

Fundamentals of Executive Compensation

JUNE 17, 2026 | PART TWO



Fundamentals of Executive Compensation



- **Part One:** Design Fundamentals



- **Part Two:** The Regulatory and Governance Context



- **Part Three:** Finance and Measurement Basics

REGULATORY & GOVERNANCE CONTEXT



11:00 a.m. ET

Part One Quiz

11:15 a.m. ET

Regulatory & Governance Framework

12:35 p.m. ET

Break

12:45 p.m. ET

Peer Group Exercise

1:05 p.m. ET

Proxy Advisory Firms & Shareholder Proposals

1:20 p.m. ET

Governance Basics

1:50 p.m. ET

Review and Hot Topics for Day 3

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Part One Quiz

Design Fundamentals

1 Which statements about Proxy Advisory firms are true?

- a. They advise institutional investors about proxy voting matters
- b. They are subject to criticism from companies
- c. They have significant influence on Say-on-Pay votes
- d. All of the above

2 Institutional investors generally have the largest share of ownership in public companies.

a. True

b. False

3 How do companies use peer groups?

- a. To measure the level of executive pay
- b. To compare their performance against peers in incentive plans
- c. To benchmark pay program design
- d. All of the above

4 Where do most public companies target overall executive pay levels?

- a) At the average of their competitor group
- b) Well above their competitor group
- c) At the median of their competitor group
- d) None of the above

5 **Size (revenue) is the most common criterion for selecting companies for an executive compensation peer group.**

a. True

b. False

6 Which elements of pay are most commonly paid in cash?

- a. Annual incentives
- b. Long-term compensation
- c. Perquisites
- d. Both a and c are commonly paid in cash

7

Which is the most prevalent form of long-term compensation for senior executives?

- a. Stock options
- b. Performance plans
- c. Restricted stock

8 Which of the following is typically NOT true about performance plans?

- a. They are the most common form of long-term compensation
- b. They are paid out only in stock
- c. The most common performance period is three years
- d. The amount earned depends on performance against a specific metric over time

9 Stock option usage has:

- a. Increased in the last five years
- b. Stayed the same over the last five years
- c. Decreased over the last five years

10 Proxy advisory firms don't typically pay attention to executive benefits or perquisites.

a. True

b. False

Executive Compensation

The Regulatory & Governance Framework

Regulatory & Governance Framework

- The regulation of executive pay has reflected the shifting role and influence of key stakeholder groups
- Corporate scandals and economic downturns have shaped regulations and increased scrutiny of executive pay
 - Dodd-Frank
 - The Role of Disclosure
- Influence of proxy advisory firm recommendations

The U.S. Governance Landscape

- In the U.S., governance of executive compensation is shared by Congress and the Executive Branch
- Congressional action on executive pay is often included in broader financial system regulation and tax reform
- The Securities and Exchange Commission (SEC) has the most direct day-to-day impact on executive pay

Dodd-Frank Act Overview

- **Enacted in 2010 after the financial crisis**
 - Aim: increase transparency, accountability and shareholder protections
 - Major impact on executive compensation and corporate governance
- **Key objectives**
 - Align executive pay with long-term performance
 - Reduce excessive risk-taking incentives
 - Strengthen shareholder oversight and transparency

Key Elements of Dodd-Frank

- **Say-on-Pay Votes:** Public companies must provide shareholders non-binding vote on executive compensation
- **Pay-for-Performance Disclosure:** Requires comparisons of pay versus financial performance in prescriptive tables/calculations
- **CEO Pay Ratio:** Disclosure of CEO pay relative to median employee pay; intended to highlight internal pay inequity
- **Clawbacks:** Mandatory recovery of incentive-based compensation triggered by accounting restatements

Key Elements of Dodd-Frank (Cont'd)

- **Hedging and Incentive Alignment:** Companies must disclose hedging policies and discourages insulating executives from equity risk
- **Incentive Alignment:** Not yet implemented; intended to prohibit excessive compensation in financial services incentives

The Role of Disclosure

- The Proxy Statement is the primary way public companies disclose the details of their executive pay programs
- We'll focus on two key elements of disclosure: the Compensation Discussion and Analysis (CD&A) and the Summary Compensation Table (SCT)
- Investors generally do not feel proxy disclosures are effective, contributing to a growing use of supplemental materials

