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S&P 500 Report

Do 2020 Trends Foretell the Future?

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Executive Summary

COVID-19, Say on Pay and Diversity Stand Out in 2020 Proxy Season

Executive compensation has been a topic of interest for many years. Proxy Season 2020 opened as the COVID-19 pandemic began to create large-scale disruptions in economic and commercial activity in the U.S. As turbulently as it began, it ended amid civil unrest against systemic racism with the Black Lives Matter protests. The uncertainty brought on by the pandemic cast a spotlight on corporate resiliency, risk management, and executive compensation, and is reshaping areas of corporate and investor focus.

CGLytics is releasing its second edition annual S&P 500 proxy season review to understand how America's largest companies by market capitalisation paid their chief executive officers (CEOs) compared to their performance. The analysis also focuses on other trends, such as CEO pay ratio and named executive officers (NEO) pay trends.

Key Takeaways:

- Pay cuts announced by S&P 500 companies could be argued to be a mere 'façade'. It was on average 6% of CEO pay for the 2019 financial year.
- Total Shareholder Compensation (TSC) and Total Realised Compensation (TRC) both climbed from 2018 to 2019. Notably, Total LTI Realised increased by 167%.
- The Communications Services sector has the highest-paid aggregate compensation in the index.
- Long-Term Incentives (LTI) continue to dominate CEO average pay. LTI awards represent over 70% of the average CEO pay. Base pay, however, forms an insignificant portion. From our analysis, the data suggests that base pay constituted only 5.9% on average of total CEO compensation mix in the S&P 500 in 2020.
- Over three quarters of S&P 500 companies fail to align executive compensation with performance.
- The IT sector has the least relative alignment between pay and performance: Only 15 percent of IT companies show alignment between pay and performance. Of the remaining companies in the IT sector of the S&P 500, 45% display relative misalignment between pay and performance.
- The 35 highest-paid CEOs on the S&P 500 reviewed in this report received an aggregated, absolute combined TRC of over USD 3.3 billion, up by 23.6% from the 2018 figure of approximately USD 2.67 billion.
- Employee pay significantly lags behind CEO pay: The data suggests that the average CEO pay ratio is 262 in the index.
- Women are vastly outnumbered in executive roles in the S&P 500. Only five percent of companies in the S&P 500 were headed by women in 2019, and women are still vastly underrepresented in executive roles.

We conducted a study on compensation of executives in the S&P 500 to determine its correlation to performance measures, such as Total Shareholder Return (TSR). In this paper, we examine executive compensation over a 12-year time frame (from 2008 to 2020) in order to provide insight into the changes in executive compensation over this time period. Also included in the report is the degree of alignment study, which was determined by subtracting the compensation rank from the performance rank within a scope of +20 or -20. Results obtained on either side determine a more generous or a conservative remuneration policy.

Key Findings

A key development of the 2020 Proxy Season was the surge in virtual shareholder meetings. While some shareholders worried that this change would allow companies to shy away from accountability and criticism, virtual general meetings enabled higher levels of shareholder participation.

COVID-19 and Issuers' Reaction to Executive Pay; Pay Cuts Merely a 'Facade'

The coronavirus (COVID-19) has affected global markets and is likely to leave a lot of economies in a state of uncertainty for the near future. Companies in various industries and markets have experienced changes in demand and in supply; while some have been impacted negatively, others have also benefitted from shifted consumer choices. Looking at the constituents of the S&P 500, several common responses to the COVID-19 pandemic can also be seen from the lenses of corporate governance. All over the globe, executives and members of the boards of directors of many of the world's largest companies announced pay cuts, perhaps for themselves as a cost-cutting measure and/or to show solidarity with their employees in these times. From our analysis, the data suggests that 116 companies in the S&P 500 issued some form of pay cuts to their CEO compensation. It is worth mentioning that most issuers announced pay cuts within a certain time frame of less than a year.
To determine the actual pay cuts when comparing to the total compensation of 2019, we had to annualise the pay cuts. This has enabled us to have a true picture of the pay cuts on an annual basis.

Salary Cut Range	Number of Companies	Average Cut vs Total Realized Compensation
0%-10% of Base Salary	68	-3%
10%-25% of Base Salary	8	-15%
25%-50% of Base Salary	4	-28%

The data suggests that more than 50% of the companies that issued pay cuts in the S&P 500 issued pay cuts within the range of 0%-10% of their base salary. For these companies, we find that the average cut represented only 3% of their 2019 compensation. Annualising the percentage of salary cuts, we again find that S&P 500 companies did not issue cuts above 50%. The average CEO pay cut was approximately only 6% of CEO pay in 2019. This outcome is not surprising given that base salary forms a small percentage of CEO compensation design. Regardless, we find that other issuers also announced certain compensation cuts which did not conform to the base salary cuts that most of the companies did. Of this, the data suggests that 28 companies said they had issued pay cuts to their CEO pay but did not disclose what exactly the pay cut was. Seven companies also announced other measures to reduce pay, which included and was not limited to donations to charity.

General 2020 AGM Overview: Appointment of Directors and Executive Compensation

In our 2019 Proxy Season reflection, we maintained that opposition from shareholders for executive compensation issues was at an all-time high. However, in 2020, did that statement still hold true? Did shareholder opposition on executive compensation issues from Proxy Season 2019 continue into 2020?

Like the previous year, in 2020 director elections and executive compensation programs continued to see more than 90 percent approval on average. During the entire 2020 Proxy Season, shareholders voted on 4,734 resolutions to elect individual directors. Of these, only 350 (7.4%) received more than 10 percent opposition votes. Only one director, Jay Hoag of Netflix, did not secure majority support.

Total votes against remuneration programs have decreased slightly since the previous proxy season. Fewer than 10 companies did not secure majority support for their executive compensation practices (both individual plans as well as say-on-pay combined), and 131 out of 448[1] companies (29%) had more than 10 percent votes against. The average shareholder support for remuneration-related proposals was 88 percent, with companies in the Financial sector receiving the highest number of votes (10%) against executive compensation plans.

