Tariffs and Transparency: Navigating Investor Expectations on Executive Pay Changes

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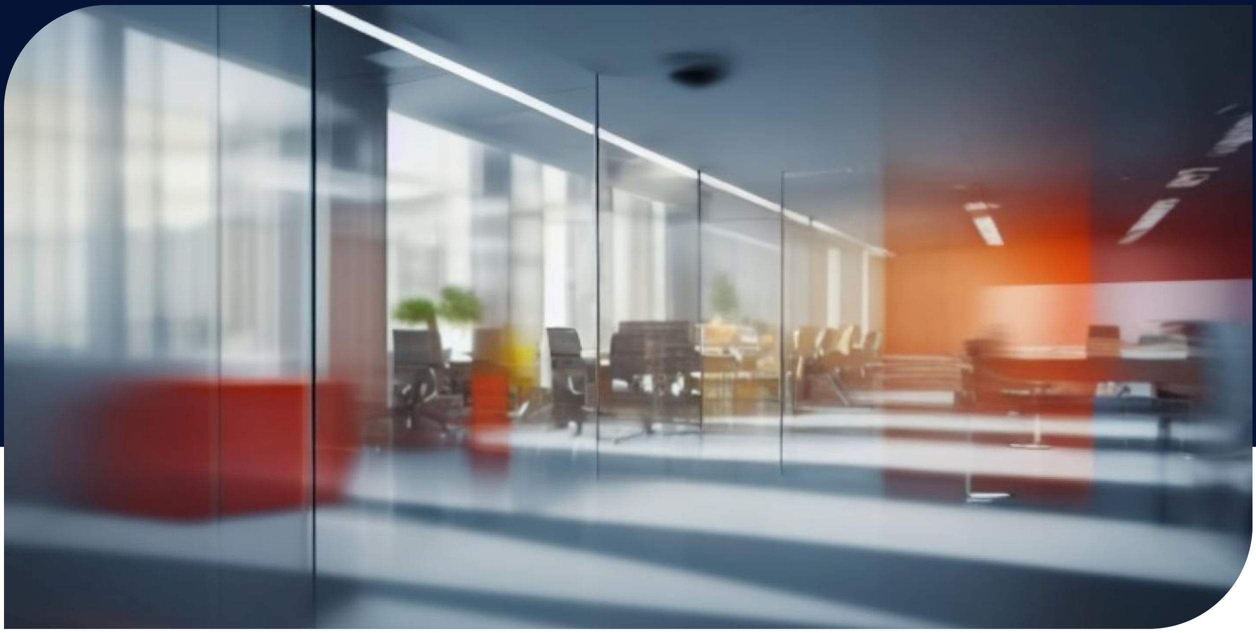

The U.S. "Liberation Day" announcement on April 2, 2025, introducing broad global tariffs, followed by pauses, adjustments and international agreements, has sparked significant market volatility. While recent trade agreements have tempered initial concerns, ongoing negotiations and administration positions, including those on regional tariffs and tariff-related price hikes, signal continued uncertainty. In this environment, visibility into expected payouts from executive compensation programs will be limited, which may prompt some boards to consider adjustments to targets or awards.

This situation is not unlike other periods of disruption, and valuable lessons can be drawn from historical precedent. While compensation committees need flexibility to respond to shifting, unforeseen conditions, proxy advisors and investors will closely monitor such pay decisions for alignment with shareholder outcomes. Committees must carefully evaluate the potential governance and reputational implications of any adjustments. Below, we outline historical context, proxy advisor perspectives and six emerging factors for boards to consider when evaluating executive pay changes.

Exceptional Pay Actions During Periods of Economic Disruption Have Historically Drawn Scrutiny

Current volatility reflects the uncertainty seen during the early stages of the COVID-19 pandemic, which led to widespread incentive payout adjustments and goal resetting, as well as during the 2008 Great Recession, when many companies issued discretionary retention bonuses. However, these actions drew criticism from investors and stakeholders who objected to insulating executive compensation at a time when investors suffered losses and the broader population experienced economic hardship.

Indeed, pandemic-related compensation adjustments were a key factor behind historically low say-on-pay support in 2022 and the highest rate of say-on-pay failures in over a decade. The pay practices contributing to the Great Recession also led to sweeping disclosure regulations, including Dodd-Frank's requirement for an advisory say-on-pay vote. Likewise, the mid-2000s stock option backdating scandals prompted heightened regulatory scrutiny and greater transparency in disclosures. These crises have shaped both regulation and investor expectations around executive compensation.