CD&A

- The CD&A provides narrative disclosures explaining the elements of a company’s executive compensation program —
 - A “principles-based” disclosure that conveys the “how” and “why” concerning compensation decisions made during the year
- It is one of the company’s primary engagement tools used to tell their compensation story to investors
- The general design and content of the CD&A is largely up to each individual company

CD&A: Typical Elements

- Executive Summary
- Elements of compensation during the year
- Performance against targets for the year
- Compensation decisions made
- Compensation policies and processes
- Employment agreements

Summary Compensation Table

- Principal source of specific pay disclosure and must include all compensation earned by Named Executive Officers (CEO, CFO and 3 Top Highest Paid Officers)
 - Salary, cash bonuses, equity awards, change in pension value, and 'all other compensation'
 - May cover up to 7 execs depending on NEO departures
- Includes both compensation actually earned and pay that has been awarded but not yet earned
 - Represents a picture of 'intended' pay levels

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Nonequity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									
B									
C									

Nonperformance-based bonus awards	Disclose ASC Topic 718 Grant Date Fair Value	Disclose incentive-based cash compensation not within scope of ASC Topic 718 when earned (includes incentive-based annual awards)	Disclose sum of increase in actuarial value of pension benefits and above-market earnings on deferred compensation	Catchall for any other compensation that cannot be covered else where	Sum of columns (c) thru (i)
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Where does it appear?

	Does this need to be included in the SCT?	If so, in which column?
An award from a performance-based LTI plan, paid in cash	YES	Non-equity incentives
An award of stock options granted as part of a new NEO's hire-on package	YES	Option Awards
The amount an NEO defers from his regular salary to the company's 401k plan	YES	Salary
Reimbursement of travel expenses for a new NEO during the recruiting process	NO	
A charitable contribution made by the company on behalf of an NEO to their alma mater	YES	All Other Compensation

Supplemental Disclosures

- Investors generally do not find company disclosures clear or helpful in understanding executive pay – particularly the pay-performance connection.
- In 2022, SEC issued another definition of “compensation actually paid” with the final Pay For Performance rules.
- To address this, some companies have expanded the use of supplemental disclosures.
- Many of these disclosures incorporate the concepts of realized and/or realizable pay.

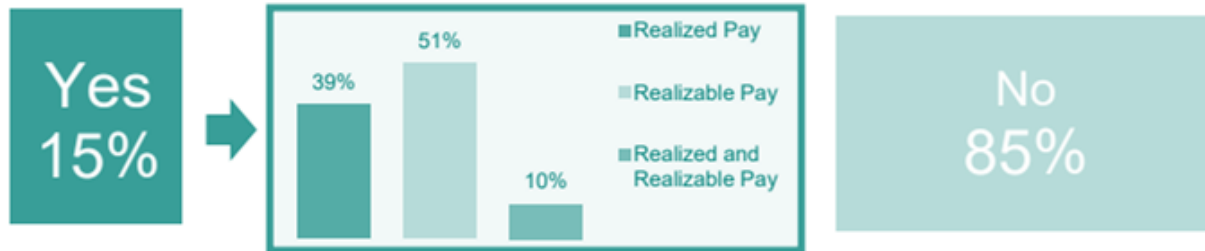
Realized and Realizable Pay

- **Realized Pay:** actual pay received during the year (salary, bonus and vested equity)
- **Realizable Pay:** actual salary, annual incentive and cash bonus received, plus:
 - Long-term cash incentives not yet earned valued at target
 - Equity incentives not yet earned valued at target using year-end stock price

Realized/Realizable Pay Disclosures

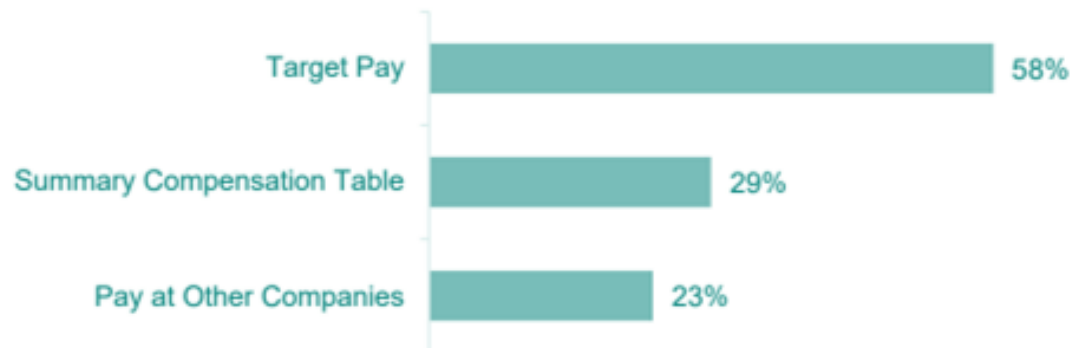
Realized/Realizable Pay Disclosure

15% of the Meridian 200 provide voluntary disclosures with alternative measurements of pay based on earned (realized) or projected (realizable) compensation. Note that in addition to pay and performance disclosures detailed on the prior page, the data below also includes pay disclosures not presented in relation to performance.



