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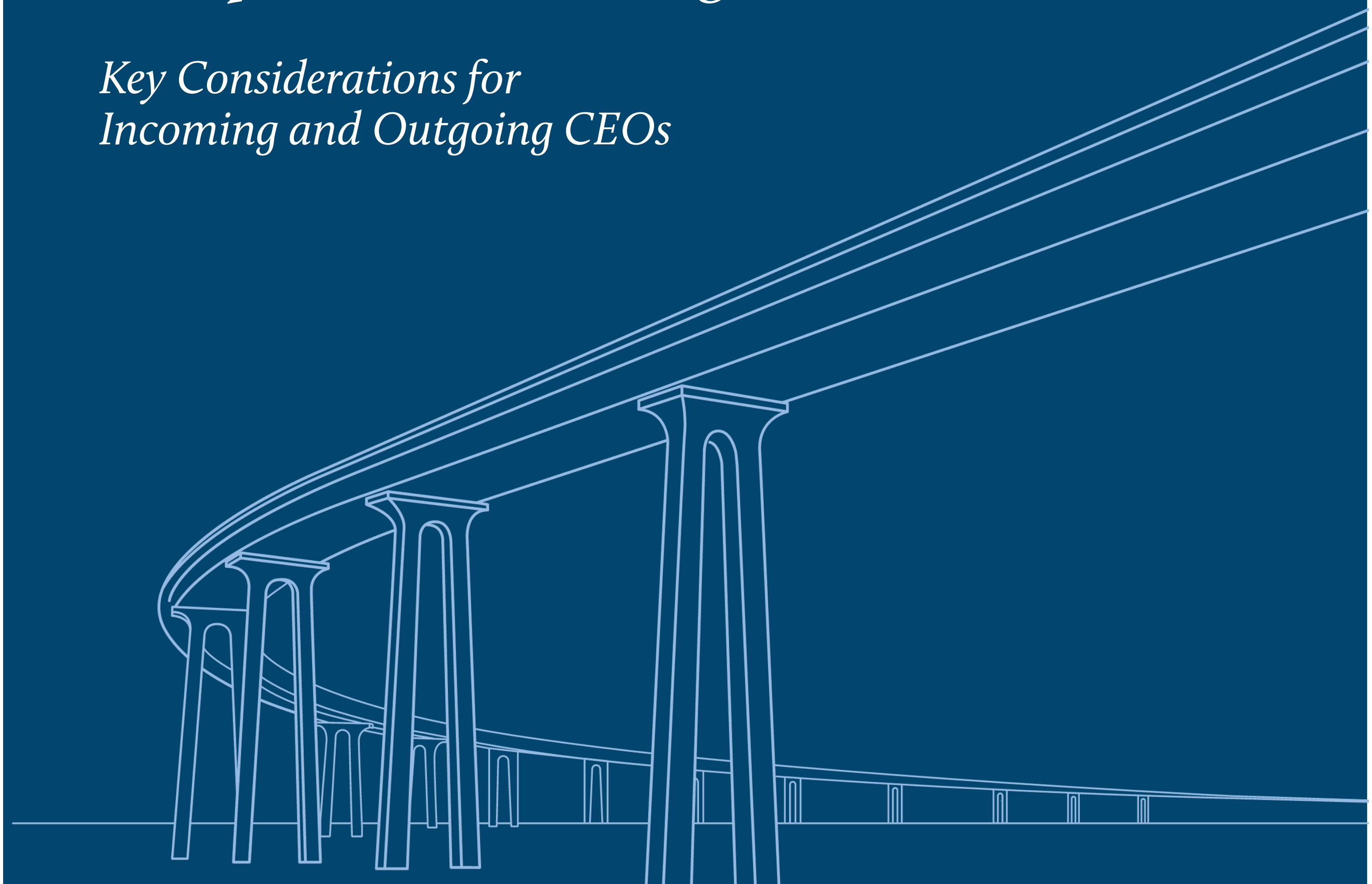
The Ins and Outs of CEO Transition Compensation Planning

Key Considerations for Incoming and Outgoing CEOs



ClearBridge
Compensation Group

www.clearbridgecomp.com

The Ins and Outs of CEO Transition Compensation Planning

A CEO transition is a defining moment for any organization, marking both a leadership change and a critical time for compensation planning. A successful transition satisfies shareholder expectations, mitigates organizational risk, and balances the interests of the incoming and outgoing CEOs. Prior to the hand-over, companies must establish a thoughtful succession plan by continually assessing the talent pipeline, preparing internal candidates, and addressing any potential leadership gaps.

