

Compensation Committees: Good Governance Process Leads to Effective Decision-Making

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Compensation Committees (“Committees”) are held to the highest legal standard when setting the compensation of executive officers. That is, Committee decision-making must pass muster under fiduciary standards to be defensible and withstand judicial scrutiny. To meet these fiduciary standards, Compensation Committees should have in place a robust governance **process** from which to develop sound compensation determinations and outcomes.

A clear understanding of the **actual** responsibilities of the Committee is a predicate to developing a sound governance process. Typically, these responsibilities are and should be outlined in the Compensation Committee’s written charter. At a minimum, a Committee’s responsibilities should address the following items:

- Which executive positions fall under the purview of the Committee?
- What compensation and benefit plans and arrangements fall under the purview of the Committee?
- What are the Committee’s responsibilities with respect to compensation and benefit plans that fall under its purview?
- What corporate governance policies fall under the purview of the Committee?

This list is not exhaustive, especially as Committees must evaluate and make decisions on a myriad of non-routine matters, such as approval of employment agreements, special awards and inducement grants. It would be an understatement to observe that a Committee’s responsibilities are extensive and demanding.

Once a Committee’s responsibilities are developed and understood, the Committee should be in a position to implement a robust governance process, designed to facilitate the Committee’s ability to make effective and prudent decisions on compensation matters and outcomes.

Outlined below are the key elements of a robust principles-based governance process.

- *Annual calendar.* The Committee should develop a comprehensive annual calendar. It is critical to note that annual Committee calendars should be considered dynamic, reviewed continually and updated throughout the year to account for new and revised corporate priorities and ad hoc agenda items. A sample Committee calendar for a calendar year company follows the end of this article.
- *Preparation for Committee Meetings.* Another practice we recommend is to establish a definitive schedule for preparing for each Committee meeting. The schedule should allow for ample time to confirm meeting priorities and prepare presentation materials, with multiple opportunities for feedback on agenda items and materials among management, outside advisors and the Committee Chair. Keeping to the schedule should help ensure that the Committee materials are fully vetted for consistency with corporate priorities, regulatory implications and potential investor and/or market reactions, etc. It is not unusual for this meeting schedule to commence 6 to 8 weeks in advance of each Committee meeting.

- *Committee Liaison.* The Committee should designate a point person (or persons) on the management team to be the principal liaison (e.g., CHRO, head of executive compensation, corporate secretary) between management and the Committee Chair and the full Committee. The Committee liaison's primary responsibilities should include sending all relevant parties notification of the time and date of each Committee meeting and the meeting agenda, ensuring Committee meeting books include all relevant documents, forwarding the electronic or paper meeting books to all appropriate parties, and preparing and distributing minutes of each Committee meeting.
- *Two Meeting Review Process.* The Committee should discuss and evaluate particularly complex, sensitive or highly important matters over at least two Committee meetings. This suggested cadence will avoid a rushed decision-making process and help to ensure that Committee members have sufficient time to understand the details of the subject matter and reach a thoughtful and prudent decision. Where possible, the Committee's annual calendar should reflect and reinforce this decision-making process.
- *Executive Session Requirement.* The Committee should regularly hold executive sessions (generally, at each meeting) when the Committee members can discuss sensitive matters without members of the management team present in the meeting. As a general matter, the Committee's deliberation on CEO performance and compensation should be handled in executive session. Similarly, Committee deliberations on any other executive officer's performance and compensation should exclude that executive officer and other executive officers whose presence is not required.
- *Confirmation of Action Items/Decisions.* The Committee Chair should hold a "debrief" meeting with the Committee's advisors and management (together or separately, depending on the situation) within 3 to 5 days following each Committee meeting to confirm approved decisions, open issues and any action or implementation items going forward.

Building an effective governance process is not a specific project-based effort – rather, it is borne of a principles-based approach which continually evolves over time, starting with the building blocks described above. Once a Committee has a good handle on using these building blocks to implement its governance process, the Committee's fiduciary responsibilities are more easily fulfilled.

Sample Committee Calendar

	FY2020			FY2021	
	May 20	Aug 20	Nov 20	Jan 20	Feb 20
Ongoing Activities (covered at each meeting)					
■ Review and approve prior meeting minutes	✓	✓	✓	✓	✓
■ Review STI and LTI results to date	✓	✓	✓	✓	✓
■ Review compensation trends, emerging issues, and legislative developments	✓	✓	✓	✓	✓
■ Conduct executive session	✓	✓	✓	✓	✓
General Activities					
■ Review and approve executive compensation philosophy	✓	✓			
■ Review and approve executive compensation benchmarking peer group		✓			
■ Review benchmark analysis of total executive compensation		✓	✓		
■ Evaluate performance of executive officers				✓	
■ Review ISS and Glass Lewis reports	✓				
■ Review Say on Pay voting results and shareholder feedback		✓			
Base Salary					
■ Review base salary adjustments for executive officers				✓	
■ Approve base salary adjustments for executive officers					✓
Short-Term Incentives: FY20 STI Plan					
■ Review FY20 preliminary results against performance goals				✓	
■ Approve payouts for FY20					✓
Short-Term Incentives: For FY21 STI Plan					
■ Review preliminary FY21 STI design			✓	✓	
■ Approve FY21 STI design					✓
Long-Term Incentives (LTI): For Performance Cycle Ending 12/31/20					
■ Review LTI preliminary results against performance goals				✓	
■ Approve LTI performance-based award payouts					✓
LTI: For Performance Awards Granted in FY21					
■ Review preliminary LTI design & grant sizes			✓	✓	
■ Approve FY21 LTI design and grants					✓
Other LTI matters: Review equity plan run rate and overhang vs. peer group		✓			✓
Proxy Filing					
■ Review draft of CD&A (and tables)				✓	✓
■ Approve final CD&A (and tables) during March 2020					
Corporate Governance					
■ Review Compensation Committee charter		✓			
■ Conduct Committee self-evaluation					✓

	FY2020			FY2021	
	May 20	Aug 20	Nov 20	Jan 20	Feb 20
<ul style="list-style-type: none"> ■ Conduct risk assessment of compensation programs ■ Review compensation consultant independence ■ Review executive officer compliance with governance policies (e.g., share ownership requirements, anti-hedging and anti-pledging policies) 					✓
					✓
					✓

The Committee will also address certain items on an ad hoc basis that will not necessarily be reflected on the calendar, such as approval of out-of-cycle grants, approval of executive employment agreements, or adoption of new or amended severance policies and governance policies.