QUALCOMM, Inc. (83 percent against), Electronic Arts (75 percent against), and DXC Technology Company (68 percent against) are instances of significant shareholder discontent. Often the cause of an opposing vote will be the relationship between pay and performance, problematic pay practices, or the questioned rigor of performance goals. In conclusion, company proposals regarding board appointments and executive compensation are being approved at high rates. This is largely due to continued reform in incentive pay for executives as well as companies seeking a more robust composition of board membership.

ESG and Diversity: Real Progress or Talking Point?

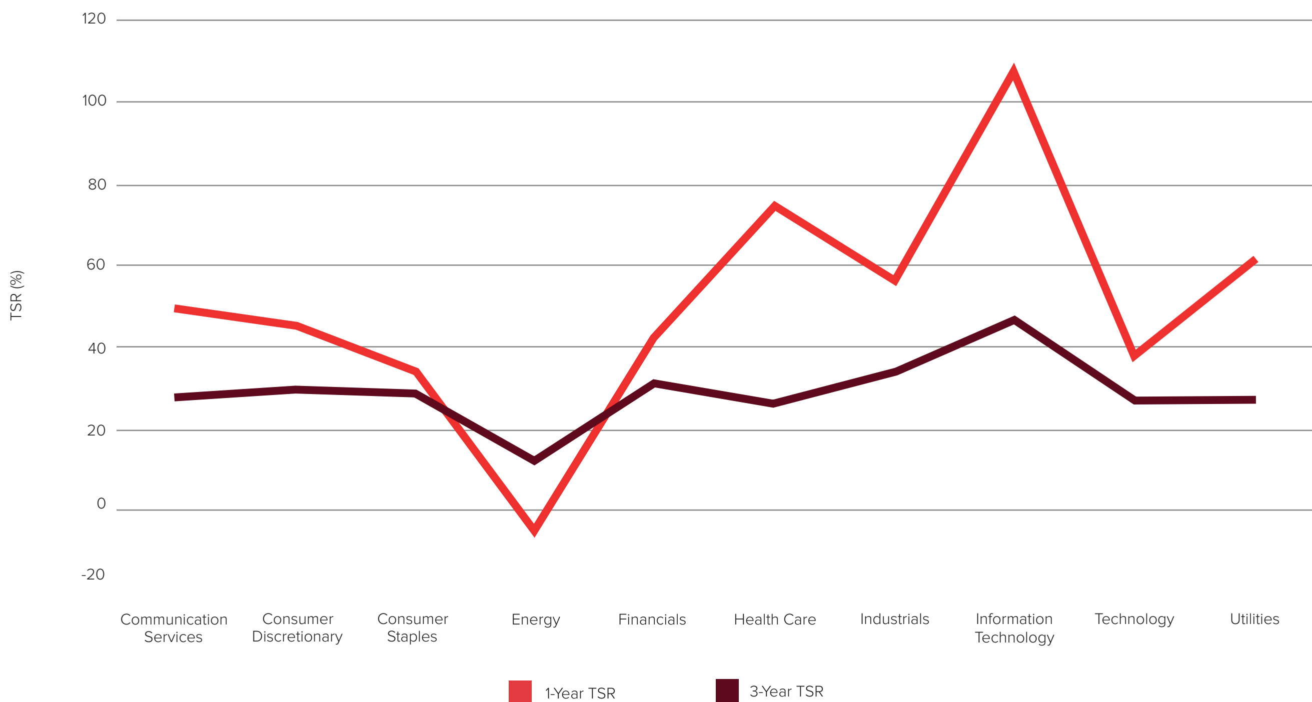
Shareholders are increasingly putting pressure on boards to diversify their membership across several dimensions, especially gender and race. While in 2008, 73 companies that are currently part of the S&P 500 did not have any female directors, in 2019 they all had at least one woman on the board. However, the same progress has not been observed at the executive level. Only five percent of companies in the S&P 500 were headed by women in 2019, and women are still vastly underrepresented in executive roles.

Several proxy disclosures in the S&P 500 highlighted company initiatives and commitments regarding diversity, environmental sustainability and pay disparities. However, as in previous proxy seasons, support for the shareholder proposals that were put to a vote remained low. For example, Amazon's shareholders did not approve shareholder proposals to establish reports on community impacts, viewpoint discrimination and promotion data. Only 15 percent of Amazon's shareholders voted to create a report on pay disparities based on gender and race. Another example is Alphabet, the parent company of Google. Alphabet did not pass any proposed motion to establish a human rights risk oversight committee or to issue reports on racial/gender pay and sustainability metrics. The only company who voted to establish an annual diversity report was Fortinet, Inc. (69 percent in favor).

1. 448 out of 500 companies had proposals related to executive compensation.

S&P 500 Financial Performance: TSR Shows Positive Growth

As shareholders continue to keep a close eye on remuneration plans and demand pay for performance alignment, it is important to understand the financial performance of S&P 500 companies. Between 2018 and 2019, the companies' average revenue and asset base increased by 3.11 percent and 6.97 percent respectively. TSR also increased by 36 percent in 2019, continuing an upward trend that had been momentarily halted by a steep 26 percent decrease in 2018. Except for the Energy sector, three-year TSR continued to be positive across all industries, with the Information Technology sector seeing a 108 percent increase from 2017 to 2019. Overall, three-year TSR was higher than one-year figures by 21 percent in 2019.