At ClearBridge, we specialize in designing compensation programs that enable seamless leadership transitions and align incentives with shareholder interests. Below, we outline key considerations for effective compensation planning amidst a CEO transition.

1. Defining Objectives

The first step in CEO transition compensation planning is to clearly define the company's goals, which often include:

- Determining the go-forward plan / role for the outgoing CEO, including whether they:
  - Transition to an Executive Chair role
  - Act in an advisory role for a defined transitional period (e.g., 6 to 12 months)
  - Remain on the board of directors (with no ongoing executive role)
  - Separate fully from the company via retirement, resignation, or termination
- Attracting and retaining a high-caliber, non-interim successor (either from internal or external candidate pool), while ensuring the desired level of engagement from the outgoing CEO during the transition
- Maintaining continuity and stability for the business

2. Key Considerations for the Outgoing CEO

The compensation strategy for the outgoing CEO must recognize the nature of the transition. Key considerations include:

- **Contractual Obligations:** Determine what is contractually due to the outgoing CEO, based on nature of separation / transition (e.g., cash severance, accelerated / continued vesting of outstanding equity)
- **Supplemental Compensation Considerations by Role:**
  - <u>Executive Chair:</u> Wide range of potential responsibilities, with compensation calibrated to the scope of the role; pay may be comparable to, or reduced from, CEO levels depending on the expected time commitment and leadership duties
  - <u>Advisory Role:</u> Generally, more limited responsibilities than Executive Chair role, tied to transitional support and/or project-specific needs; pay is often structured as a fixed cash retainer or monthly fee
  - <u>Board Service:</u> Typically, former CEO would receive standard board compensation
  - Note: Continued vesting of outstanding equity may help compensate for board / advisory roles, if not already provided contractually

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3. Key Considerations for the Incoming CEO

Compensation planning for the incoming CEO must address recruitment requirements (if applicable), retention goals, and alignment with performance expectations. Key considerations include:

- **Competitive Market Compensation Positioning:** Desired positioning varies by individual, with lower positioning common for first-time CEOs and higher positioning common for experienced hires
- **Existing Retention Features for Internal Hires:** Assess retention features and participation in existing incentive plans to ensure adequate go-forward alignment
- **Buyout / "Make-Whole" Awards for External Hires:** To assist in recruitment, consider the cost of buying out unvested equity awards or other compensation from the executive's prior employer
  - In calculating make-whole award value, consider discounting the value of future vestings at prior employer (e.g., buyout 100% of value for awards vesting / bonuses paid in next 12 months, 75% of value for awards vesting in 12 to 24 months, 50% of value for awards vesting in 24 to 36 months)
- **Sign-On Awards:** Sign-on awards may build ownership early and incentivize outsized performance, but may also lead to misalignment with other executives if not designed carefully
  - Sign-on awards may also help to bridge the gap in actual earned compensation in the first few years of tenure, before the regular equity vesting schedule reaches a steady cadence
- **Incentive Plan Design:** If a new incentive program is designed for the incoming CEO (e.g., one-time performance-vested awards), determine whether it should also apply to the broader leadership team to ensure alignment with key business priorities
  - If the incoming CEO is joining the bonus plan mid-cycle, consider whether to provide a guaranteed pro rata target bonus to recognize potentially limited influence on results for remainder of year

4. Governance-Related Considerations

Strong governance underpins effective CEO transitions, ensuring decisions are transparent, defensible, and aligned with shareholder expectations. Key considerations include:

- **Shareholder Communication:** Disclose the rationale for transition pay decisions (e.g., make-whole awards, advisory fees) clearly and consistently
- **Risk Mitigation:** Consider the use of separation agreements to enforce non-compete, non-solicitation, or clawback provisions that protect company interests during and after the transition
- **Succession Readiness:** Regularly assess internal CEO candidates and ensure retention and incentive plans support long-term leadership development

CEO transitions require thoughtful and strategic compensation planning. Successful compensation programs can ensure that companies achieve a seamless transition, align executive interests with shareholders, and set the stage for future success.

At ClearBridge Compensation Group, we partner with boards and leadership teams to design and implement customized compensation programs that balance strategic priorities, competitive positioning, and stakeholder expectations. Our deep expertise ensures that your incentive plans not only meet today's challenges but also position your organization for long-term success.

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