discretion. We did negative discretion after having a great year in 2021."* It is important to remain balanced in the use of discretion over time, considering both the upside and the downside of various actions.

The evolution of the compensation committee

Most participants' compensation committees have taken on oversight of human capital management priorities like corporate culture, recruitment and retention of talent, leadership development and succession, and DEI initiatives. These additional tasks require robust reporting, and time must be given to them on committee agendas. Most committees have set aside at least one meeting a year to focus on human capital issues. Some have more frequent discussions on these topics. *"Every quarter there's a balanced agenda that brings* *these issues forward,"* said one director. One of the most pressing issues is culture, its evolution, and the interpersonal conflict risks it brings. *"Culture is starting to cross all committees. Just putting it on the human capital committee isn't happening anymore,"* said another director. Participants discussed the importance of integrating topics across the board, with one observing, *"It's been important to have a nexus that works with management on a growing set of topics. So many things are sitting across multiple committees."*

This document reflects the network's use of a modified version of the Chatham House Rule whereby names of network participants and their corporate or institutional affiliations are a matter of public record, but comments are not attributed to individuals, corporations, or institutions. Comments from Mr. Sonderling and Ms. Rhodes, however, are attributed. Network participants' comments appear in italics.

Appendix: Participants

The following members participated in all or part of the meeting:

Phyllis R. Caldwell
Oaktree Specialty Lending

Stephanie Coyles
Sun Life Financial

Mark Feidler
Equifax

Leo Mackay
Cognizant Technology Solutions

Linda Mills
AIG

Karen Puckett
Entergy

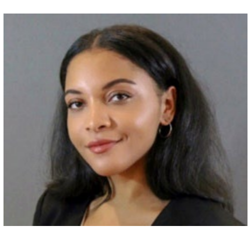
Virginia Rhodes
Meridian Compensation Partners

Keith E. Sonderling
U.S. Equal Opportunity Commission (EEOC)

Stephanie Stahl
Carter's

John Thompson
Norfolk Southern

The following team members from Tapestry Networks participated in the meeting:



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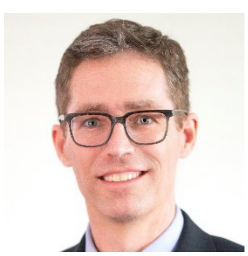

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