CAPflash
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Three Keys to an Effective Compensation Committee

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As most calendar fiscal year companies have completed their annual compensation cycles, it is a good time to revisit the factors that are important to have an effective Compensation Committee. With the continued focus on executive compensation and the evolving regulatory environment, the role of Compensation Committees and their members has transformed. Increased transparency, mandatory Say on Pay votes on executive compensation and more active shareholders have also led to increased responsibilities for Compensation Committees. Given this, it is more important than ever for the Compensation Committee to work effectively to satisfy shareholder objectives. This CAPFlash highlights three keys – composition, planning and process – for having an efficient and best-in-class Compensation Committee.

KEY 1: COMMITTEE COMPOSITION

Composition of the board Compensation Committee is the first step toward achieving an effective Committee. Below are some tips to keep in mind when determining which Board members should be on the Compensation Committee:

- Compensation Committees are typically composed of 3 - 5 board members with different, yet complementary backgrounds and skills
- The Committee should have representation from an active senior executive, an academic, an industry expert, etc., as appropriate. If the Compensation Committee is composed of members with different backgrounds it will allow for more comprehensive and fully vetted discussions
- The Chair of the Committee should be a strong facilitator who pushes forth open discussion and is willing to hear opposing viewpoints, while being an effective communicator and consensus builder
- The Chair works to bring meetings to resolution and to conduct efficient meetings

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KEY 2: PLANNING

A second important factor for having an effective Compensation Committee is proper planning. Providing Committee members with a road map of what is going to happen at each meeting and throughout the year allows for a more thoughtful approach to topics. Some planning tips include:

- Annually review the Compensation Committee charter to ensure that the Committee complies with their responsibilities and to see if any changes are required based on regulatory and legislative changes, or evolving practices
- Review the annual calendar at the beginning of each fiscal/calendar year and highlight any key priorities for the year (e.g., long-term incentive plan re-design)
- Provide Committee member education on key and emerging topics on an ongoing basis so they can

make informed decisions. Recent emerging topics include the risk assessment process, SEC disclosure rules, shareholder red flags, and the voting policies of the two main proxy advisory firms – Institutional Shareholder Services ("ISS") and Glass Lewis

- Obtain views of shareholders on an ongoing basis; listen closely to shareholders to get ahead of any potential issues on an annual basis

- Educate new members to provide them with a background on the company's historical pay practices and performance

KEY 3: ESTABLISH PROCESSES

Finally, another important factor for having an effective Compensation Committee is having proper and systematic processes for each Committee meeting. Effective Committee processes include:

- Set meeting dates with plenty of lead time to allow for well attended meetings by Committee members, management and external advisors

- Preview each meeting agenda with Committee Chair; establish time limits for topics

- Preview meeting materials well in advance of meetings to address all issues that may potentially arise

- Allow major decision points to be covered at two meetings to give the Committee time to preview and fully vet prior to final approval

- Ensure open and ongoing communication with management to have context for decision making

- Involve the Audit Committee and company Finance during the goal setting process for absolute performance plan goals in the annual incentive and long-term incentive plans

- Involve Legal in CD&A and proxy disclosure, potential filings related to any pay decisions and other technical issues

- Annually test effectiveness of pay plans relative to actual company and stock price performance as well as pre-established goals

- Monitor evolving regulatory, legislative and corporate governance practices by including the topic as an annual or biannual agenda item

- Conduct an executive session at each Committee meeting to ensure any concerns are addressed

- Schedule calls after each Committee meeting with Committee Chair, management and external advisors to debrief and confirm next steps

- Annually assess the performance of the Compensation Committee and its external advisors during the self-assessment process

In our experience, Compensation Committees that incorporate these three keys have more efficient meetings and are more effective in bringing tough decisions to resolution. While not all approaches will be the same, using a framework with similar characteristics often leads to more engaged Committee members and more organized meetings. In today's environment, with Say on Pay and increased shareholder concerns, it is increasingly important to have a best-in-class Compensation Committee.

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