Past Proxy Advisor Views of Pay Adjustments

During the COVID-19 pandemic, proxy advisors such as ISS acknowledged that pay adjustments might be justified in times of economic disruption, but also articulated firm expectations for how companies should proceed:

- Companies should clearly disclose the rationale and decision-making process.
- Changes should be temporary and proportional, and should not be used to mask long-term underperformance.
- Transparency around the use of discretion is critical, especially if used to increase payouts.
- Adjustments to unvested equity awards are generally viewed unfavorably due to their long-term nature.
- Retention awards are subject to heightened scrutiny, especially when granted shortly after low or forfeited regular incentive payouts.
    - ISS considers the payment of discretionary bonuses when formulaic bonuses failed to pay out to be a problematic pay practice, resulting in an automatic recommendation against say-on-pay, or, in its absence, against Compensation Committee Members.

Top Six Factors to Consider in the Current Environment

While the current uncertainty recalls past market disruptions, there are several ways in which policy-driven impacts, such as tariffs, resulting directly from decisions made by the administration and anticipated during President Trump's campaign, differ from unexpected shocks like COVID-19. Rapid market swings, varying sector-specific impacts, stakeholder expectations and revised investor engagement protocols add an extra layer of complexity to pay decisions. To avoid proxy advisor and investor dissent, companies should consider the following:

1. **Avoid rushed decisions and retain flexibility.** Companies should remain cautious about altering pay targets prematurely, as pauses, exceptions and recent deals underscore the extreme fluidity of the situation. Investors will be skeptical of high payouts based on overly conservative assumptions and will expect negative discretion to be applied in these cases.

2. **Expect additional scrutiny around stock option timing.** Similarly, given the strong market reactions to tariff-related announcements, investors are likely to be on alert for opportunistic grant practices that seek to take advantage of heightened volatility. Newly required proxy disclosure regarding stock option grant timing in relation to the release of material non-public information allows for additional scrutiny. Strong documentation of grant rationale and timing decisions can help mitigate concerns.

3. **Provide clear and transparent proxy disclosure of tariff impacts.** Unlike COVID-19, which disrupted nearly every industry simultaneously, tariff exposure varies more significantly across sectors and geographies. Investors and proxy advisors need more information on exactly how the company is impacted in order to assess the appropriateness of adjustments, particularly if they are not familiar with specific industry dynamics.

4. **Consider the reputational and optics risk for other stakeholders.** While investors are watching how companies manage costs, they are not the only stakeholders to consider. Adjusting executive pay while cutting jobs or raising prices could attract negative media attention and provoke backlash from employees and consumers, especially given public pressure from the administration to avoid price increases.

5. **Continue proactively engaging investors, despite challenges in obtaining clear feedback.** The SEC's changes to 13D/G guidance have limited the level of feedback many U.S. investors can provide without being considered "activists," subject to different filing standards. While previously, institutional investors could express concerns about extraordinary executive pay actions, they are now less likely to signal these concerns before voting against say-on-pay. Nevertheless, companies should continue proactive outreach to tell their story.

6. **Keep in mind that governance decisions, particularly those related to executive pay, are increasingly subject to political scrutiny.** Tariff-related pay adjustments also have the potential to be politically divisive. This is especially true in sectors disproportionately affected by tariffs or national policy debates. Boards should consider how reactionary pay adjustments may be perceived in today's politicized environment.

Investor Considerations for FY25 Pay Changes and Disclosure

Patience is key when considering any adjustments to incentive targets or payouts, particularly in a situation as fluid and subject to rapid shifts as this. Should adjustments be deemed necessary, investors and proxy advisors are more likely to be supportive when companies disclose a robust rationale and explicitly link adjustments to shifts in company strategy and shareholder interests. Providing a quantifiable explanation, where possible, of tariff impacts and how they relate to pay changes enhances transparency and investor trust. Expect stock option grant timing to be monitored much more closely than in previous years. One-off awards are always subject to heightened scrutiny and are often drivers of low say-on-pay results; if necessary, these awards are best received when modest, strategically justified and performance-based. Investors also prefer that discretion be used sparingly, primarily to moderate rather than enhance payouts, particularly if targets were set too low. Although the dynamics of investor engagement have changed somewhat, proactive off-season outreach remains important to clearly communicate decisions and avoid surprises ahead of the next proxy season.

Authors

Martha Carter
Vice Chair and Head of Governance Advisory

Matt Filosa
Senior Managing Director

Sean Quinn
Senior Managing Director

Sydney Carlock
Managing Director

Diana Lee
Senior Vice President

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