NEO Pay Included in Disclosure	Prevalence
CEO Only	71%
All Named Executive Officers Depicted Separately	16%
CEO and Average of Other Named Executive Officers	13%

When presented relative to other compensation figures, realized or realizable pay is typically compared to target pay, Summary Compensation Table pay or pay at other companies.



SEC Rulemaking: Democratic Era

- **2020–2024, the SEC had a Democratic majority and issued rules on:**
 - 10b5-1 plans
 - Pay-for-performance disclosures
 - Clawbacks
 - Climate
- **Proposed rules (not finalized):**
 - Section 956 Dodd-Frank Act regarding incentive compensation for financial institutions (Proposed for 3rd time in June 2024)
 - Enhanced human capital metrics rules (Target: 2025)
 - Board diversity (Original Target: April 2024)

SEC Agenda in Current Administration

- Pursuing significant disclosure reforms aimed at simplification, scalability, financial materiality to investors and encouragement of public companies
- **Agenda:**
 - Proposed Rule to Change filing definitions and requirements for companies under \$2 billion in public float (currently in comment period)
 - Proposed to shift from quarterly reporting to a voluntary semi-annual framework (currently in comment period)
 - Streamline proxy disclosure (Eliminate PVP, pay ratio, reduce # of NEOs from 5 to 3, revise and streamline proxy tables, revise clawback requirements to remove “little r” restatements and remove the cost of executive security from the definition of compensation)
 - Targeted Fall 2026

Today's SEC: Disclosure Reform

- Center comments supported:
 - Eliminating duplicative tables from the proxy and streamlining the SCT to include annual total target compensation and total annual earned compensation
 - Reducing NEOs from 5 to CEO and CFO only
 - Amending clawback requirement to exclude “little r” restatements and provide more flexibility to boards in using discretion
 - Eliminating the cost of executive security from an executive's total compensation

Push for Pay Equity Through Disclosure

- While not strictly an executive compensation issue, concerns regarding pay equity are a significant governance issue
 - Expansive reporting requirements from EU Directive
 - U.S. public policy actions focused on state and local salary history prohibitions
 - A nationwide pay equity/pay transparency rule proposed for all government contractors performing contract work (abandoned before Trump took office)
- Shareholder activists in the U.S. target specific industries and ask for expanded disclosure
 - Arjuna Capital, Proxy Impact, New York Pension Funds and Comptroller

Non-Compete Agreements

- In 2024, FTC issued nationwide ban on non-compete agreements, viewing them as anti-competitive and stifling innovation and the creation of new businesses
 - Rule was supposed to take effect September 4, 2024 but blocked by legal challenges
 - **In 2025, FTC announced it will not defend existing rule and have asked for comments on how non-compete agreements restrict competition**
 - The Center supports reasonable non-competes for senior executives and those with access to confidential or proprietary information. Clear distinction between non-competes and other restrictive covenants, such as forfeiture agreements
 - Bipartisan support of banning non-competes – expect more state bans and limited federal rules

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Break
Our Session Will Resume Shortly

Executive Compensation

Group Exercise: Peer Groups

Who are your pay peers?

- How many peers are listed?
- Is the peer group comparing pay, performance or both?
 - If the company has two peer groups, what factors may have influenced that decision?
- What criteria are used to select the peer group or groups?
- Are there any companies you expected to see that weren't in either of the peer groups?
- Were any peer companies ones that you didn't expect to see? Why?

Executive Compensation

Proxy Advisory Firms & Shareholder Proposals

What are Proxy Advisory Firms?

