

Vanguard Investment Stewardship Insights

Executive compensation: In uncertain times, good judgment is critical for boards



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Note: Vanguard publishes Investment Stewardship Insights to promote good corporate governance practices and to provide public companies with our perspectives on important governance topics and key votes. This is part of our growing effort to enhance disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide additional clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can do.



Businesses and investors are navigating a truly complex moment in history. COVID-19 has taken a devastating toll on human life, health, and well-being. Individuals are facing financial insecurity; companies are trying to survive through the most volatile market and economic conditions in memory. Rarely have the complex roles of company leaders and board members been more crucial or challenging than they are today.

Because the crisis is both economic and personal in nature, many companies' **executive compensation/remuneration plans** are receiving greater scrutiny from investors, employees, and other stakeholders. The scrutiny is heightened particularly for companies that are laying off workers, reducing employee pay, dealing with employee safety issues, receiving government financial support, or experiencing declines in share price performance.

A pillar of good corporate governance

While the current market environment is new, Vanguard's perspective on executive pay is not. Performance-linked compensation policies focused on the long term can be fundamental drivers of sustainable practices, long-term growth, and shareholder value. There is no universal approach to executive pay; expectations and norms vary by industry type, company size, and region. On behalf of the Vanguard funds, we continue to evaluate executive compensation proposals on a case-by-case basis and look for pay plans that incentivize long-term outperformance versus peers.

Considerations during the crisis

As boards set and manage executive pay plans, Vanguard encourages directors to be guided by good judgment on critical short-term matters (such as financial survival and workforce safety) as well as longer-term factors that align with a company's purpose and strategy. We offer the following considerations to boards:

Variable pay. Variable compensation is meant to form an integral part of "at-risk" pay in order to align management with shareholders' interests. The Vanguard funds may support plans in which variable compensation makes up the majority of executives' total pay and is measured with a long-term focus beyond the next quarter or year.

Performance targets. In general, we do not believe it is appropriate for compensation committees to adjust or create "easier" performance targets, especially now, despite the challenging environment. Simply stated, at-risk pay should remain at-risk.

Relative performance metrics. The use of relative performance metrics such as relative total shareholder return is a key component of a plan that supports pay-for-performance alignment. While these metrics are important during good market conditions, they are crucial amid downturns. In volatile markets, comparing relative performance metrics with those of a relevant set of peers helps guard against outsized payments for market recovery versus true long-term company outperformance.

Awareness, context, and communication

Vanguard recognizes that during these uncertain times it is difficult for directors to set long-term targets. We encourage boards to apply both a financial and, increasingly, a social lens when considering how executive pay, human capital, or capital allocation decisions factor into the overall context and public perception of a company's practices.

Boards should apply discretion to executive pay outcomes and be thoughtful about the reputational risks that may be associated with awarding large payouts at the wrong time. We welcome the board's discretion to adjust the timing or amount of payouts to better align with the experiences of shareholders and stakeholders. With any change to executive pay outcomes, we expect increased communication and disclosure about the board's decision process and rationale for the changes. Always important, such communication between companies, shareholders, and other stakeholders is critical in times of crisis.