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RESEARCH
Viewpoint on Executive Compensation

S&P 500 CEO Compensation Increase Trends

2020 pay held flat and projected to increase in 2021 and 2022 due to rebound in stock market and very competitive labor market

AUBREY BOUT, PERLA CUEVAS, JOSE LAWANI, AND BRIAN WILBY

Executive Summary

- CEO median actual pay among S&P 500 companies remained flat in 2020.
- Overall, actual CEO pay in 2021 will potentially increase in the low- to mid-single digits due to higher bonuses and larger LTI awards (at some companies) amid strong performance coupled with conservative bonus goals set during the pandemic.
- In the past, CEO pay increases have been supported by historical total shareholder return (TSR); in fact, annualized pay increases have been 10% lower than TSR performance.
- We expect median CEO target pay increases in early 2022 to be in the mid-single digits as the economy and companies continue to grow; in high-growth industries, CEO increases could be greater than 10% due to a highly competitive labor market.
- Individual CEO pay increases will continue to be closely tied to overall company performance and peer group compensation increases; it is notable that S&P 500 TSR was +18% in 2020 and 29% in 2021, primarily driven by large-cap technology companies.
- Performance share plan usage declined slightly with 92% of S&P 500 companies employing them — likely due to the difficulty of setting multi-year goals.

Introduction and Summary

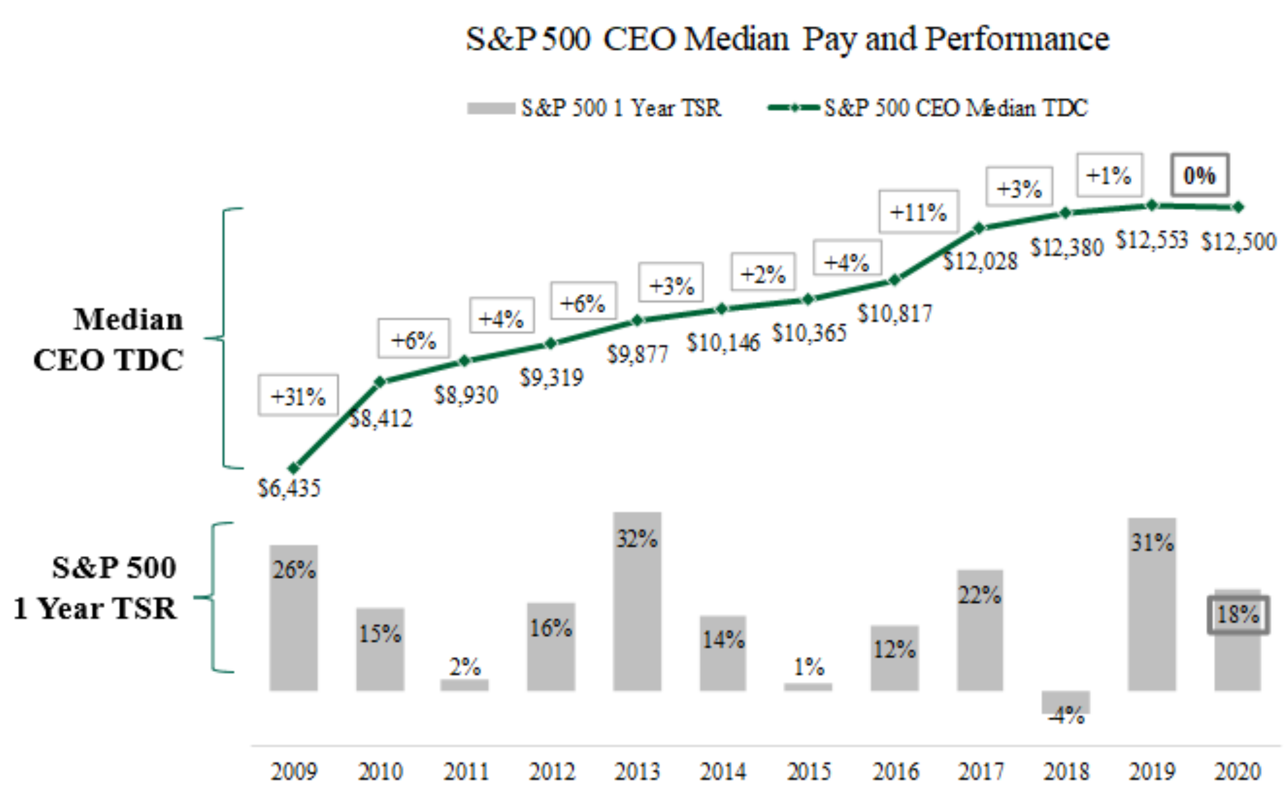
CEO pay continues to be discussed extensively in the media, in the boardroom, and among investors and proxy advisors. Despite strong TSR in 2020, CEO pay remained flat due to the negative impact of the COVID-19 pandemic, particularly resulting from lower bonus payouts. CEO median total direct compensation (TDC; base salary + actual bonus paid + grant value of long-term incentives [LTI]) increased at a moderate pace in the first part of the last decade: in the 2% to 6% range for 2011-2016. CEO pay accelerated with an 11% increase in 2017 — likely reflecting sustained robust financial and total shareholder return (TSR) performance — before returning to 3% in 2018 and 1% in 2019, more in line with historical rates. Our CEO pay analysis is focused on historical, actual TDC, which reflects actual bonuses based on actual performance; this is different from target TDC or target pay opportunity, which uses target bonus and is typically set at the beginning of the year.

