

Our approach to U.S. Executive Compensation

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Investment Stewardship

For years, BlackRock Investment Stewardship (BIS) has advocated for well-structured compensation programs that reward executives for creating long-term financial value for shareholders. We recognize that boards hear from many investors of various styles who offer viewpoints on executive compensation structures and who, at times, may voice conflicting feedback. We believe it is important for compensation committees to give appropriate weight to the views of *long-term investors* given they will likely remain shareholders for the full duration of the executive pay programs.

BIS believes that boards are best situated to design and implement executive compensation structures, and we do not offer prescriptive guidance on executive compensation program construction.

Instead, this document complements our [global incentives commentary](#) by outlining high level factors that U.S. companies may consider as they set future executive compensation programs – particularly given recent dynamics, trends, and practices observed across the U.S. market.¹

We encourage compensation committees for U.S. companies to consider the following:

- How the balance between retentive and motivational components² in compensation program design promotes long-term performance
- How the compensation program rewards long-term financial value creation, sustained across the duration of the program's performance period
- How pay underpins strategy, with clear disclosure of the rationale for the selected performance metrics
- How resilient the pay program may be across dynamic market environments and the business cycle
- How the committee might responsibly use discretion to reinforce alignment of pay program outcomes with long-term shareholders' interests
- How to provide sufficient disclosure in unusual situations such as executive transitions and newly public companies

Making compensation resilient by appropriately weighing retention and motivation

Over the past decade, executive pay has been increasingly granted through performance-based and market-based awards. Over the full calendar year of 2021, the median S&P 500 CEO had 68% of total disclosed pay delivered through performance-based vehicles, with approximately half of total CEO pay delivered through long-term performance-based equity awards.³

We believe over-indexing executive pay to performance-levered awards increases the potential for a perceived need for special awards and award modifications, especially in tumultuous business environments. Since 2020, the business environment has been challenging for many companies and as a result, many performance awards have not paid out under the formulas within the plan design. Similarly, many options grants are underwater. We have noted that some boards have used discretion, special awards, and/or award modifications to increase the compensation likely to be realized by executives. In essence, these committees seem to be, at least in part, rewarding executives for expended effort rather than for realized results aligned with returns to long-term shareholders.

We ask that companies consider and explain how their executive compensation program is *resilient* and, thus, will deliver reasonable pay outcomes across a broad range of business outcomes and market environments. In this context, resilient means that programs will provide sufficient retentive impact without intervention when market conditions are difficult, motivate appropriate risk behaviors by executives, reward performance when conditions are more favorable, and adequately reflect the financial performance that shareholders are experiencing.

Given increased uncertainty of business outcomes, these considerations may impact compensation committees' decisions regarding the mix of performance-levered and service-based award types, absolute and relative performance metrics, and metrics based on total shareholder return and strategically relevant operational and/or financial factors.

Rewarding sustained⁴ long-term financial value creation

In the last several years, some compensation committees have adopted long-term pay programs centered on awards that are earned upon the attainment of goals over short timeframes, rather than measuring performance delivered across the full business cycle or duration of a multi-year performance period. Stock price goals are often used in this context; in these awards, shares are earned when the company maintains a certain stock price goal for a relatively short period (often less than 90 days), rather than a multi-year period.

Many companies state that the goal of share-based incentives is to align management's interests with those of shareholders and yet this aim is not fully realized when awards are earned based on short-term performance. While we may understand the rationale for using these types of awards within a basket of long-term awards, focusing a program on such awards is often not aligned with sustained financial value creation.

If a board seeks to use these awards, it is helpful to align to long-term investors by also tying a significant portion of awards to metrics that measure performance through the full period of the long-term incentive plan (typically at least three years). Certain award features may also help mitigate concern, such as features aligning executives' interest in maintaining stock price appreciation beyond the brief trading day period.

No matter the program design, we appreciate the board's perspective on how the compensation program encourages long-term financial value creation that is sustained across the full business cycle or duration of the awards.

Aligning strategy and compensation

We believe that compensation should reinforce corporate strategy and we find it helpful when compensation gives executives direction in *how* to deliver financial value to shareholders. Therefore, the compensation program can provide a valuable window into the board's viewpoints on key value drivers by clearly laying out the rationale for the selection of performance metrics and explaining *how* those metrics encourage the delivery of long-term financial value to shareholders.

Especially during turbulent business environments, setting long-term goals on fundamental metrics can be difficult. While we usually find well-constructed relative total shareholder return metrics and modifiers to be a valuable component of compensation programs, we appreciate disclosures that help investors understand the longer-term financial value drivers that give more insight into the fundamental performance and progress of the business. Those metrics may include relative performance - or progress made - on indicators such as financial and operational measures. We defer to the expertise and knowledge of compensation committee members as to which indicators are most relevant to the company's business model, positioning, and strategic direction.