- Firms that assist institutional investors in voting their shares at shareholder meetings through analysis, vote recommendation and voting administration
- Two firms control 80% of the market – Institutional Shareholder Services (ISS) and Glass Lewis
- Proxy advisors develop policies on a broad range of issues, including corporate governance, executive compensation, and mergers and acquisitions

Proxy Advisor Impact

- Recommendations have a significant impact on the outcome of a shareholder vote
- Smaller investors rely on proxy advisor recommendations and do not complete independent analysis
- Impact of a 'NO' recommendation by ISS may cause support for a Say on Pay proposal to decline on average by 27%

Areas of Concern

- Potential conflicts of interest
 - Providing voting recommendations to investors while providing consulting services to companies
 - Providing recommendations on shareholder proposals backed by their own clients
 - Ownership may be problematic (Glass Lewis)
- Lack of knowledge of how pay plans operate leads to errors and inaccurate interpretations
- Failure to meaningfully engage with companies

Changing Landscape of Proxy Advisors

- **President Trump Executive Order directs the SEC Chair:**
 - To conduct comprehensive review and potential overhaul of all rules and regulations governing proxy advisors (anything tied to ESG, DEI and shareholder proposals)
- **The Order also directs the FTC and Department of Labor:**
 - FTC: Work with Attorney General to determine whether proxy advisors are engaging in unfair methods of competition or deceptive practices and review state antitrust investigations into potential violations of federal law
 - Department of Labor: Strengthen fiduciary standards under ERISA
 - Greater transparency about how advisors are used by plan managers and ensure decisions are based on the financial interests of American workers and retirees rather than social agendas

Changing Landscape of Proxy Advisors

- **AI Takeover: JP Morgan and Wells Fargo announced they will no longer utilize proxy advisors**
 - Turning to AI platforms and internal analysis for making recommendations
 - Many large investors will likely follow suit as AI is more customizable and costs less over time
 - Smaller investors may still need ISS research and voting services

ISS Methodology Shifting in Response

- Shifting their business models from “one size fits all”
 - More focus on client policies and custom benchmark voting
- Updating product analytics and subscription services to assist companies in comparative benchmarking and modeling

ISS Methodology

- Three quantitative pay for performance tests
 - Relative degree of alignment (shifting from 3 yr to 5 yr period)
 - Absolute degree of alignment
 - Multiple of Median
- If there is an elevated level of concern from the quantitative tests, they will consider a qualitative review that examines:
 - Poor pay practices
 - Poor communication and responsiveness

Glass Lewis Methodology

- Recently announced an overhaul of their pay and performance alignment methodology
 - Expanded measurement period from 3 to 5 years
 - Introduced two new tests for a total of 5 weighted quantitative tests
 - *CEO STI Payouts vs TSR:*
 - *CEO CAP vs TSR*
 - CEO Granted Pay vs TSR
 - CEO Granted Pay vs Financial Performance (EPS, Revenue growth, ROA, ROE) relative to Glass Lewis peers
 - NEO Pay vs Financial Performance
- Final measurement will be based on a new 0–100 score, replacing their previous letter grade approach

Shareholder Engagement Practices

- Valuable communication tool to understand how the company is perceived
- Director engagement is on the rise (usually Lead Independent Director or Comp Committee Chair)
- Preparation is key. Know investor expectations and proxy voting policies
 - Recognize “hot button” topics and differing priorities among investors
- State meeting goals and tailor discussion to optimize time together
 - Use intentional, precise language
 - Active listening
 - Understand their engagement preferences

Shareholder Engagement Shake-Up

- New SEC guidance about what constitutes “changing or influencing” a company may make passive investors less likely to engage
 - Expect investors to be vague about the positions on various topics
 - Questions may be more open-ended with less prescriptive agendas
 - May read disclaimers that they are not intending to influence the company
 - Many have removed statements about voting against directors if certain expectations are not met
 - As a result, companies may have less information about investor expectations and see more surprises in proxy voting

Evolution of Shareholder Proposals

- Originally focused on governance and compensation practices, then expanded to broader range of ESG topics and now many institutional investors are focused on **material issues that impact long-term shareholder value**
 - 2025 saw a rise in anti-DEI proposals – with almost no success
- Activist campaigns globally have increased 5% since 2025, surpassing 2018's record
 - 6% uptick in U.S. campaigns (115)
 - Elliot Investment Management led with 18 campaigns, spending \$20 billion
- Record 32 CEOs resigned within a year of activist campaigns in 2025

