10 Keys to Great Compensation Committee Processes

Executive compensation is complex and institutional investors and proxy advisors are increasingly aggressive and prescriptive in their views of executive compensation. This makes the role of a public company compensation committee complex and demanding. It is now more important than ever that the Committee process is effective and efficient. While great process does not guarantee that compensation decisions will be perfect or free from external challenge, it:

- Helps the Committee make good decisions, based on the right information
- Provides the basis for strong disclosure of compensation outcomes and the rationale for decisions
- Minimizes potential conflicts between the Committee and management

We provide our take on ten key elements to a great compensation process.

1. Communicate, Communicate, Communicate

Open and direct communication between the chair of the Committee, the HR team, the CEO and the compensation advisors is critical to making and documenting appropriate compensation decisions.

Open communication builds a relationship of trust that allows management and the Committee to raise concerns for discussion, comfortable that both sides will work towards an appropriate outcome. This is particularly important on issues where the Committee and management may have different perspectives, such as ensuring there is sufficient stretch in performance targets.

2. Two Bites at the Apple

Deal with complex issues and significant changes to the compensation program at more than one meeting. At the first meeting, management can present the issues and alternative approaches and seek directional feedback from the Committee. At the second meeting, management can present specific proposals/recommendations for approval that have been refined to reflect Committee input.

This “two bites at the apple” process allows the Committee to reflect on significant decisions, ask for and receive additional information, and provide input before management’s proposals are fully developed.

Timing for a significant incentive design change might be as follows:

- Summer meeting—proposed changes to incentive design and metrics (with alternatives and external market perspective) presented to the Committee for feedback
- Fall meeting—final incentive design and metrics presented for approval. Proposed methodology for target setting (and any likely adjustments and adjustment principles) presented for Committee feedback
- February meeting—actual targets presented for Committee approval

3. Committee Chair and HR Review of Materials before Posting

Sharing materials with the Committee Chair, the HR team and the Committee advisor, before materials are posted is a critical practice. This usually starts with an exchange of written materials with management providing their materials to the advisor and the advisor providing its materials to management.

This is ideally followed by a conference call to review and discuss the materials. Areas of potential difference of view are discussed, factual issues resolved, changes made, alternative approaches considered, materials enhanced and areas of real difference of view narrowed.

This saves Committee time, and ensures that the Committee focuses its time on substantive concerns. It also allows the Committee Chair to socialize sensitive issues with other members of the Committee (or Board) in advance, if needed.

4. Do What's Best for the Business Strategy

Understand but don't be a slave to market norms and proxy advisor expectations. While it is critical to consider competitive practice, first and foremost, companies should do what is right for their business, its strategy and its current challenges and strengths.

Understanding market norms and proxy advisor expectations allows the company to understand when it is doing something unusual. Focus should be on doing this for strong business reasons and making clear disclosure of the business rationale for any decisions, especially those that are likely to draw adverse attention.

5. In Camera Sessions

Best practice is to start ***and*** end each meeting with an in camera, private or executive session. The private session at the start of the Committee meeting is often used by the Committee Chair to tee up the key agenda items, identify critical issues and get an advance sense of Committee members' views.

The in camera session at the end of the meeting allows the Committee to have a final discussion and raise any issues that are more comfortably raised without management present including CEO performance assessment and compensation decisions.

Whether or not there is anything of substance to discuss, the Committee should follow a consistent process of having in camera meetings. This avoids the awkwardness of a Committee member having to suggest that a private session is required, which telegraphs concern. It also allows for the good disclosure and legal record that an in camera session is held at each Committee meeting.

6. Use an Annual Calendar

Start with an annual calendar that follows the meeting and public disclosure cadence. Fourth and first quarter meetings have a very heavy agenda with items that are critical to the annual reporting cycle. Accordingly, it makes sense to use the "off-cycle" meetings for significant discussions relating to incentive design, assessment of pay and performance, succession planning and talent development, etc. Using a 12-month rolling calendar can make sure that these critical, but less time sensitive issues are addressed in a thoughtful manner.

In addition to the 12-month rolling calendar, it is a helpful practice to include the agenda for the upcoming meeting, with the materials for each meeting.

7. Review Draft Disclosure for Challenging Decisions

It is not always possible to make decisions that meet the multiple and sometimes conflicting requirements of shareholders, proxy advisors, executives and business strategy. When a Committee makes a decision to do something that may be controversial—a special retention award, an adjustment to performance targets, etc., it is a good practice to prepare a draft of the disclosure that could be made of the decision. This helps management and the Committee to understand whether there is a clear, compelling and discloseable rationale for decisions that are outside the mainstream and if any immediate disclosures are required.

8. Avoid Unexpected NEOs

Special retention awards and unusual forms of compensation (such as long-term performance cash, which is disclosed when it is paid out, rather than when it awarded) can create anomalies in executive compensation which can make an executive a named executive officer (NEO) for a single year. This may be unavoidable. However, when making decisions about unusual awards, part of the information that should be provided to the Committee is an analysis of how the award will potentially affect who the NEOs are.

9. Keep an Up to Date Compensation Dashboard

Many directors sit on multiple boards. Even for directors who sit on a single board, compensation programs are sufficiently complex that a compensation dashboard can be helpful. The dashboard summarizes the compensation of the NEOs, the compensation peer group, annual incentive plan measures and weightings and long-term incentive vehicles and mix and performance measures. The dashboard is part of the materials for each meeting, often in the appendix, and provides the critical context for decision making easily at hand.

10. Independent Advisor Support

Many companies have an independent advisor to the Committee. The advisor can provide assistance in a number of ways including:

- Preparing a memo in advance of each Committee meeting which summarizes the materials and provides comment on areas that warrant more in-depth review and discussion by the Committee
- Specifically commenting on more difficult decisions and providing context relating to the likely reaction of investors and proxy advisors, how to enhance disclosure, market practice and alternatives to achieve business goals that are less likely to be viewed negatively by stakeholders
- Bringing both an independent perspective and experience from many different client situations to the discussion, particularly on challenging issues
- Keeping the Committee members abreast of marketplace trends and regulatory developments

* * * * *

The ***Client Update*** is prepared by Meridian Compensation Partners. Questions regarding this Client Update or executive compensation technical issues may be directed to:

Christina Medland at (416) 646-0195, or cmedland@meridiancp.com

Andrew McElheran at (416) 646-5307, or amcelheran@meridiancp.com

Andrew Stancel at (647) 478-3052, or astancel@meridiancp.com

Andrew Conradi at (416) 646-5308, or aconradi@meridiancp.com

Matt Seto at (416) 646-5310, or mseto@meridiancp.com

John Anderson at (847) 235-3601, or janderson@meridiancp.com

www.meridiancp.com