

# **Improving Executive Compensation Governance: Strategies and Best Practices**

**June 20, 2007**

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## ■ Our Speakers

- **David Swinford**, President of Pearl Meyer & Partners, works closely with compensation and governance committees as well as Boards to help link compensation with business strategy; including incentive plan design, the development of meaningful performance standards as well as contractual arrangements.
- **Matthew Stinner** is a Managing Director and head of the Boston office of Pearl Meyer & Partners. He advises clients on compensation strategy and governance philosophy and implementation, as well as all areas of executive and employee compensation.
- **Howard Breindel** is co-founder and partner of Directors Desk. He brings extensive experience building successful businesses with in-depth expertise in the convergence of technology and corporate communications. Directors Desk is currently used by dozens of Fortune 100, midcap and small cap companies representing more than 1500 directors in over 25 states.

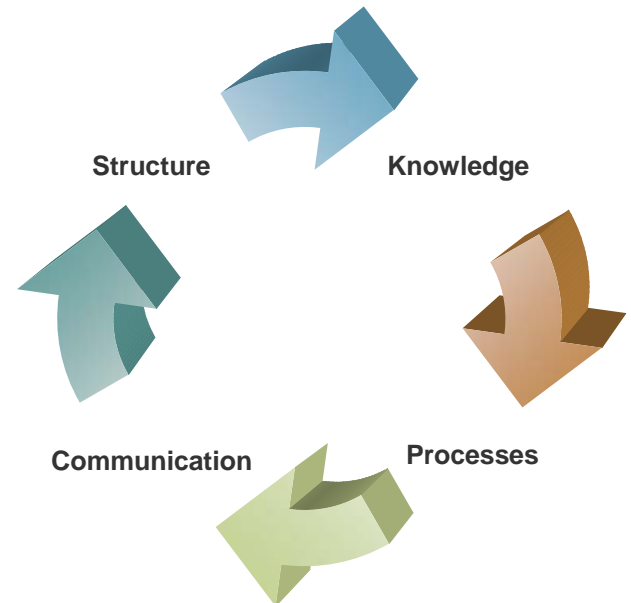
- **Introduction**
- **Executive Compensation Governance Overview**
- **Emerging Best Practices**
- **Key Issues in Light of Governance Best Practices**
  - Aligning pay and performance
  - Capitalizing on CD&A lessons
  - Executive pay communications
  - Today's decisions under tomorrow's lens
  - Maximizing technology
- **Directors Desk**
- **Questions and Answers**



# Executive Compensation Governance Overview

# What is Executive Compensation Governance?

- **Governance is the protocols within which executive compensation decisions are made and implemented by Directors and others**
- **Participants in the framework include**
  - Board members
  - Compensation Committee members
  - Company management
  - Advisors such as accountants, lawyers, administrators and consultants
- **Effective governance requires the right structure, knowledge, processes and communication**



## ■ Why is Governance Such a “Hot Issue”

- **Media hype and newsworthy executive compensation blow-ups**
- **Option backdating, spring-loading and other scandals**
- **Regulatory inquiries and accounting restatements**
- **Institutional shareholder activism**
- **Increased regulatory action, attention from Congress and the IRS**
- **Financial exposure and reputational risk**