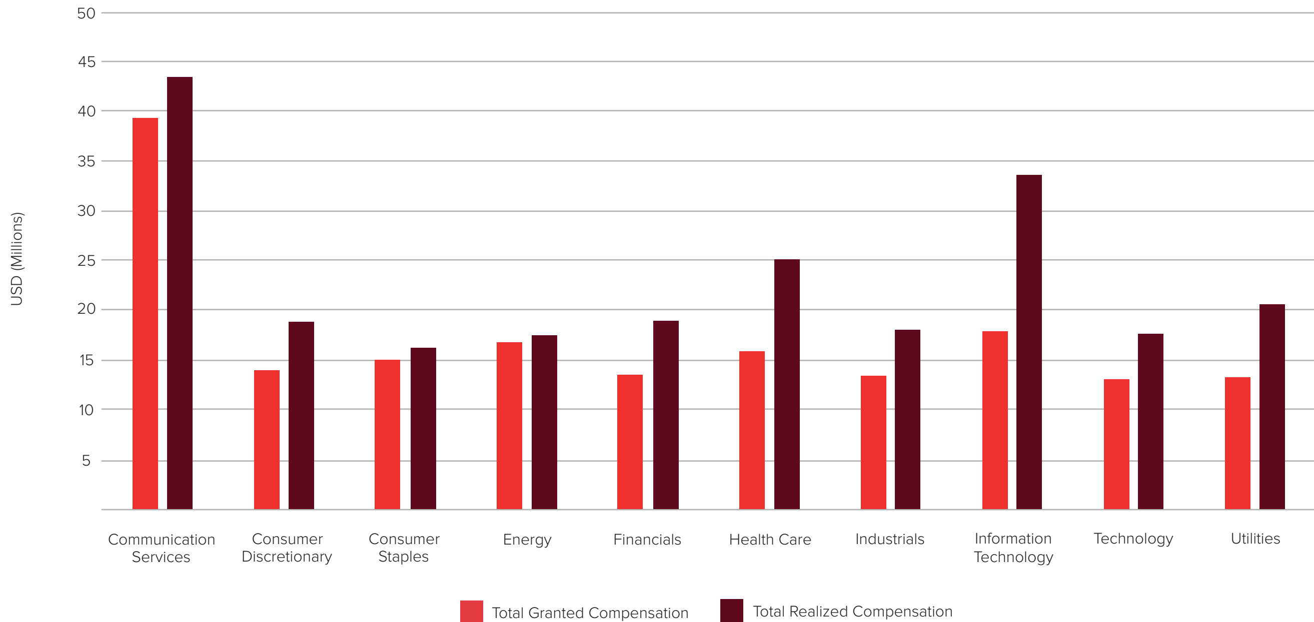


What Is Driving Executive Compensation?

Prior to the pandemic, companies in the S&P 500 index saw significant momentum in economic growth. Revenue, asset base and Total Shareholder Return (TSR) all increased across the board within the index, together with growth in average CEO compensation. However, shareholders continued to keep a close eye on remuneration plans and pay for performance misalignment. For the year in review, more than three quarters of S&P 500 companies displayed a misalignment between compensation and performance. Over the last few years, what stakeholders perceive as excessively high levels of CEO compensation has spurred pressure on boards to reign in their compensation practices.

CEO Pay on the Upward Trend

The chart below shows that realised pay was the main form of compensation in 2019 for S&P 500 companies. While the highest average realised pay occurred in the Communication Services industry[2] (USD 43.4 million), the IT sector saw the largest difference (187 percent) between total granted compensation (TGC) and total realised compensation (TRC). Executives in both industries realised an average of USD 29 million in long-term incentives in 2019.



While both TGC and TRC declined along with TSR in 2018, in 2019 they increased by 10 and 12 percent respectively as TSR values rose. The average TRC was nearly USD 22.5 million, growing 16 percent since 2014 and 117 percent since 2008. CEOs' average realised LTI awards increased from USD 6.3 million in 2008 to USD 16.9 million in 2019, showing a significant growth of 167 percent.

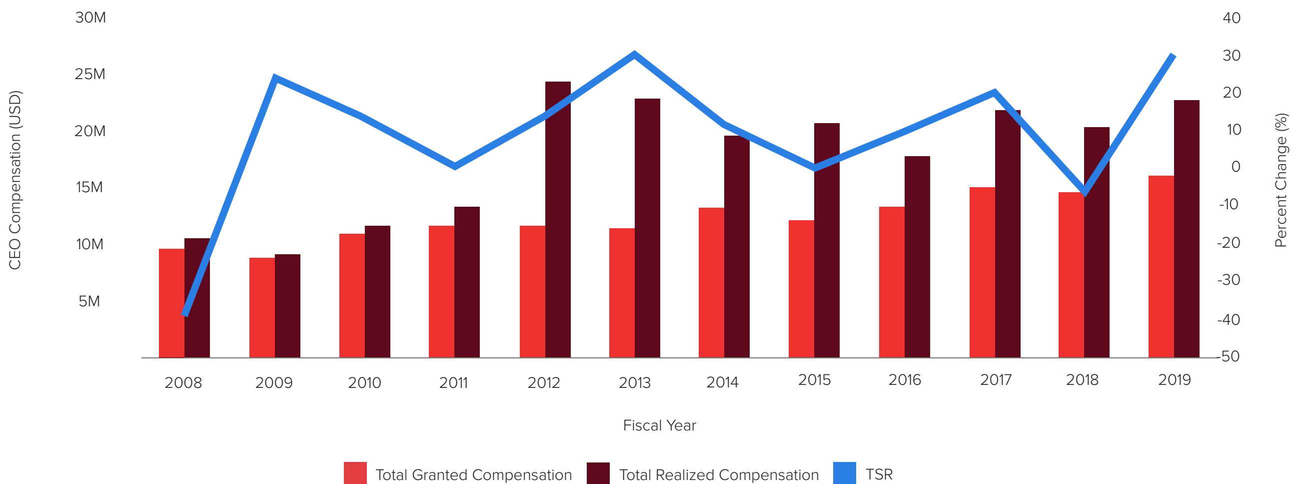
2. Such as Facebook or Verizon.

Is CEO Pay in Disparity with Company Performance?

Shareholders have consistently advocated for Pay for Performance alignment, making it a vastly important topic among compensation committees and shareholders themselves. Pay for Performance, simply put, is a compensation strategy that utilises salary, bonus, STI and LTI to incentivise executive performance in line with the company's actual financial performance, in either relative or absolute terms. This performance is generally independently measured among companies using predefined metrics or qualitative benchmarking. Pay for Performance is valuable because it aligns the interests of all parties (company, employee, shareholder) involved.

Many shareholder proposals and press articles have argued that CEO pay is on average too high, out of step with overall company performance. We therefore looked into the data to determine whether these assertions are valid and learn whether or not CEO pay is truly out of alignment with company performance. When comparing CEO compensation to company performance, we notice that, while granted pay has risen steadily over the years, realized pay tends to coincide with absolute growth in TSR. TSR, TGC and TRC have all increased in absolute terms between 2008 and 2019. With TSR at -39 percent in 2008, the average CEO received USD 9.5 million in granted pay and USD 10.3 million in realized pay. As TSR rose to 29 percent in 2019, CEOs received total granted pay and total realized pay of USD 15.9 million and USD 22.5 million, respectively.

