The Dog Days are Over for Summer Compensation Committee Agendas – Expanded Compensation Committee Mandates May Require a Full Summer Committee Meeting Agenda

Written by: Laura Hay and Susan O'Donnell

Summer agendas traditionally have provided an opportunity to take care of less-time sensitive "odds and ends," ensuring that all charter duties have been fulfilled. However, as compensation committees continue to expand their scope, the summer meeting agenda is becoming more important, providing an opportunity to discuss people and culture issues, succession and talent development, environmental, social and governance (ESG) topics, executive compensation program efficacy and the overall governance process.

In revisiting the summer agenda, committees should ask the following 10 questions:

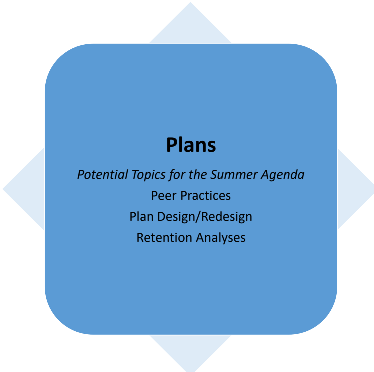
1. What do our shareholders expect and are we meeting their expectations in terms of pay-for-performance, ESG, human capital and talent management and corporate culture?
2. Should our charter and calendar, and even the name of the committee, change to adapt to new/emerging needs?
3. Do our compensation programs truly align with our business objectives and strategic plan?
4. How are we differentiating pay for performance, succession and strategic importance?
5. Do our programs and pay decisions support strong pay-performance alignment?
6. Do we really know how well our executive compensation program stacks up against our existing peers, and companies from which we are recruiting or losing talent?
7. Does the committee understand our talent risks, challenges and opportunities?
8. Is management keeping the talent pipeline full in a manner that broadens the playing field for talent?
9. Is the Committee focusing on the "right" issues? Have our policies and plans been updated to recognize a post-COVID environment, emerging risks or expectations?
10. Are we bringing fresh perspectives to the Board and governing from a place of strength?

The answers to these questions will guide the compensation committee's focus in four key areas – the"4P's" – Performance, Plans, People and Process. A summer agenda that delves deeply into one or more of these four areas can empower compensation committees to understand the overall executive compensation program holistically at a time in the annual calendar that is not dominated by the need for decision making.

Using the questions above, the following provides examples of how topics related to the 4P's could expand into meaningful discussion and a substantive summer agenda.

Performance – With full-year financial and compensation data available for both the company and its peers, an in-depth analysis can assess the effectiveness of the company's compensation program and pay outcomes. Areas to consider include pay-for-performance alignment, whether the metrics align with strategy and whether pay outcomes meet shareholder expectations.

- *Pay-for-Performance*: Reviewing CEO realizable pay relative to performance compared to peers can assist the compensation committee to assess whether its pay programs are operating as intended, to deliver compensation outcomes that are aligned with performance.
- *Metric Selection*: The post-COVID world looks different. While the key financial underpinnings are likely unchanged, incentive plan metrics will need to address increased focus on ESG and other non-financial goals that address business strategy, diversity, equity and inclusion (DE&I) and other culture-oriented initiatives.
- *Goal Calibration*: Rising inflation and interest rates along with continuing supply chain issues and a potential economic slowdown make goal setting and resulting award payouts more challenging. Designs may need to be more resilient with additional risk mitigators included in the plan design. For example, committees may consider wider or asymmetric payout curves, including modifiers to address performance relative to peers, financial performance less than the prior year and/or using qualitative performance considerations to address continued challenges in setting goals.



Plans – Compensation programs that may have once been best-in-class may have lost their luster as companies compete for talent seeking a different value proposition. As the war for talent increases so does the need for companies to proactively identify top performers and address gaps in compensation.

- *Peer Practices*: Reviewing compensation and incentive design at both traditional and emerging peers (e.g., where talent is acquired or lost) may provide insight into pay mix, performance metrics and plan structure.
- *Plan Design/Redesign:* Modelling potential plan changes in the summer provides an opportunity for more feedback between compensation committees, their consultant and management and an more time for iterative design and time for reflection, before a decision is made.
- *Retention Analyses*: Assessing "retention glue," (the expected value of unvested equity and future wealth creation opportunities) can identify value gaps before they become problematic.

People – As committee responsibilities expand to focus on human capital, summer agendas allow time for a deep dive into the oversight and governance of succession planning, talent development, Human Capital Management (HCM) and DE&I. Companies with established programs may want to integrate these topics into one meeting so that committee members can see the interconnections rather than discussing them piecemeal throughout the year.

- *Top Talent Initiatives:* Combining succession planning, talent management, DE&I and programs to create differentiation, retention and belonging of key employees provides a complete view of the programs that support a healthy talent pipeline.
- *Metrics for Governance:* Depending on the maturity of the human capital and DE&I programs, compensation committees could have a meaningful discussion on what metrics are helpful to track and to discuss with the Board. For established programs a multi-year review of progress, discussing both areas of progress and setbacks may provide insight into areas for greater focus.
- *Development of DE&I Goals:* Building off the metrics above, compensation committees may want to look at a subset for inclusion as a metric in the incentive programs.

Practices – While the items listed under practices are often found on summer agendas, committees may want to consider a more in-depth and critical review of what might be otherwise be considered routine items. For example, what is the new "normal" and does the current compensation philosophy address the impact of new risks related to ESG issues and remote work?

- *Compensation Philosophy:* Philosophies are most effective when they are detailed and tied to specific design features. For example:

  — What roles do meritocracy, tenure and strategic importance play in our philosophy?

  — What is the intent of each compensation element and what is the optimal pay mix at each level?

  — For "at-risk pay," how do we define "performance"? How is poor, expected and exceptional performance determined?

  — How do we ensure consistent application of the philosophy? What controls and governance process do we have to ensure that we adhere to the philosophy?

- *Peer and Industry Pay Trends:* In-depth analyses against peers can inform changes in plan design, compensation practices and even goal setting. For example a multi-year review of actual payouts to targets compared to peers may inform whether goal setting is too aggressive or not rigorous enough. Equity burn rate studies can suggest whether to expand participation or be more intentional in who receives equity awards.

- *Compensation-Related Governance:* With the remaining unfinished rules under Dodd-Frank back on the SEC's docket, now is a good time to review compensation risk assessments and determine the criteria being used address emerging risks such as ESG.

In summary, compensation committees should look at their meeting cadence with an eye toward future needs and the committee's expanding role. The summer agenda may be an ideal way to "find time" outside the busy compensation decision season to enable proactive and intentional discussions that pave a smoother path to stronger end-of-year decision making.