We appreciate when companies provide insight into the goal-setting process, and help us understand the level of rigor of the performance goals as well as how those goals align with the company's strategy. We also appreciate disclosure that explains the board's oversight of compensation program goal-setting. As boards provide these important insights, we also note that good disclosures tend to be concise and to the point; relevant information can be shared without extending disclosures to unnecessary lengths.

Retaining flexibility in executive compensation programs

We recognize that there are a narrow set of business outcomes and market conditions where compensation program intervention by the board is aligned with long-term financial value creation, and we believe that committees should retain flexibility to exercise discretion where warranted. However, we also believe that pay program outcomes should reflect dynamics both within and beyond the executives' control. We look to directors to make adjustments in the best interests of long-term shareholders.

When boards make one-off retention awards to executives, we appreciate fulsome disclosures explaining how the award aligns with long-term shareholders' interests and how the quantum and structure of the award was decided.

In recent years, we have noted a rise in front-loaded multi-year grants, sometimes referred to as "mega-grants" or "moonshot" grants. We seek to understand how those programs align with our clients' interests as long-term shareholders; we recognize that a front-loaded nature limits the board's ability to make compensation program course-corrections over a multi-year period, increasing the potential for both windfalls and retentive risks.

Improving compensation disclosure in unusual situations

Certain infrequent situations tend to receive close scrutiny from shareholders, e.g., compensation program re-designs, executive transitions, and Initial Public Offerings (IPOs).

Periodically, boards elect to overhaul the design of their executive compensation programs. These compensation program re-designs offer the opportunity to more closely align executives with the strategy of the company and, ultimately, with the interests of shareholders. When compensation programs are significantly re-tooled, we find it helpful when companies clearly explain their reasoning and how the adjustments better motivate executives to deliver long-term financial value.

Executive transitions – either with executives sourced from outside or inside the organization – often involve significant payments and grants. We find it helpful when companies disclose the nature of those payments and grants – specifically, the run-rate pay for the new executive, as well as the structure of other payments including replacement equity and inducement awards.⁵ It is also helpful to understand the board’s approach to and execution of succession plans for key executive roles including any challenges faced in their implementation. We assess compensation in the broader context of the company’s business environment and governance framework.

At recently public companies where large grants were made around the time of the IPO, it can be challenging for shareholders to understand the alignment between pay and performance. In those cases, we seek to understand how those grants align with shareholders’ interests, and how the ongoing compensation program motivates executives to pursue long-term financial value creation. We encourage recently public companies to allow the public market to settle on the company’s share price before setting performance-based stock price awards.

Our approach in focus

We take a case-by-case approach. Through our engagements with company management, we aim to understand the following:

Alignment with strategy

- Where compensation plans singularly focus on relative total shareholder return or stock price metrics, how is the board overseeing management on strategic priorities? What balance of long-term operational and financial metrics provides this focus?

Compensation Committee oversight

- How does the compensation committee stay current on compensation practices? How is the relevancy of advice from compensation consultants to the company evaluated?
- What does the compensation committee believe are the most significant risks to the compensation program and how are they mitigating these risks? When options or concentrated cliff-vesting are used, how does the committee mitigate against overly risky/short-term decision-making by executives?

Consideration for the purpose of various awards

- What is the retentive value of the pay plan (particularly when including high weighting of performance-based awards) over different macroeconomic environments and how does the retentive value evolve?
- How does the change-in-control provisions related to executive severance agreements align management with long-term shareholder interests?

Periods of leadership transition, transformation, etc.

- What lessons has the committee learned in prior experiences of succession planning?
- When discretion is used, what are the intentions going forward to normalize the compensation plan and to help shareholders know what to expect year over year?

Transparency: bringing the investors along for the journey

- How does the compensation committee balance transparency to the detriment of their competitive advantage with the need to equip shareholders with information to sufficiently assess the rigor of awards?
- For recently-IPO’d companies subject to less stringent reporting standards, how does the board explain to public shareholders how management is attracted, retained, and motivated to act in the interests of long-term shareholders?

Risk-mitigating policies

- How often does the compensation committee review and update risk-mitigating policies such as stock ownership requirements or stock holding guidelines?

Case Studies⁶

Technology sector: Executive compensation amid executive transitions

Company: Intel

Issue: Poor structure, overly-short-term focused amid leadership transitions

BIS repeatedly engaged with Intel's board and management over several years to convey concerns about Intel's compensation program amid executive leadership transitions and operational delays in a challenging talent and macro/business environment. Prior to the 2022 annual meeting, we engaged with Intel's board and management to discuss the new CEO's total compensation package – which included a one-time new hire equity award valued at approximately \$110m – which was not necessarily aligned with long-term financial value creation given the structure. We were concerned about the structure of the compensation program as it was overly short-term focused in terms of performance periods and had annual award setting within the long-term plan.

As a result of our concerns, we did not support the advisory vote on compensation.