Compensation vs. TSR: Absolute Growth



The average TGC growth was five percent between 2008 and 2019, with the greatest downturn (eight percent) occurring between 2014 and 2015. While realized compensation rose as well, it was also affected by fluctuations in the market. As TSR increased in 2017 and decreased in 2018, so did realized compensation. The only exception is the 2008-2011 period, where TGC was consistent despite significant changes in TSR. Overall, TRC has fluctuated with a noticeable three-year trend. It is important to remember that realized pay includes vested stock, which often vests in three-year periods. Furthermore, realized pay tends to coincide with absolute changes in TSR due to the latter often being a primary performance criterion of performance-based compensation plans.

Alignment Between Pay and Performance, Time for a Closer Look?

One of the key concerns asked by shareholders and stakeholders when evaluating executive compensation practices and policies at an individual company is whether or not the pay quanta are in step with the company's financial performance. Several arguments have been made that these quanta are actually more in line with similar pay practices based on sector or individual company particularities than company performance[3]. In this paper, we have compared company TSR to its CEO's realised compensation relative to all other S&P 500 companies, and we observe a broad range of results. A company that has a zero percent margin between the two criteria shows perfect Pay for Performance (P4P) alignment. PPG Industries Inc., was the only company to reach such a result in 2019. Companies that are ± 20 points from zero are considered to have a more conservative or generous remuneration policy. More than three quarters of S&P 500 companies show a disproportionate P4P alignment. This data can be used to evaluate a company's pay practice, the most significant factor driving say-on-pay votes during Annual General Meetings.

When pay is disproportionally higher than performance, it often invites deeper scrutiny into the company's pay practices and the board's rationale for the composition of executive pay packages. Eighteen companies reviewed during this study had TSR significantly lower than their CEOs' realized compensation, with the ratio between the measures placing them in the bottom 10th percentile. For example, Regeneron Pharmaceuticals had TRC in the 98th percentile and TSR in the bottom 10th percentile. Companies like ABIOMED, Inc., Occidental Petroleum Corporation, and DXC Technology Company demonstrated the strongest P4P misalignment.

On the other hand, four companies displayed particularly conservative P4P practices, with TSR significantly higher than their CEOs' realized compensation. The CEOs of Copart, Inc., Take-Two Interactive Software, DISH Network Corporation and Ingersoll Rand had TSR in the bottom one percent. Despite shareholder demands that executive pay should align with TSR, CEO compensation quanta remains somewhat arbitrary. The cases above where misalignment is at its greatest follows no particular pattern within the index based on sector.

S&P 500 companies that showed the greatest Pay for Performance misalignment (2019):

- ABIOMED, Inc.
- Occidental Petroleum Corporation
- DXC Technology Company
- Mylan, Inc.
- Cabot Oil & Gas Corporation

S&P 500 companies that showed the greatest Pay for Performance conservative pay practice (2019):

- Copart, Inc.
- Take-Two Interactive Software, Inc.
- DISH Network Corporation
- Ingersoll Rand Inc.

3. WSJ, Best-Paid CEOs Run Some of the Worst-Performing Companies'

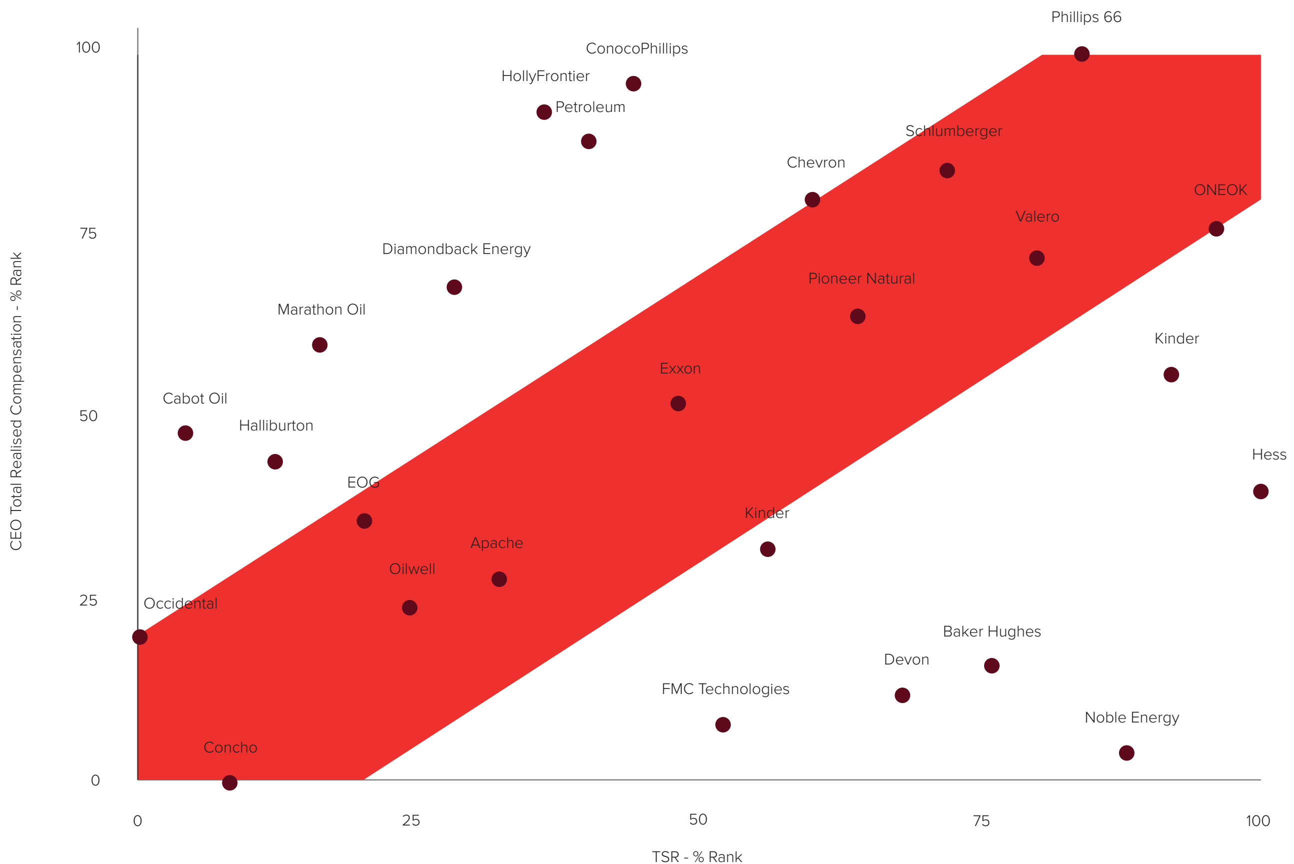
Understanding Pay vs. Performance by Sector

To understand whether some sectors were more likely to overpay or underpay their executives in 2019, we analysed the two industries with the highest and lowest average TSR: the IT sector and the Energy sector.

