Fundamentals of Compensation Committee Governance

The fundamentals of good compensation committee governance have evolved over the years as executive compensation has become more complicated, more visible and more controversial. The goals of such processes are to ensure that the following goals are met:

- Enough time is provided to consider proposals in full, from multiple angles;
- Appropriate competitive information and analysis is considered;
- Technical and regulatory matters are considered in the design process;
- Decisions are properly explained to shareholders and outside governance monitors; and
- The compensation committee has access to independent advice.

The fundamentals fall into four categories: Planning, Due Consideration, Analysis and Access to the Consultant. We also provide potential questions to ask during meetings.

Planning

- Designate a single point of ongoing management contact with the Committee, e.g., the Head of Human Resources or Head of Executive Compensation.
- Establish a Committee calendar for the entire year in advance, with topics assigned to specific months.
- Receive input from the Committee Chair and the consultant before each meeting regarding appropriate agenda items, management recommendations and supporting materials.
- Review of materials by the Committee Chair before materials are finalized and sent out.
- Create compensation structure and incentive design (management); provide critical review and approval (Committee).

Due Consideration

- Provide meeting materials no less than five days in advance of the meeting.
- Discuss critical or controversial issues over the course of several meetings.
- Conduct executive sessions of the independent Committee members, excluding management, at each meeting. Some Committees prefer such a session at both the beginning and end of each meeting.

Analysis

- Agree, in advance, on a pay philosophy specific enough to guide the Committee's actions. Define the applicable pay market and the desired percentile standing, if any, as well as "pay" and "performance".
- Request regular market data analyses, annual or biannual as appropriate depending on the emphasis in the pay philosophy on market data.
- Commission regular peer group reevaluations to test appropriateness, e.g., every two to three years, using multiple appropriate criteria.
- Request analyses from various angles such as distribution of salary increases or individual performance ratings, comp ratios, growth in pay over time, change in market competitiveness over time, overall cost of pay programs at threshold/target/maximum, etc.
- Ask the consultant (to ensure an independent view) for analyses of plan payout vs. performance for short-term incentives and total pay.
- Request tally sheets that show the potential value of outstanding incentive awards, sum historical actual payouts and gains to executives, and illustrate contingent payments under various termination scenarios.
- Request regular regulatory, legislative, ISS and trends updates, to keep up with events.
- Request periodic (e.g., triennial) reviews of severance benefits (CIC and non-CIC), stock ownership guidelines, impact of pensions and other programs that stay fairly stable over time.
- Conduct an annual compensation risk assessment.

Access to Consultant

- Ensure the Committee Chair has access to the consultant outside of meetings.
- Consider requesting a pre-meeting memo from the consultant to the Committee which discusses each meeting agenda item, particularly those in which the consultant has not been involved or where management developed the final presentation.
- The consultant should present his or her own work at meetings to ensure the Committee is hearing the consultant's views directly, not directed by management, and to allow questions.
- Consider holding executive sessions with the consultant, before or after Committee meetings, or both.
- Conduct a formal annual evaluation of the consultant, to provide feedback and ensure the consultant is meeting the Committee's needs and requirements.

Questions to Consider During Meetings

- What major assumptions were used to develop the market data being presented?
- Regarding proposals for change:

  — What are the downsides and weaknesses of the action being proposed?

  — Were other alternatives considered? If so, why were they discarded?

  — What is the overall cost and/or incremental cost of the proposal?

- Were there areas of disagreement between the consultant and management? If so, how were they resolved?
- When considering retention pay—are we ignoring aspects of our pay or benefits program, prospects or culture that already provide retention?
- Are we paying for performance? If so, how is pay defined? How is performance defined?
- Regarding long-term incentive designs:
  - — Does this program focus executives as much as possible on the long-term?
  - — Will this plan design stand the test of time, through good performance and bad? Or will we be asked to make exceptions during poor performance cycles and pay out anyway?
- How will this proposal be viewed by shareholders? Proxy advisors, like ISS and Glass Lewis? The media?