Oil & Gas Sector: Use of discretion in executive compensation

Company: Chevron

Issue: Transparency and performance metrics associated with long-term financial value

Given the company's disclosures and their ongoing efforts to increase transparency, BIS believed Chevron's compensation committee has shown effective oversight over the company's compensation program. Where subjective evaluation and discretion has been used to determine ratings and resulting payouts for 2021, we believed that the company's compensation committee has exercised judgement in a manner generally consistent with shareholder interests.

Further, BIS recognized the steps forward made in the Chevron executive compensation program in 2021, notably adding a relative capital productivity metric to the long-term incentive plan and adding "Energy Transition" as a pillar of the annual incentive plan. We determined that those metrics, combined with relative total shareholder return in the long-term incentive plan and financial results, capital management, and operating and safety performance in the annual incentive plan, provide a reasonable suite of metrics that support long-term financial value creation.

As a result, we voted to approve executive pay at the 2022 shareholder meeting.

Media & Entertainment Sector: Responding to shareholder concerns about compensation plan structure

Company: Netflix

Issue: Unique structure with insufficient rationale; lack of responsiveness to shareholder concerns

Netflix has a unique compensation program which includes allowing executives to choose between cash and stock options, the use of options without specified vesting criteria, and a lack of stock ownership guidelines. Notably, the company made changes to the 2021 compensation program by removing all guardrails, thus providing executives even more flexibility in determining the structure of their own incentive pay.

At the 2021 annual general meeting, management's Say on Pay⁷ proposal narrowly passed with just 50.7% support, demonstrating significant shareholder concern about the company's compensation philosophy. As a result of our continuing concerns about the company's pay practices and the lack of responsiveness to the vote outcome in 2021, we did not support the Say on Pay proposal or the election of one of the directors who serves on the compensation committee.

Consumer Sector: Voting on executive compensation at U.S. based vehicle and component manufacturing companies

Company: Harley-Davidson, Inc., QuantumScape, Lucid Group, Inc., and Rivian Automotive, Inc.

Issue: Limited disclosures and concerning pay practices in a sector undergoing strategic change to facilitate the energy transition

BIS did not support the Say on Pay proposals at the annual general meetings of several vehicle and component manufacturing companies, including Harley-Davidson, Inc., QuantumScape, Lucid Group, Inc., and Rivian Automotive, Inc. These companies are increasingly benchmarking themselves against technology peers – and other electric vehicle companies – to attract talent, leading to pay structures that may not be consistent with the financial interests of long-term shareholders. While we recognize that the companies in this sector are undertaking strategic changes and/or investing in emerging technologies to facilitate the energy transition, we look to their board of directors to set incentive structures that align proportionately to their stated strategy, much of which is still anchored in traditional technologies.

Consequently, we did not support compensation at these companies over concerns related to:

- Mega or front-loaded grants tied to the share price rather than outcomes of strategic change being sought over the long-term;
- Potentially problematic sign-on grants and/or one-time awards; and/or,
- Limited disclosures that failed to demonstrate how their pay structures appropriately incentivize executives to deliver appropriate risk-adjusted returns and long-term financial performance.

Endnotes

1. To be read in conjunction with "[Our approach to engagement on incentives aligned with financial value creation](#)"
2. For clarity, "retentive components" are designed to retain executives (e.g., Restricted Stock Units, awarded as long as an executive remains employed by a company) whereas "motivational components" are designed to encourage an executive to generate performance (e.g., Performance Share Units, awarded only for achieving goals set for certain performance metrics).
3. Source: ExecComp Analytics (ECA); ISS-ESG Executive compensation database
4. For clarity, by 'sustained,' we mean that awards made under a company's long-term incentive program are measured against performance goals achieved and maintained over a multi-year period.
5. For clarity, by 'replacement equity' we are referring to awards commonly issued to an executive in assumption or substitution of awards previously granted by an entity with whom the company is now undergoing a merger, acquisition or other transaction; According to [NYSE listing standards rule 303A.08](#), "an employment inducement award is a grant of options or other equity-based compensation as a material inducement to a person or persons being hired by the listed company or any of its subsidiaries, or being rehired following a bona fide period of interruption of employment. Inducement awards include grants to new employees in connection with a merger or acquisition."
6. Source: A [vote bulletin](#) detailing our vote rationale for each of these case studies provides greater details around the context, our assessment, vote, and sometimes subsequent follow-up. Intel: <https://www.blackrock.com/corporate/literature/press-release/vote-bulletin-intel-may-2022.pdf>; Chevron: <https://www.blackrock.com/corporate/literature/press-release/vote-bulletin-chevron-may-2022.pdf>; Netflix: <https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-netflix-jun-2022.pdf>; Consumer automotive companies on page 42 of BIS 2022 Voting Spotlight: <https://www.blackrock.com/corporate/literature/publication/2022-investment-stewardship-voting-spotlight.pdf>
7. "Say on Pay" is the generic expression referring to the ability of shareholders to vote on a company's compensation policy, plan, and/or practices

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