When considering a company's relative position within the Energy sector, there is an almost even split between companies whose P4P is aligned or misaligned. As shown in the S&P 500 Energy Sector chart below, the plotted points within the red region indicate a company whose pay is aligned with performance. Two companies are perfectly aligned, National Oilwell Varco and Pioneer Natural Resources.

While no company's realized pay is significantly higher than its performance, Cabot Oil & Gas Corporation displays a median compensation and TSR in the bottom 5th percentile. On the other hand, Noble Energy is an example of a company where performance (90th percentile) significantly eclipses compensation (bottom 5th percentile). Overall in 2019, a quarter of companies in the Energy sector displayed negative P4P alignment and a quarter performed in a way that outpaced executive pay. It is important to remember that 27% of companies in the Energy sector had negative TSR.

S&P 500 - Energy Sector
Total Realized Pay vs. TSR (2019)



While half of companies in the Energy sector are aligned, only 15 percent of IT companies show alignment between pay and performance. Forty-five percent of companies have compensation that is significantly higher than performance, and 38 percent of companies demonstrate more conservative pay practices. As for the Energy sector, only two companies are perfectly aligned, Juniper Networks and NVIDIA Corporation. However, while the Energy sector includes 26 companies, the IT sector is made up of 71 companies. This means that IT companies are less likely to show alignment between pay and performance compared to the Energy sector. With a TSR of -28 percent, DXC Technology shows the worst P4P misalignment. Conversely, CDW Corporation's performance (top quartile) significantly eclipses compensation (bottom 5th percentile).

Companies with greatest pay for performance misalignment, IT:

1. DXC Technology Company
2. F5 Networks, Inc.
3. Cognizant Technology Solutions Corporation

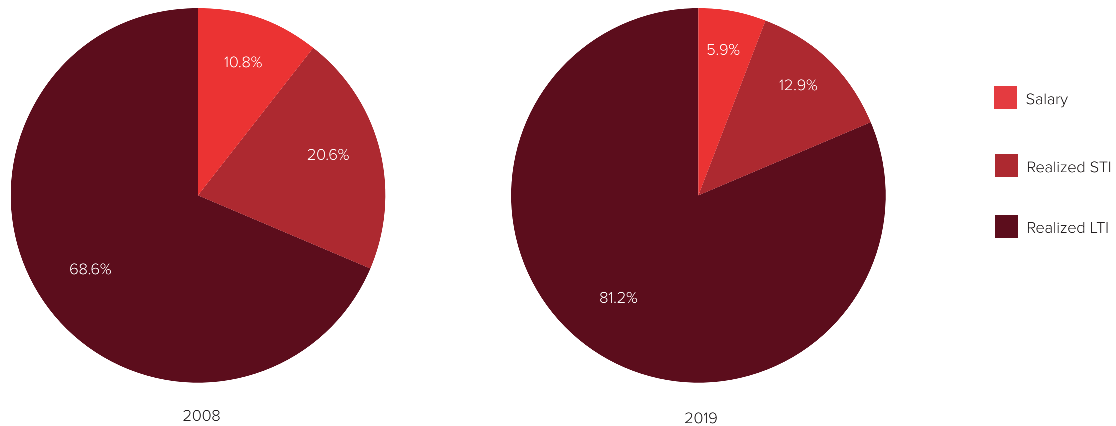
Companies that showed the most conservative P4P practices, IT:

1. CDW Corporation
2. FLIR Systems, Inc.
3. Seagate Technology PLC
4. Skyworks Solutions, Inc.

Long-Term Incentives Dominate Design of Compensation Mix

The compensation mix for CEOs in the S&P 500 has not significantly changed since the previous fiscal year. However, pay structure has meaningfully changed over the last decade. Increasingly, LTI awards for CEOs are based on company performance, as measured by performance criteria such as EPS, an increase in operating cash flow, or other similar metrics. This is in contrast to executive salaries, which are typically based on seniority of position and underlying responsibilities. The visuals below represent the compensation mix in terms of salary, short-term incentive and long-term incentive pay in fiscal 2008 and 2019. Companies in 2019 remain intent on including more realised LTI compensation. Shareholders again often encourage a higher percentage of LTI in order to ensure that executives are focused on the company's long-term performance. In 2008, the average LTI component represented 68.6 percent of total CEO pay. A decade later, in 2018, the average LTI portion of pay rose to 76.9 percent. The trend continues into 2019, where LTI awards and pay rose once again to 81.2%. Additionally, salary dropped to 5.9 percent and realized STI dropped to 12.9 percent.

