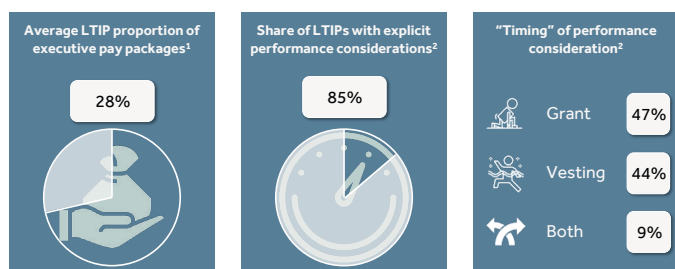


Three key questions to structure an LTIP discussion

In this “corona”-impacted year, discussions in Boardrooms are and/or will be heavily impacted by the recapitulation of how well the respective company was and is able to cope with these unprecedented times. The viability of the company’s compensation framework in general, as well as the long-term incentive program (“LTIP”) specifically, is an integral part of these discussions.

Following the financial crisis, “pay for performance” has become a watchword among investors, proxy advisors, and market regulators, particularly highlighting the first two goals of executive pay programs. In response to this, companies have increasingly included references to realized performance and have illustrated – and continue to do so – its relevance for executive pay in their compensation reports.

Market practice among 100 largest stocks of the SPI



¹ of total compensation amount. ² of plans.

LTIPs make up a considerable portion of executives’ pay packages among the 100 largest stocks of the SPI. In most cases these are featured with explicit performance condition(s) at grant, at vesting or even at both instances.

Three key questions to address when challenging the appropriateness of LTIPs within the annual review or in response to changed overall market and/or company specific circumstances:

1 What do we want to achieve with our LTIP?

Executive pay programs are expected to accomplish three main – partially competing – goals. Firstly, they aim to reward participants for the creation of shareholder value. Secondly, they intend to limit compensation cost to levels that prioritize the wealth of the company’s shareholders (i.e. enabling alignment between management reward outcomes and shareholder experience) and lastly, they also target the retention of key talent, especially in periods of poor performance attributable to market and industry factors. Notably, the first two are particularly relevant for LTIPs.

Yet, the current situation with increased overall market uncertainty has revealed a tendency of companies to consider sacrificing “pay for performance” for the (perceived) necessity to retain talent. This is reflected for example in discussions concerning “additional grants to compensate”, “abolishment of performance conditions”, “corrections of pre-determined ambition levels”.

Such potential amendments may mitigate the (perceived) retention risk yet go against the pursued alignment of LTIP outcomes with shareholder experience.

2 How is performance reflected in LTIP outcomes?

Given the intention to stringently link executive pay to realized performance, the most natural question would be how to parametrize an LTIP in a way to promote a culture of sustainable high-quality performance with appropriate risk-taking and enhanced value creation for the company and its shareholders. Structuring the Board discussion along the following three levers (see next page) can help to more adequately assess the link between pay and performance in LTIPs.

Modelling possible vesting scenarios and simulating future LTIP outcomes provides additional insights into how LTIPs “behave” in general, as well as in particular situations. It can positively contribute to the needed level of confidence in the overall quality and robustness of the LTIP.

Performance measures



Does the LTIP reward the “right” performance and does it consider the “right” performance metrics?

Should executives be engaged around a specific performance imperative and thus contribute to or focus on operational value creation?

Or should the LTIP be conditioned on stock market performance to allow for a more direct link to shareholder experience?

Is a combination of both perspectives a viable solution (with the advantage of reflecting both angles but at the same time increasing complexity)?

Aspiration level



What is the target performance level that leads to the expected vesting factor?

To what extent are shareholders’ (return) expectations reflected in the target performance level?

Does the attainment of the desired performance standard require a stretched enough level of effort and is at the same time perceived as “doable” by LTIP recipients?

How robust (also from a governance perspective) and comprehensible is the approach to quantify the target performance level?

Pay to performance sensitivity



How strongly does the vesting factor react to small deviations from the target performance level?

How much risk and/or leverage should be entailed in the LTIP?

Is the relation between performance achievements and reward outcomes (i.e. vesting curve) set in a way to allow for a realistic performance-related chance to realize vesting?

What are behavioral impacts of (un-) symmetrical incentive curves below and above the target performance level? And is there a need for additional performance constraints³?

³ For example, via limiting or overruling the calculated vesting factor of certain performance outcomes, commonly applicable for relative metrics.

3 How do we make decisions regarding our LTIP?

When it comes to LTIP design, companies typically cannot circumvent also observing broader market practice as well as proxy advisors’ opinions (which are standardized and often portray an equivocal view).

Yet, while market knowledge is very valuable, simply following it does not guarantee effective LTIPs nor successful say-on-pay votes at AGMs. As every company is unique and shaped by the combination of its individual purpose, strategy, corporate culture, legacy,

etc., focusing on the company’s concrete situation and needs when discussing and approving LTIP design features seems the only right strategy.

If communicated in a convincing manner with sufficient rationale supporting the chosen design and its relevance to the respective business model and corporate strategy, an LTIP tailored to the company (even if it deviates from standard market practice) is likely to be also valued by shareholders⁴.

⁴ See also “[Lessons Learned aus Say-on-Pay 2020 – 7 Leitsätze zur Vergütungskommunikation](#)”.

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