Compensation and HR Committees—Expanded Oversight

In response to changes in the expectations and focus of institutional investors, evolving securities disclosure rules and broader societal shifts, many companies are now seeking to formalize board-level oversight of:

- Environmental, sustainability/social and governance ("ESG")
- Human capital management ("HCM") and company culture
- Diversity, equity and inclusion (DE&I)
- Talent development and succession planning

For many companies, the logical board committee to oversee these areas is the Compensation or HR Committee (Committee). As a result, many companies are reconsidering the role and charter of this Committee, and expanding its oversight—in some cases to align with an increase in the Committee's scope that has already happened, and in other cases as a planned addition to the Committee's purview, in recognition of the growing importance to the business of these critical areas.

This client update provides an overview of the external pressures on companies to address these areas and discusses the resulting changes we are seeing to the traditional compensation committee in the areas of:

- Committee name
- Committee mandate
- Committee annual work plan
- Dialogue with shareholders on compensation

External Pressure on Companies to Address Broader People Issues

Perhaps the most significant change we have seen in the last 2 years (and likely accelerated by the pressures of COVID-19) is a greater focus on human capital. We see this reflected in:

- A rising broader societal interest in employee wellness and on social equality—particularly gender and racial equity initiatives (e.g., the 30% Club, the Prosperity Project and Black Lives Matter)
- Institutional investor focus on ESG, and increasingly on the social and sustainability aspects of ESG (e.g., the Canadian Investor Statement on Diversity & Inclusion pledge signed by investors managing more than $2.3 trillion in assets)
- Canadian and U.S. securities laws both requiring enhanced disclosure of diversity beyond gender, which has required many companies to step up their internal review of diversity, pay equity and inclusion while also adding to their external disclosure of both level of diversity and initiatives to increase diversity
- Corporations introducing or expanding requirements for real diversity and inclusion, and employee safety, throughout their supply chains

- Proxy advisor (ISS and Glass Lewis) focus on sustainability in their reviews, reports and related vote recommendations

Emerging Changes to the Committee

Many companies follow strong processes, which include: (i) reviewing the Committee charter or mandate annually to ensure it remains relevant; and (ii) establishing an annual Committee work plan, to ensure that all the important work within the Committee's mandate has a place in the normal Committee meeting cycle and on the relevant meeting agenda.

In the last two years, we have seen a trend to expand the Committee mandate, which has resulted in many companies changing the name of the Committee and adding oversight of broader human capital issues to the Committee mandate.

Changes to the Name of the Committee

Primarily as a symbol of a more fundamental change, many Committees are changing their name from Compensation Committee or Human Resources Committee to reflect a broader scope. Some of the alternative names we have seen include:

- People, Culture and Governance Committee
- Compensation & Talent Management Committee
- Human Capital and Compensation Committee

The change in name can send a strong external signal that the board and the company have increased their focus on broader human capital issues, but it is not a necessary element of an expansion of the Committee's oversight role.

Changes to the Committee Mandate

The more important part of the shift in Committee oversight is an expansion of the Committee's mandate.

We have seen the addition of a variety of new items and responsibilities, such as:

- Assess and review the company's talent development and succession programs, review and discuss succession plans (emergency and long-term) for the CEO and the CEO's direct reports
- Review the "Social" aspects of the company's ESG (Environmental, Social, Governance) programs, including receiving periodic updates from the company's management and discussions about if and how ESG metrics should be part of executive compensation programs
- Review the company's diversity, equity and inclusion programs, including analyses of pay equity
- Review the company's human capital strategy and organizational culture and assess the alignment with the company's strategy
- Receive periodic reports from management on human resources programs and practices, including employee training and development, workforce planning and recruitment, employee engagement and company culture
- Oversee the company's development and implementation of the company's policies and strategies relating to its human capital management, and monitor their effectiveness

Generally, it is preferable not to be overly prescriptive, as the mandate sets a minimum standard, which must be met, or explained. For example, we typically recommend referencing "periodic" rather than "quarterly" or "at each meeting" reviews to ensure that the mandate remains focused on the Committee's role of oversight, rather than involvement in operational issues.

It is the Committee's responsibility to ensure that management is addressing these critical issues, in a way that is aligned with good governance and responsible business practices. However, management generally takes the necessary execution action and is responsible to report to the Committee.

Changes to Annual Committee Work Plan

Many Committees have an annual Committee work plan as a tool to ensure that each of the areas of the mandate are addressed at the appropriate time in the Committee annual meeting schedule.

Much of a public company Committee's work is driven by the annual performance and meeting cycle and the proxy and annual general meeting cycle. It is best practice to have at least one meeting (typically spring or summer, for calendar year end companies) at which important, but not time urgent, matters can be reviewed and discussed by the Committee. This typically includes governance and incentive design topics (e.g., clawback policies, share ownership requirements, compensation risk reviews and review of the annual and long-term incentive design). This meeting could also include agenda items focused on the Committee's expanded role:

- Updates on diversity and inclusion status and progress against initiatives—this could include, for example, a report by management on gender diversity at various levels in the business, a comparison of compensation levels, high potential designations and exceptional performance ratings by gender, with a review of any apparent gaps, to identify (and correct) gaps that are not driven by tenure, experience, education background or other relevant objective factors
- Succession planning and talent development reports—this could include a review of potential successors for the executive roles, with a discussion of developmental opportunities (expanded roles, lateral movement, coaching etc.) as well as key retention risks, being provided
- A report on employee wellness and mental health initiatives, flexible work arrangements and mentorship
- A report on employee engagement (including survey results, turnover etc.) and company culture

Shareholder Outreach

Increasingly, the Committee (particularly the Committee Chair) is actively involved in dialogue with shareholders on executive compensation. This takes a number of forms:

- Proactive proxy disclosure that goes beyond the legal requirements to explain and advocate for the company's approach to compensation. This now often includes a letter from the Committee Chair at the start of the CD&A, which highlights key aspects of the executive compensation programs and the relationship between pay and performance. It may also include additional voluntary disclosures, such as realizable pay, to better illustrate the alignment between executives and shareholders created through performance-contingent equity awards, based on their *outcome* rather than their grant-date value

- More direct engagement with investors—this may include ongoing proactive discussions, or more reactive engagement in response to a negative proxy advisor vote recommendation or a weak say on pay vote outcome. These engagements are typically in the form of an initial letter to investors explaining the company's position, with an invitation to discuss any questions with the Committee Chair. Following a weak say on pay vote, the proxy advisors will expect companies to not only engage with shareholders, but also disclose the outcome of that engagement

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