S&P 500 CEO Compensation Mix 2008 vs. 2019

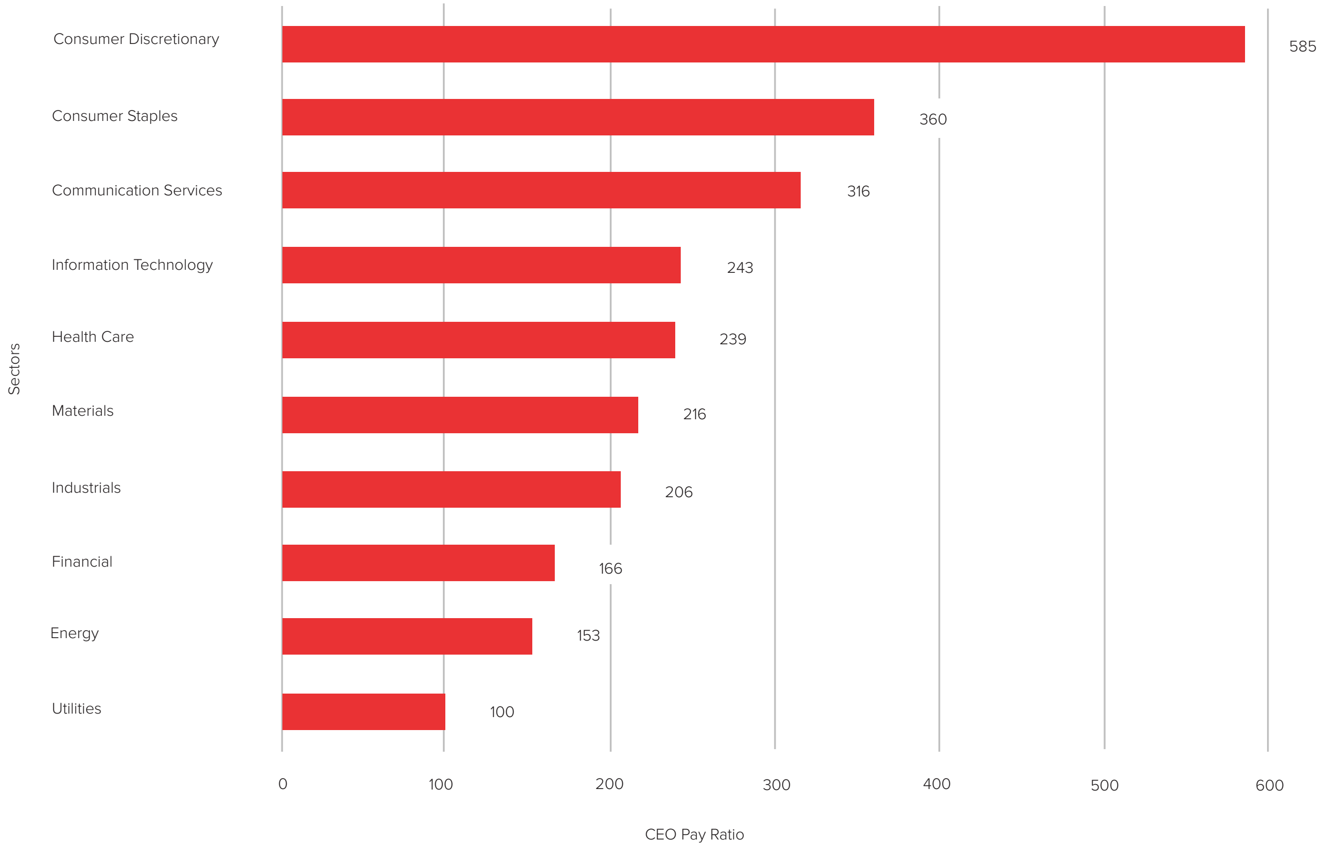


- The 35 highest-paid CEOs on the S&P 500 reviewed in this report received an aggregated, absolute combined TRC of over USD 3.3 billion. This was a relatively significant increase from FY 2018, when CEO pay totalled approximately USD 2.67 billion. To put that in perspective, the top 35 CEOs had an average compensation of USD 96.67 million this year. Realized pay continues to be the main component of compensation year after year.
- Notable compensation figures in 2019 include Reed Hastings at Netflix, Inc., who received TRC of USD 222.6 million, nearly doubling the front-runners of 2018. Both Tim Cook of Apple and Robert Sands of Constellation Brands, Inc., received TRC of approximately USD 125 million in compensation.
- Though not always the case in previous years, in FY 2019 there seemed to be an alignment between CEO pay and Company TSR. As shown in the 'Is CEO Pay in Disparity with Company Performance?' section above, in 2019, TGC and TRC rose in conjunction with a 29 percent growth in TSR.

CEO to Employee Pay Ratio: How Much Is Too Much?

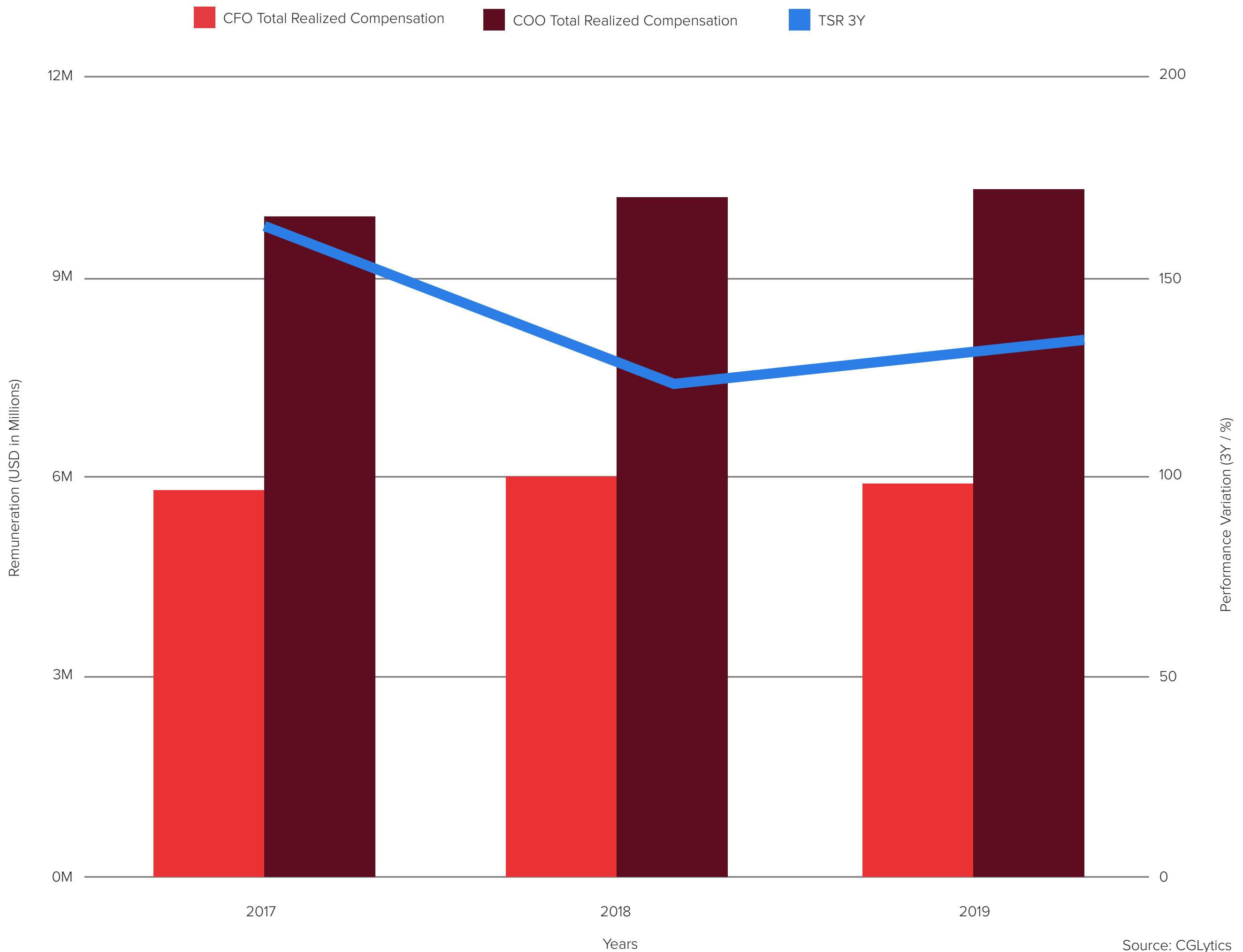
In a move designed to improve transparency and assist shareholders in say-on-pay decisions, the Securities and Exchange Commission ruled that registrants must provide CEO pay ratio information. The average pay ratio for all S&P 500 companies in 2019 was 262:1, meaning that it would take a median worker 262 years to earn an S&P 500 leader's annual pay. If a company is in the 90th percentile of the index, its CEO earns 513 times more than its median employee. The company with the lowest pay ratio was Twitter, with its CEO Jack Dorsey earning only USD 1.4 million compared to the median employee's USD 213,155. On the other hand, Aptiv PLC had the highest pay ratio of the index, with CEO Kevin Clark making 2,077 times more than the company's median employee. Aptiv was closely followed by McDonald's Corporation (1,939:1) and NIKE, Inc. (1,935:1). In total, 10 CEOs in the S&P 500 had compensation that was more than 1000 times their median employee's in 2019.