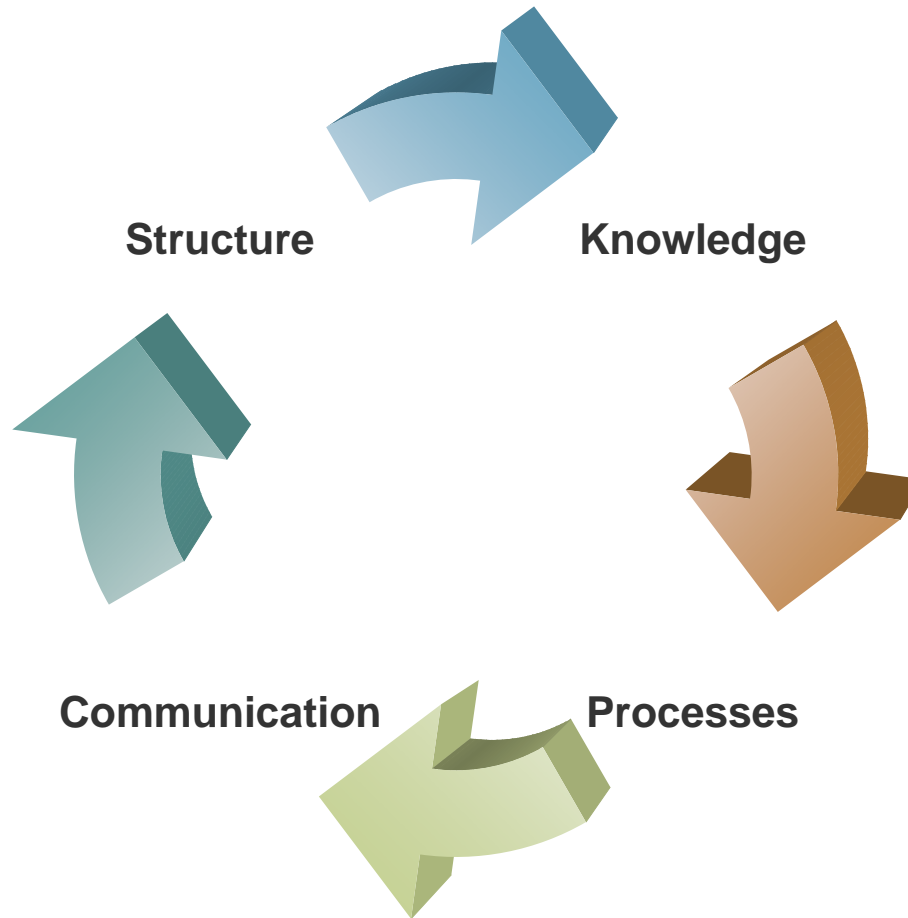
## ■ High-Level Governance Challenges

- **Insufficient Processes** – lack of established and documented processes for critical Compensation Committee functions
- **Lack of Continuity** – lack of continuity from meeting to meeting and from old Directors to new Directors
- **Communication and Access** – inability to effectively communicate among Directors and Management
- **Document Management** – ineffective document management capabilities for key executive compensation documents
- **Collaboration** – difficulty enabling collaboration among Directors



# Emerging Best Practices

# Emerging Best Practices



## ■ The Right Structure



- **Separate Compensation Committee with appropriate independence**
- **Compensation Committee members with the right skills and experiences**
- **The right connectivity between the Compensation Committee and other Committees**
- **An established executive compensation calendar with timely reminders**
- **Clear and appropriately leveled roles and responsibilities for recommending, approving, monitoring, and implementing elements of the executive compensation program**
- **Appropriate checks and balances within the structure**
- **Committee documentation**

## ■ The Right Knowledge



- **Board training and education on the role of the Committee**
- **All necessary documentation available, current and understood by Committee members (e.g., plan documents, employment contracts, compensation philosophy)**
- **Appropriate advisors engaged by the Committee to supplement knowledge and make recommendations**
- **Understanding of incentive plans and fundamentals behind targets**
- **Knowledge of elements of executive pay, historical compensation, how elements compare to the market and what compensation could be prospectively**
- **Continuity of institutional knowledge with management/Director changes**



- Overall meeting processes
- Oversight and monitoring (due diligence) of administration
- Selection, management and termination of advisors
- **Establish formal processes governing key recurring events:**
  - Annual and special executive compensation decisions
  - Incentive strategy and goal setting/measurement
  - Pay for performance assessment
  - Testing compensation paid versus compensation philosophy
  - Plan design component and strategy changes
  - Setting Board compensation
  - CD&A/summary table preparation



- **Protocols for information flow among key constituencies within the governance structure - Board, Compensation Committee, management and advisors – concerning communication:**
  - Timing
  - Form, and
  - Content
  
- **General communication strategy relating to executive compensation:**
  - For employees
  - For shareholders
  - For the media
  
- **Message kit for response to public/media inquiries**
  
- **Designated spokesperson(s)**



## Key Issues in Light of Governance Best Practices

## ■ Aligning Pay and Performance

- **Failure to align pay and performance is drawing attention:**
  - Driving shareholder activism
  - Drove new SEC disclosure rules
  - Continues to be a challenge
  
- **Sample governance practices that could minimize these issues:**
  - Appropriate **structure** to ensure approval, monitoring and implementation of incentive plans at proper levels
  - More Board **knowledge** around issues such as how incentives interrelate, what they drive, what's reported to the street vs. what the plans are based on, how executives would have been paid over last 3 years under a proposed plan
  - Clear **processes** that drive clear management presentations around incentive metrics to the Board and a thorough vetting of all proposed metrics, plan payouts and exceptions
  - Clear **communication** among the Board, management and shareholders around why the company has established its incentive programs, what they're designed to reward, how they're supposed to pay out, and how they actually pay out

