Evaluating executive compensation in times of crisis

Vanguard’s Investment Stewardship team has engaged with hundreds of companies during the COVID-19 crisis, and many companies and their boards have asked about our approach to evaluating executive compensation. As the pandemic continues, we offer the following perspectives to make portfolio companies, clients, and other stakeholders aware of our expectations on behalf of the Vanguard funds.

Our philosophy hasn’t changed

In our last Insights on compensation, we shared key considerations for well-structured executive compensation plans that could withstand the most challenging market and economic conditions, including a pandemic. Although we recognize the unprecedented challenges that companies have faced and that will continue to play out over the coming months, our philosophy on executive compensation has not changed. We look for compensation policies that incentivize long-term outperformance versus peers and drive sustainable value for a company’s investors.

Build long-term plans and stay the course

We continue to evaluate executive compensation case by case and look for a strong focus on performance and the long term. The Vanguard funds are more likely to support plans in which a majority of executive compensation remains variable, or “at risk,” with rigorous performance targets set well beyond the next quarter. Companies across all sectors have experienced varying levels of disruption from the COVID-19 pandemic, including many businesses that have had to fully or partly close following government-mandated lockdowns.

Vanguard understands that the crisis may have hurt companies’ performance. However, we remain steadfast in our view that compensation committees should not retroactively adjust performance targets or time horizons, despite the challenging environment. “At-risk” compensation should remain at risk, just as the Vanguard funds’ capital does—along with that of other shareholders. We believe that the experiences of shareholders and executives should be aligned in both good and challenging times.

Align relative metrics with shareholder interests

We reiterate the importance of using relative performance metrics, such as relative total shareholder return. Using a relative metric is an important way to ensure that performance is measured appropriately relative to peers. If a company is performing poorly but doing better than a subset of its peers, then its executives would be appropriately rewarded. Companies with executive compensation plans that included these metrics before the pandemic should remain on course and will be better positioned to navigate complex compensation decisions during future downturns.

Appropriately balance structure and discretion

Executives have navigated the pandemic while managing unexpected risks and expenses involving workplace health and safety, extreme market volatility, shifting business models, and shocks to supply and demand. Although short-term actions may have been necessary since the start of the pandemic to guide a company back on track, long-term incentives should continue to focus on creating value for years to come.

Vanguard understands that companies may need to adjust their targets or metrics for future awards, but retroactive changes to in-progress plans may raise concerns about the structure of a compensation plan. Adjustments to compensation using upward discretion that boosts executive payouts should reflect the current experiences of a company’s shareholders and stakeholders. If its workforce suffered mass layoffs (or redundancies), for example, or if the company accepted significant financial support from the government, increased year-end incentives for executives would call into question the appropriateness of the compensation plan. In most cases, executives’ awards should not be buffered from the challenges of these difficult times.
In the same regard, compensation structures that allow for outsized incentives tied to pre-pandemic stock prices should have appropriate measures in place to ensure that executives are rewarded for relative long-term performance, not for a broad-based market recovery. Company boards should consider how executive pay decisions might affect public perception of the company’s practices.

Communicate and disclose key changes

If a board does make changes to its compensation plan, the company should provide robust disclosure so that shareholders and stakeholders can understand the board’s rationale. Companies should not wait to engage with investors to explain their approach to compensation. Vanguard will look for clear, detailed, and meaningful disclosure that provides appropriate context and enables peer comparison. Periods of crisis and distress are not the time for boilerplate language.