The magnitude of the ratio appears to vary highly according to which sector the company falls in. The Consumer Discretionary sector had by far the highest pay ratio, more than double the average for all S&P 500 companies. On the other end of the spectrum are the Financial, Energy and Utilities sectors, whose averages range from 100 to 166.



Overview of CFO and COO Compensation

Data analysis from other executives, such as the chief financial and chief operating officers (CFOs and COOs), also offer valuable insight into the S&P 500's 2019 fiscal year. The chart below shows that S&P 500 COOs are paid, on average, approximately USD 3,000,000 more than CFOs over the last three years. Additionally, both CFO and COO pay have risen slightly over the last three years, while TSR has fluctuated from 48.8, 35.1 and 51.6 percent in 2017, 2018, and 2019, respectively. Based on this information, we are able to infer that in terms of both 3- and 5-year relative TSR, CFO and COO compensation is not directly correlated with company performance.



The 35 highest-paid CFOs in the S&P 500 received a total combined Total Realized Compensation (TRC) of approximately USD 782 million, an average of USD 22.3 million. In contrast, the 35 highest-paid COOs received an aggregate amount of USD 976 million, or an average of 27.9 million. The COO year after year remains the breadwinner between the two vital executives, earning about USD 5.5 million more in Fiscal 2019. Sheryl Sandberg of Facebook Inc., was the year's highest-paid Chief Operating Officer, earning nearly USD 250 million, while Facebooks' Chief Financial Officer was also among the top 35 highest-paid CFOs. Other companies to have both executives included within the top 35 of the index are AT&T, Inc., ConocoPhillips, MSCI Inc., and PayPal Holdings, Inc.

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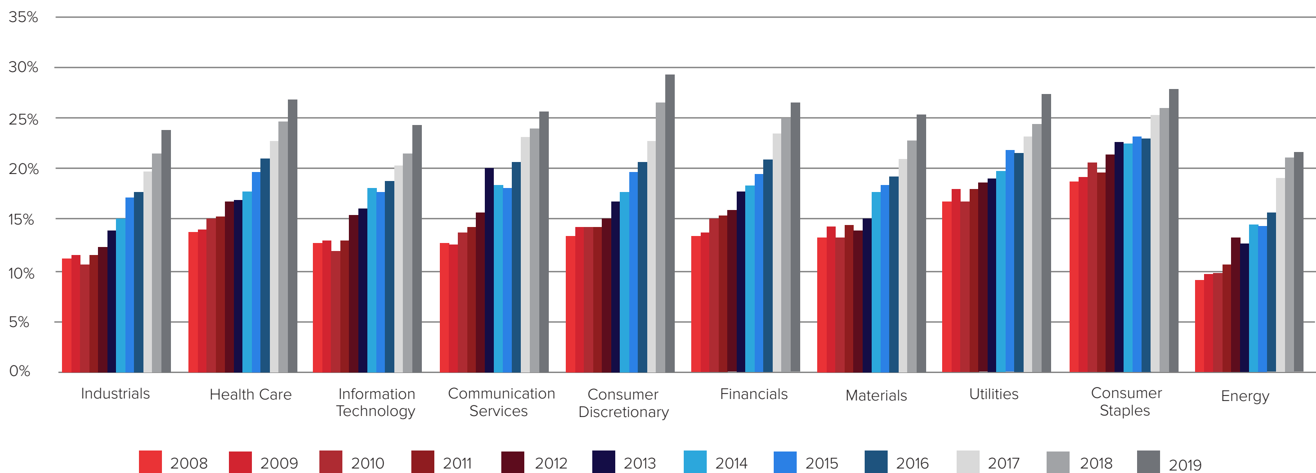
S&P 500 Gender Diversity: Still a Long Way to Go