As proxies are filed in early 2022, we expect that 2021 overall CEO actual TDC will increase in the low- to mid-single digits and possibly as high as 8% as some companies gave larger LTI grants. We expect bonus payouts to be potentially higher as a result of conservative goals set during a time of COVID-19 uncertainty. There will be some variation with companies in strong-performing industries likely seeing higher increases in compensation. CEO 2021 actual pay will be supported by steady base salaries and LTI grants, as most companies had strong financial performance at the time awards were granted (typically Q1). With regard to 2022 CEO target pay, we are expecting increases to be in the mid-single digits given very strong financial and TSR performance (S&P 500 was +29% in 2021) as the economy continues to grow and Boards increasingly try to motivate and retain executives in a very competitive labor market. Executives in industries with favorable economic conditions and higher growth (e.g., technology and biotechnology) will likely see more significant pay increases (greater than 10%) while those in hard-hit industries may see flat target pay.

Historical Trends in CEO Actual Pay and LTI Vehicles

CEO pay rebounded 31% in 2010 after 9% and 13% decreases during the financial crisis of 2008 and 2009, respectively. Since then, year-over-year pay increases have been moderate — in the 1% to 6% range — except for the 11% increase in 2017 (Figure 1). A rebound in pay is expected in 2021 and 2022, but not as dramatic a change as during the "Great Recession," as pay did not decrease at the median this time around although CEOs in industries negatively impacted by COVID-19 did see substantial decreases.

Figure 1:



Over the last 10 years, LTI vehicle use has shifted away from stock options, mostly in favor of performance-based plans. From 2010-2020, performance plan and restricted stock prevalence increased, and stock option prevalence decreased (Figure 2). The rise in performance-based plans can largely be attributed to the introduction of Say on Pay and the preferences of proxy advisors and some shareholders for LTI programs that they consider to be "performance based" (note: the proxy advisors do not consider stock options with only time-vesting features to be performance based). This being said, the prevalence of performance-based awards declined slightly in 2020, likely due to the difficulty companies had in setting multi-year goals with confidence during the pandemic.

