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Vanguard Investment Stewardship Voting Insights

# Say on Pay at TransDigm Group Inc.

April 2024

**Company:** TransDigm Group Inc. (TransDigm)

**Meeting date:** March 7, 2024

**Proposal(s):** Item 3: Approval, on an Advisory Basis, of the Compensation of our Named Executive Officers

## How the funds voted

At the 2024 annual meeting of TransDigm, a U.S.-listed company that produces, designs, and supplies aircraft components, the Vanguard-advised funds supported an advisory vote to approve the executive compensation plan (i.e., "Say on Pay").[1]

## The funds' proxy voting policies

As articulated in the funds' proxy voting policies, the Vanguard-advised funds evaluate compensation plans on a case-by-case basis, taking into consideration the facts and circumstances at the company in question. Compensation policies linked to long-term relative performance are fundamental drivers of sustainable, long-term returns for a company's investors. Providing effective disclosure of compensation policies, their alignment with company performance, and their outcomes is crucial to giving shareholders confidence in the link between executives' incentives and rewards and the creation of long-term returns for shareholders. We do not believe there is a one-size-fits-all approach to executive compensation, as the norms and expectations for executive compensation vary by industry type, company size, company maturity, and region.

The Vanguard-advised funds are more likely to support compensation plans in which a majority of executive compensation remains variable, or "at risk," with rigorous performance targets set well beyond the next quarter. Some of the key considerations that we evaluate when reviewing executive compensation include:

*Alignment of pay and performance.* The funds look for evidence of clear alignment between pay outcomes and company performance. This is mainly assessed through alignment of incentive targets with corporate strategy and analysis of three-year total shareholder return and realized pay over the same period vs. a relevant set of peer companies. If there are concerns that pay and performance are not aligned, a fund may vote against a pay-related proposal.

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

*Compensation plan structure.* Plan structures should be aligned with the company's stated long-term strategy and should support pay-for-performance alignment. Where a plan includes structural issues that the funds determine have led to, or could in the future lead to, pay-for-performance misalignment, a fund may vote against a pay-related proposal. For compensation structures that are not typical of a market, the Vanguard-advised funds look for specific disclosure demonstrating how the structure supports long-term returns for shareholders.

*Governance of compensation plans.* The funds look for boards to have a clear strategy and philosophy on executive pay, utilize robust processes to evaluate and evolve executive pay plans, and implement executive pay plans responsive to shareholder feedback over time. The funds also look for boards to explain these matters to shareholders via company disclosures. Where pay-related proposals consistently receive low support, the funds look for boards to demonstrate responsiveness to shareholder concerns.

## Analysis and voting rationale

From 2018 through 2023, the Vanguard-advised funds voted against Say on Pay at TransDigm, and in certain years, withheld support from Compensation Committee members. During this period, we shared concerns with members of the Compensation Committee and company management regarding the executive compensation program's structure and governance, including the committee's use of upward discretion in the short-term incentive plan; an uncapped carryforward/carryback feature, whereby excess achievements in one year can be applied to compensate for shortfalls in the preceding or successive year; and utilization of one-time equity grants. Some elements of TransDigm's executive compensation plan were unique within the industry, such as a long-term incentive plan entirely composed of performance-based options conditioned on a proprietary metric. Given the unique features of the plan, we discussed with company leaders our desire to better understand the compensation plan's philosophy and how its structure aligned executives' incentives with long-term shareholder returns.

More recently, the Compensation Committee made changes to the executive compensation plan that alleviated some of our concerns related to plan structure and disclosure. In advance of TransDigm's 2024 annual meeting, we assessed that there was improved pay-for-performance alignment between executives' incentives and TransDigm's shareholder returns when compared to peer companies' performance. We also observed that the company had enhanced disclosures related to the executive compensation plan, providing further clarity into the Compensation Committee's governance and oversight of the plan, the plan's design and philosophy, and the Compensation Committee's use of discretion within the annual incentive plan. These enhanced disclosures, coupled with sufficient pay-for-performance alignment, gave us comfort with the plan design and its alignment with long-term shareholder returns.

During our analysis of TransDigm's Say on Pay vote at its 2024 annual meeting, we also noted the issuance of one-time grants to some TransDigm executives. We engaged with a member of the Compensation Committee and other company leaders to gain further understanding of the Compensation Committee's approach and rationale for issuing these awards. During the engagement, company leaders shared context around the issuance of the one-time grants to senior executives and provided insights into the board's decision-making process, emphasizing that retaining key executives was necessary to achieve the company's stated goals. Furthermore, company leaders explained how the award's design supported the objective of long-term retention, given its conditioning to an annual operating performance goal over a five-year measurement period.

We concluded that the board's rationale for the one-time grants was reasonable, given that the award design and structure aligned with long-term shareholder returns, and relevant disclosure was provided to shareholders to understand the rationale for and design of the grants. The alignment of pay and performance, coupled with structural changes and disclosure enhancements resulted in the funds' support of Say on Pay at TransDigm's 2024 annual meeting.

Vanguard publishes Investment Stewardship Policy and Voting Insights to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our effort to provide useful disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can provide. Insights should be viewed in conjunction with the most recent region- and country-specific voting policies.

The funds for which Vanguard acts as investment advisor (Vanguard-advised funds) retain the authority to vote proxies that the funds receive. To facilitate the funds' proxy voting, the boards of the Vanguard-advised funds have adopted Proxy Voting Procedures and Policies that reflect the fund boards' instructions governing proxy voting. The boards of the funds that are advised by managers not affiliated with Vanguard (external managers) have delegated the authority to vote proxies related to the funds' portfolio securities to their respective investment advisor(s). Each external manager votes such proxies in accordance with its own proxy voting policies and procedures, which are reviewed and approved by the fund board annually.



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