

## Principles to guide effective compensation governance

By Matt Stinner

## Compensation The Right Stuff

The new boardroom frontier requires developing defensible and logical structures for information gathering, decision making, communication, and ongoing oversight. The process must consider not just board and compensation committee members, but senior management; outside advisers such as accountants, lawyers, and consultants; and the views of external influencers such as institutional shareholders, proxy rating services, and regulators.

We have identified seven key areas where board members can take immediate action to

improve their oversight and management of executive compensation programs. Additionally, the board should consider how to craft effective and consistent executive compensation messages that address the different interests and priorities of employees, shareholders, and the media.

■ **Provide in-depth analysis.** Directors today are expected to develop a rich understanding of the inner mechanics of executive pay programs, such as the sensitivity of executive performance to outside factors, how pay compares to the marketplace, and the level of total payouts under various performance and termination scenar-

ios. Board members can develop a wider and deeper perspective from simple management summaries that outline plan components, analyze incentive metrics, and review pay trends.

■ **Establish and follow protocols.** As with most endeavors, the devil is in the details. Detailed written protocols that define processes help ensure that programs such as stock option plans are administered as intended by the committee.

■ **Create a compensation calendar.** An established executive compensation calendar provides timely notice to directors that key recurring events are due for discussion, providing an opportunity for thoughtful consideration of issues that otherwise might get short shrift or fall between the cracks.

■ **Make the best use of outside advisers.** The selection, evaluation, and replacement of outside advisers should be based on a clearly stated process. Moreover, board members should expect that they will serve in a truly advisory role by offering independent insight and judgment.

### Detailed minutes of meetings can serve as vital evidence of thoughtful deliberation.

■ **Define roles.** Responsibilities should be clearly defined to ensure that the compensation committee, full board, and management each retain and are limited to oversight of appropriate issues.

Adherence to clearly defined and appropriate roles and responsibilities in the governance process ensures that the right group or individual is recommending, approving, monitoring, and implementing elements of the executive compensation program.

■ **Clarify communication.** A formalized policy clarifies how information should flow among committee members, the full board, management, and advis-

■ **Document the details.** Directors need easy access to background compensation materials and data not just in advance of meetings, but on an ongoing basis. The ability to readily refer to plan documents, employment contracts, the committee's compensation philosophy, and other key data allows more time for consideration of issues and helps prevent "partial picture" decision making.

Moreover, as demonstrated by the Disney ruling, detailed minutes of meetings, including any disagreements among members,

can serve as vital evidence of thoughtful deliberation of controversial decisions. Without a detailed record of committee members' discussions, it is difficult to maintain continuity between meetings and to educate new directors who may lack institutional knowledge.

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