Figure 2:

Year	LTI Vehicle Prevalence for S&P 500 CEOs		
	Performance Plan	Stock Options	Restricted Stock
2009	50%	70%	46%
2014	83%	59%	59%
2019	94%	50%	69%
2020	92%	47%	67%

Trends in CEO Pay versus S&P 500 Index Performance

In recent years, CEO actual pay increases have been supported by strong company TSR. In fact, pay increases over the last 10 years have trailed TSR performance by ~10% when examining the compound annual growth rates (CAGR) of compensation and shareholder return: the TSR CAGR was 14% while CEO pay grew at 4%. TSR performance is notable for 2019 and 2020 (31% and 18%, respectively); however, CEO pay generally remained flat, changing by only 1% and 0%, respectively (Figure 1). This moderation in pay in recent years can mostly be explained by companies and Boards exercising good judgment and restraint due to the COVID-19 pandemic.

There is a positive correlation between share price performance and CEO pay. In a positive stock price environment, Compensation Committees are often more supportive of CEO pay increases, typically delivered via larger LTI grants, while CEO base salaries increase modestly or periodically (i.e., less frequently than an annual basis) and comprise a small portion of the executive pay package. Annual actual bonuses, though not as significant as the LTI portion of total compensation, can have a meaningful impact on whether compensation grows year over year. When a company is having a good year and is exceeding budget goals as well as investor and analyst expectations, the CEO bonus often pays above target and increases year over year (often, the share price also increases as company performance is strong). That said, there will be some years where a CEO's bonus pays above target when the company exceeded its budgeted goals while the share price declines due to stock market volatility or correction and sector rotation. The opposite can also happen, goals are not met, resulting in lower bonuses while the stock market goes up — this is what happened to many companies in 2020 in part due to the COVID-19 pandemic. However, we expect that bonuses will be up in 2021 as a result of strong performance coupled with conservative goals set during the pandemic.

CEO Pay Projections

1) We expect 2021 overall CEO actual TDC to increase in the low- to mid-single digits due to stronger financial results than projected at the beginning of the year when bonus goals were set; there will be some variation with strong performing industries likely seeing increases in compensation.
    a) The Aggregate S&P 500 Index year-over-year revenue and operating income for 2021 are currently forecasted to increase by 16% and 37%, respectively (S&P Capital IQ).
2) We expect median CEO target pay increases in early 2022 to be in the mid-single digits and possibly higher given very strong financial and TSR performance (S&P 500 was +29% in 2021); this increase will be primarily made by increases in LTI compensation.
    a) In certain high-growth industries (e.g., technology and biotechnology) and high-performing companies, CEO increases could be greater than 10% (primarily with larger LTI awards) because of a highly competitive labor market, while executives in slow-growth industries or heavily impacted companies might see no increases.

The above projections assume continued global rollout and broad usage of the COVID-19 vaccine with minimal disruption to the U.S. economy from variants; they do not account for additional major market shocks (e.g., geopolitical uncertainty, dramatic changes in the economic or political environment, unanticipated modifications to the Federal Reserve's interest rate policies, or significant drops in the overall stock market).

Methodology

The CEO pay analysis consists of S&P 500 companies led by CEOs with a ≥3-year tenure. Pay data includes base salaries and bonuses paid for each year as well as the reported grant date fair value of LTI awards. Our analysis of consistent incumbent CEOs was designed to highlight true changes in CEO compensation (as opposed to changes driven by new hires or internal promotions, which typically involve ramped-up pay over a period of 1-3 years).

Note on Realizable Pay

Our methodology used year-over-year CEO actual pay and was based on the accounting value of LTI as reported in proxy summary compensation tables. These amounts are more akin to pay opportunity than realizable pay, which includes in-the-money value of stock options, ending period value of restricted stock, and estimated value of performance shares. Our past research has strongly correlated realizable pay and TSR performance. While we have shown there is a positive correlation between CEO annual pay increases and TSR performance, we are confident the correlation is not as significant as that between realizable pay and TSR increases.

General questions about this Viewpoint can be directed to Aubrey Bout (aubrey.bout@paygovernance.com) or Brian Wilby (brian.wilby@paygovernance.com).