Real Estate Forum®

An ALM Publication

June 2016

Public Markets Perspective

CEO Pay Increases Slow, ISS Intensifies Scrutiny

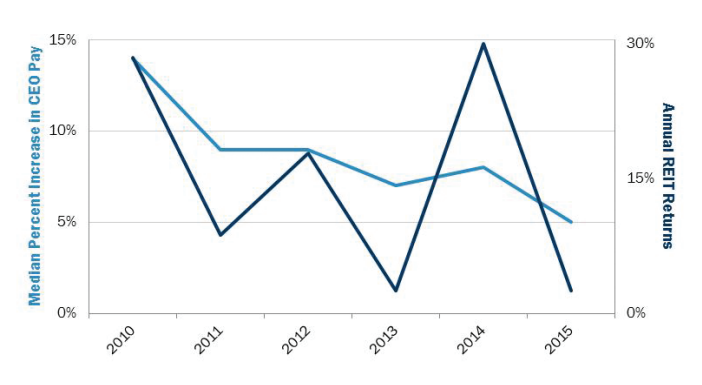
Board awareness of the relationship between total shareholder returns (TSR) performance and CEO pay has increased in recent years, in part due to the influence of proxy advisory firms—including Institutional Shareholder Services, or ISS. ISS evaluates pay-for-performance alignment using a proprietary model that is heavily dependent on the TSR-CEO pay relationship, the "quantitative evaluation." Board sensitivity to TSR and annual pay decisions is evident as the alignment between the two continues to strengthen.

Testimony to this, in 2015, approximately 40% of CEOs received a decrease in pay as REITs posted muted TSR. Further, last year, CEO compensation at the largest 50 REITs (by enterprise value) increased at the slowest pace since the 2008 financial crisis, with CEO pay increasing by 5% at the median. This is in contrast to CEO pay increases which averaged 9% since 2010.

Notable this proxy season, as CEO pay has become more aligned with TSR performance, fewer REITs have triggered a "misalignment" under the ISS quantitative evaluation. However, a positive quantitative result has not consistently translated into a positive ISS say-on-pay voting recommendation, due in large part to an intensified focus on the other qualitative factors. For example, ISS has expanded its attention to the rigor of performance goals and to annual incentives that pay out above target in a year with negative TSR (notwithstanding the fact that such payouts did not trigger a pay-for-performance misalignment); additionally, a handful of REITs have received a negative ISS voting recommendation due solely to poor disclosure.

By Katie Gaynor and Jarret Sues

Conversely, many REITs have been able to overcome a negative result under the ISS quantitative evaluation if their proxy statement provides straightforward and well-thought out disclosure. ISS, as well as investors, are focusing more attention on telling the story, and REITs that are able to "sell" their executive compensation program have been able to receive a favorable say-on-pay vote even if pay and TSR performance are not perfectly aligned.



Executive pay levels remain in the spotlight and will continue to be heavily scrutinized. However, paying the "right" amount is no longer enough to satisfy proxy advisor and investor expectations. Today executive compensation needs to also have the right mix of cash and stock, use appropriate metrics with justifiable rigor, employ proper governance features and be transparent and effectively communicated to shareholders. The challenge placed upon boards moving forward continues to be developing a compensation plan that effectively motivates and rewards management while being mindful of external pressures.

__Katie Gaynor__ is a managing director and __Jarret Sues__ is a senior director in the executive compensation and corporate governance solutions practice at FTI Consulting. They may be contacted at katie.gaynor@fticonsulting.com and jarret.sues@fticonsulting.com, respectively.

The views expressed here are the authors' own.