## Capitalizing on CD&A Lessons

- **CD&A preparation challenged many companies:**
  - Insufficient minutes and lack of recall on decision reasoning
  - Inadequate compensation philosophies
  - Necessary information scattered
- **Good governance practices would help companies minimize the pain and risk associated with the CD&A:**
  - Formalize the governance **structure** with formal annual calendars and clear and appropriately leveled roles and responsibilities with easily accessible supporting documentation
  - Improve **knowledge** of the “why” behind decisions and the application of decisions to the compensation philosophy
  - Implement a post-CD&A mortem **process** to ensure that open items, difficult disclosures, and questionable decisions aren’t dropped until next year
  - Formalize **communications** among governance participants to ensure continuity in decision-making year-over-year and from incoming and outgoing Directors

## ■ Communicating Executive Pay Strategy

- **Most companies are not prepared to effectively address communications regarding their executive pay practices:**
  - What happens if the media calls?
  - Is there a clear and consistent company message?
  
- **Sample governance practices that could minimize these issues:**
  - A **structure** that has the right connectivity between the Board's Committees and company spokespeople
  - Complete **knowledge** and understanding of the company's executive compensation philosophy
  - **Processes** that ensure that the right people are communicating at the right times and to the right constituencies
  - Clear **communication** among all participants in the governance structure around key messages, compensation philosophy, and unusual situations

## ■ Today's Decisions Under Tomorrow's Lens

- **Yesterday's decisions judged by today's standards:**
  - Option grant timing
  - Information management
  - SERP accumulations
  
- **Sample governance practices that could have minimized these issues:**
  - Better checks and balances in the governance **structure** to ensure critical decisions are not made at the wrong levels
  - More Board **knowledge** around dynamic compensation and trends in executive compensation
  - **Processes** requiring regular reviews of dynamic compensation and equity grant timing
  - Better **communication** to avoid “partial picture” decision-making

## ■ Today's Decisions Under Tomorrow's Lens

- **Example of current issue that could create a similar issue:**
  - Change-in-control agreements with gross-ups or “no action” on 280G that are either too expensive or “inefficient”
  
- **Reason for today's position:**
  - Prevalence supports position
  
- **Tomorrow's Lens:**
  - Executives, not companies, responsible for taxes
  - CIC agreements should maximize benefit to company & executives
  
- **Governance Angle:**
  - Spend the time to truly gain the **knowledge** of your current CIC agreements – require simple readable summaries
  - Establish a **process** to regularly quantify CIC agreements with growth assumptions
  - Develop a **communication** strategy to address agreements you can't get changed

## ■ Maximizing Technology

- **Technology has the ability to improve governance practices:**
  - Technology can streamline executive compensation governance
  - Pearl Meyer & Partners has developed a relationship (non-financial) with an excellent governance portal – Directors Desk
  
- **Technology such as the Directors Desk portal facilitates:**
  - Mapping an effective governance **structure**, maintaining a single calendar with timely reminders with all relevant documents attached each calendar event
  - Establishment of a continuity of institutional **knowledge** by providing a single, easy access repository for key documents, contracts, consultant's reports, management presentations, etc.
  - Development of **processes** that can be maintained and tied to the event calendar to ensure that all critical task and processes occur during the year and are consistent year-over-year
  - **Communication** among all participants with secure e-mail, private message boards, a polling feature, contact information and a webcast feature



## Directors Desk Technology Solution



# Pearl Meyer & Partners' Executive Compensation Services

- **Governance Risk Management Review**
  - Governance structure, systematic knowledge, processes and communications around executive and Board compensation
  - Examines roles and responsibilities in the structure for recommending, approving, monitoring and implementing elements of the executive compensation program
  - Includes a comparison of by-laws and charters to actual practices
  
- **Board & Committee Education**
  - Explain rules and standards for governing executive compensation
  - Outline organization's programs based on documents, minutes and public filings, including a review of best practices in governance
  
- **Assessment of Governance Documents**
  - Compilation and review of all documents pertaining to salary, incentives, benefits and perks for executives
  - Includes plan documents, security arrangements, administrative guidelines, charters

- **Establishment of Core Executive Compensation Processes**
  - Establish and document processes for major executive compensation processes
  - Establish frequency of implementation of each process and assist with development of the annual calendar
  
- **Development of a Board Portal**
  - Create a Board Portal hosted by **Directors Desk**
  - Provides host of services:
    - » Calendar and event management tools
    - » Collaboration tools
    - » Document management tools
    - » Secure e-mail and online discussions
    - » Voting and survey capabilities
    - » Contact management
    - » Web conferencing
    - » Compensation process summaries
    - » Communication protocols and more

## Questions & Answers

- **For copies of this presentation please visit:**
  - <http://www.pearlmeyer.com/directorsdesk>
  
- **A link to the recording of this Webcast will be available Tuesday at:**
  - <http://www.pearlmeyer.com/directorsdesk>

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