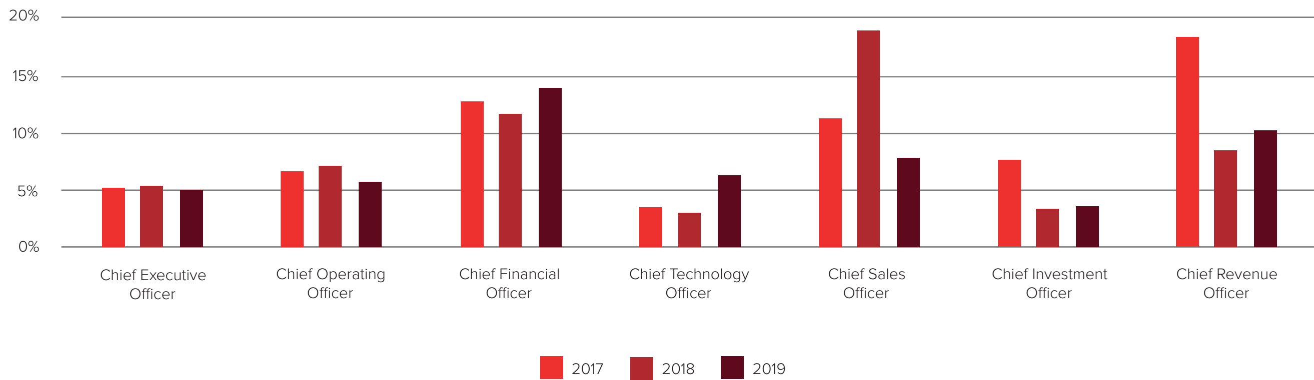
Amid the rising tide of support for gender diversity, companies have been actively working to increase the number of women on boards and executive teams. In this review, we sought to determine whether the diversity efforts of S&P 500 companies had any tangible effect.

Between 2008 and 2019, the number of women sitting on S&P 500 boards clearly improved across all sectors. While only 13 percent of board members were female in 2008, the number has since doubled.

The Consumer Discretionary sector is the one with the greatest female representation and the one where the number of female board members has grown the most, from 14 percent in 2008 to 29 percent in 2019. Conversely, the Energy sector has the lowest percentage of female board members (22 percent), followed by IT and industrial companies.



As for executive roles, only 27 companies had female CEOs in 2019. Only five percent of companies in the S&P 500 were headed by women, a figure that has not changed over the past few years. In 2019, CFO was the role with the highest female representation at 14 percent. With three percent of roles filled by women, chief investment officer is the role with the lowest number of female executives. While 19 percent of chief sales officers were women in 2018, only eight percent of these roles were held by women in 2019. Progress is being made on boards but women are still vastly underrepresented in executive roles.



Improving Corporate Governance in 2020

On trend with evolutions in corporate governance over the past couple of years, the 2020 Proxy Season highlighted progress in various talking points across the entire S&P 500 index. Over the past few years, there has been a significant increase in both the total number of women serving on company boards and the overall percentage of directors who are female. In 2019, approximately 67 percent of S&P 500 companies reported at least three female members on their board of directors, an increase of 11 percent from 2018 and a 30 percent increase from just three years ago. Additionally, every single board included at least one woman. Though this represents progress, the fact remains that approximately 95 percent of chair and CEO positions are still filled by men. Change is slow, but efforts to improve gender diversity are showing momentum and tangible results.

We also see continued improvement in the disclosure of racial and ethnic diversity numbers. In addition, this past year saw a greater level of inclusion of the use of skill matrices among directors and director nominees to create more balance in the skill set diversity of boards of directors. We anticipate this trend to continue and accelerate in the wake of the experiences of 2020.

2019 was a record year for companies making commitments on ESG and sustainability issues. Similar to the past several proxy seasons, the most significant portion of pay-related proposals were in consideration to tying executive compensation to different environment and social factors.

2021 Proxy Season: Trends and What's to Come

In our 2019 report, we discussed activist investors' engagement in shaping policy for executive compensation, strategy, and performance; ESG issues; and board diversity. These trends continue to surface and remain at the forefront of AGM discussions. Nearly a decade after the enactment of the Dodd-Frank Act into law, it seems that CEO pay ratio will increasingly become a prominent and standard metric in the shaping of compensation practices[4].

Reduced commercial activity due to the COVID-19 pandemic will have a significant impact on both short- and long-term performance-based compensation. Many executives reduced their base salaries temporarily to deal with losses due to the pandemic but continued to receive time-based stock. With many outstanding business plans and performance goals rendered obsolete, companies have no current certainty about the timing or pace of recovery to reinstate these plans with confidence.

It may be fair to expect a continued push for board diversification in terms of directors' gender, race, ethnicity, age and skillset. Trends over the last decade have shown that companies are trying to bring in more diverse and younger individuals, although they aren't always succeeding. In addition to more opportunity, Proxy Season 2020 brought out the highest percentage of directors who only serve on one board, further exemplifying companies' commitments to listening to investor recommendations.

This issue, which has been a talking point among activist investors over the past few years, is significant because of the commitment it takes to serve on several company boards (either public or nonpublic). In fact, overboarding was the second most-cited reason for Glass Lewis to recommend a withhold vote from a nominee. We note that the primary reason that Glass Lewis recommended to vote against individual directors was for boards with concerns over their level of independence. We can also expect to see further disclosure in important data points, such as the percentage of diverse groups represented and the inclusion of skill matrices.

As highlighted by the uncertainty brought on by the ongoing pandemic, we expect that risk management, executive compensation changes, supply chain resilience and capital allocation – particularly concerning share buybacks or reverse stock splits, will continue to be areas of focus for companies and shareholders alike.

Lastly, we are left with curious questions regarding the long-lasting effects of a pandemic in which the corporate world thrived virtually. Could there be potential development in virtual meetings as well as full virtual work environments going forward? How could these affect a company's free cash flow? It is equally as important to consider the effects that a virtual work environment might have from a governance standpoint. How will shareholders regard the competence of management in such environments? Questions like these remain as we approach Proxy Season 2021.

4. In response to the financial crisis of 2008, the Dodd-Frank Wall Street Reform and Consumer Protection Act was a major financial overhaul enacted in July 2010. The Act was put in place to regulate the financial markets and protect consumers and mandated the inclusion of say on pay for investor approval at their AGMs as well as disclosure of the CEO pay ratio in U.S. companies' proxy statements.

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