Executive Compensation

Governance Basics

Board Duties

- Directors manage the business on behalf of and have a fiduciary duty to the corporation and the shareholders:
 - **Duty of Care:** Make informed business decisions based on all material information reasonably available
 - Duties listed within charter; duty of obedience
 - **Duty of Loyalty:** Act in a manner reasonably believed to be in the best interest of the corporation and shareholders – no self-dealing
- Boards conduct most of their work through established committees

Common Board Committees

Three committees are required by most stock exchanges:

Audit

Compensation

Nominating &
Governance

- **Finance and Executive Committees** are common (more than 33% of S&P 500)
- **Compensation/Human Capital Management Committee** scope is expanding to include broader talent-related issues

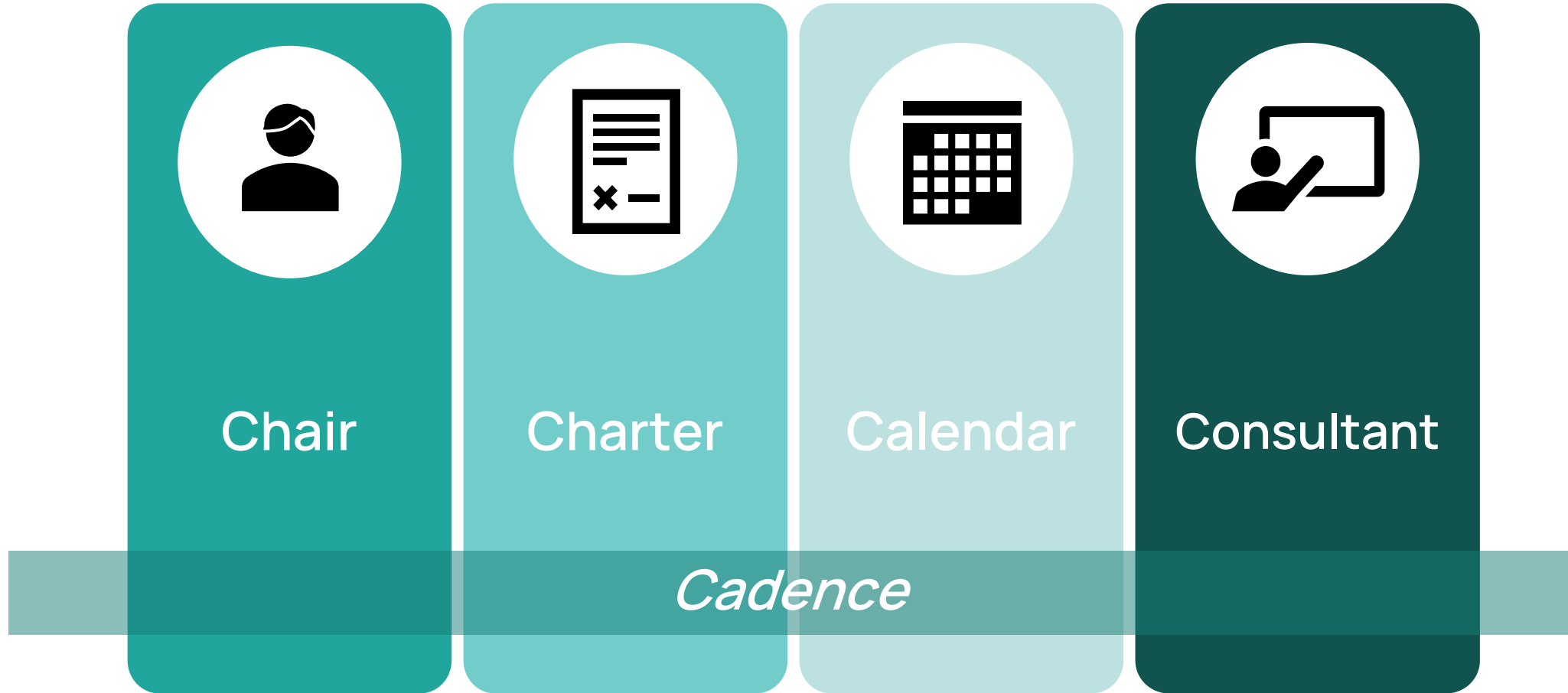
A Real-World Perspective



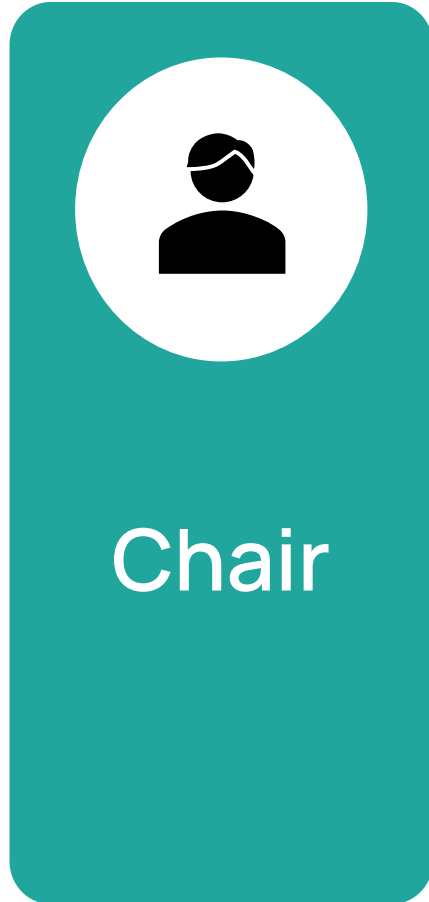
Patricia F. Russo

Board of Directors: GM, Merck, and KKR
Chairman of the Board, Hewlett Packard Enterprise

Comp Committee Roles and Process



Committee Chair



- Primary role is to set the Committee's agenda and facilitate its decision-making process
- Must maintain independence while communicating effectively with management
- Engage and manage independent advisor

Committee Charter



Charter

- Required by stock exchanges, sets forth the Committee's responsibilities
- Also provides the authority to hire independent advisors
- Typically, responsibilities are translated into activities in the Committee's Annual Calendar to ensure they are met

Committee Calendar



Calendar

- Establishes plan to fulfill committee responsibilities over the course of the year
- Typically, four to six meetings per year, each with assigned duties/actions
- Also supported by standard meeting format and agendas

Committee Consultant



Consultant

- Committees may engage their own advisor, independent of management
 - Independent viewpoint
 - Technical expertise
 - Access to competitive information
 - Important to some external stakeholders
- **Key question:** will the advisor be allowed to perform work for management?

The Comp Committee's Expanding Role

TRADITIONAL COMPENSATION COMMITTEE RESPONSIBILITIES

- Review and discuss the “Compensation Discussion and Analysis” of the company’s proxy statement
- Set the compensation philosophy and peer group used as reference in establishing competitive targets and pay programs
- Oversee the company’s incentive compensation and benefits plans
- Assess the company’s financial and non-financial goals against actual performance, including the performance of the company’s CEO and other executive officers
- Determine and approve long-term incentive plans as they relate to equity compensation share use and dilution to shareholders
- Review and recommend the compensation for non-employee directors

EXPANDED MANDATE

- Institutional investors and internal stakeholders have increased their expectations of companies’ talent, corporate responsibility and engagement and inclusion strategies
- The most common expanded topics for the Compensation Committee include:

TALENT MANAGEMENT, RETENTION, AND SUCCESSION PLANNING

INCLUSION AND BELONGING, AND BROADER WORKFORCE ISSUES

CULTURE AND EMPLOYEE ENGAGEMENT

PAY EQUITY

Why the Expanded HCM is Vital

45%

more revenue from innovation in diverse management teams (BCG)

Talent Drives Success

Companies can have the right strategy, market, and resources – but without the right talent, goals remain out of reach. Human capital is the critical underpinning of long-term sustainability.

56%

of S&P 100 committees have adopted expanded HCM committee names

Culture Shapes Performance

Compensation can lead culture. By rewarding 'culture carriers' and linking pay to behaviors, boards send powerful signals – moving beyond technical skills to build resilient, high-performing organizations.

65

S&P 100 committees now include succession/leadership in their charter

Oversight Creates a Feedback Loop

As committees deepen involvement in succession, pay equity, and performance management, managers get more value from boards and boards get more from managers – strengthening the entire talent pipeline.

Selecting an Independent Compensation Consultant

- 2026 Center survey indicated that nearly 75% of companies now review comp consultant performance annually:
 - 30% completed an RFP in the past 3 years
 - 23% selected a new compensation consultant as a result
 - 23% have a separate executive comp consultant for management and another 4% are considering it
 - Check out the Center's Guide for Selecting a Consultant

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Fundamentals of Executive Compensation

Part Two Recap

Tomorrow: Group Discussion

- What topics would you like to further discuss or have a question about?
- Email questions to Megan at mwolf@chro.org

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Thank you!