

NACD Event Highlights

October 12, 2010 Breakfast Event

The Next Challenge for Compensation Committees – Ensuring Pay and Performance Alignment in 2011 & Beyond

Before Dodd-Frank and ‘Say on Pay,’ a company’s Compensation Discussion and Analysis (CD&A) served as a disclosure exercise. Going forward, the CD&A will be an advocacy document. Starting with the executive summary, CD&As will have to demonstrate responsiveness to shareholder concerns, that risk-taking has been mitigated, and that executive pay has truly been connected with performance.”

—Compensation Consultant “Mike Paydoc”

- Which pay for performance metrics best correlate with shareholder value creation?
- How has the Dodd-Frank financial reform law changed the regulatory landscape for Compensation Committees?”
- Do clawback provisions affect risk-taking behavior in the real world?

A meeting of the compensation committee of the fictional “Superior Software Corporation” – a \$2 billion, Massachusetts –based software and services company – was the focus for NACD New England’s October 12, 2010 Breakfast Event. Three executives with extensive board experience and a consultant to the compensation committees of companies across New England role-played a crucial meeting of Superior Software Corporation’s Compensation Committee that focused on the company’s 2011 executive compensation plan.

Portraying the role of compensation committee chairman “Peter Compsay” was James Coppersmith, vice chairman of Rasky Baerlein Strategic Communications, a widely respected, Boston-based public relations and marketing company. Coppersmith is or has been a director of the Pizzeria Uno Corporation, Chyron Corporation and numerous other publicly held companies and nonprofit organizations.

The role of Superior Software’s CEO, “Joe Stickler,” was played by George McClelland, a veteran corporate executive and entrepreneur who serves on the boards of Safeguard Scientific, where he is chairman of the nominating and governance committee and a member of both the audit and compensation committees, as well as Friends of the Children – Boston and F Squared Investments.

Playing the role of Superior Software’s senior vice president of human resources, “Jane Fairness,” was Allison Quirk. An executive vice president at State Street Corporation, Quirk serves as head of global human resources and a member of the company’s management committee. She also is or has been a director of Boston Financial Data Services, the Boston Ballet, the Massachusetts Conference for Women and Ellis Memorial House.

Portraying the role of “Mike Paydoc,” consultant to the fictional Superior Software Compensation Committee, was Steve Van Putten, managing director in the Boston office of Pearl Meyer & Partners, an independent advisor to boards and senior management in the areas of compensation governance, strategy and program design. Van Putten consults across a range of industries working extensively with Fortune 1000 companies primarily at the board level.

The discussion opened by focusing on the first item on the agenda [\[link to PowerPoint deck\]](#), the future regulatory implications of Dodd-Frank. In addition to the currently required Risk Analysis disclosure and the near-term issue of Say on Pay, committee members discussed potential future disclosure requirements related to pay for performance, internal pay equity and clawback policies.

The group then went on to review current marketplace trends in short-term and long-term incentive compensation using the fictional positioning of Superior Software as a springboard for a broad review of key issues. They discussed the prevalence of various company financial performance metrics ranging from the frequently used EPS growth to the less-common return on invested capital or return on net assets. They discussed the pros and cons of available compensation vehicles, citing a combination of stock options and time-based restricted stock as the vehicle most prevalent in Superior Software’s industry.

The committee then turned to a key issue in compensation planning: the correlation between a company’s total compensation, individual compensation and corporate performance as measured by total shareholder return. Using fictional Superior Software’s proposed 2011 compensation plan as the focus for analysis, Coppersmith, McClelland, Quirk and Van Putten shared their opinions not only on the features and structure of Superior’s plan, but also on a number of underlying issues.

Key among these issues is the extent to which a company’s executives and other employees who receive incentive compensation 1) are familiar with their plan and its benchmarks, 2) understand how their individual performance translated into pay during a given period, and 3) actually align their behavior with their incentives and, as a result, collectively produce the intended improvement in corporate results and growth in shareholder value.

The fictional directors wrapped up this segment of the meeting by highlighting the all-important issue of how to structure compensation plans to ensure that the realizable value delivered to executives is aligned with total shareholder return performance.

Superior Software’s Compensation Committee meeting concluded with a review of fictional management’s 2011 compensation program recommendations and agreement on next steps for management and the committee’s consultant. Following that was an audience question-and-answer session that focused on a variety of incentive compensation issues, including:

- Should compensation be adjusted when macro trends affecting the stock market have greater influence on shareholder return than executive performance?

- Why track any metrics other than total shareholder return in setting executive compensation?
- How should “long-term” be defined; why does it typically mean three years?
- What can be done to accommodate growing shareholder concerns about the impact of severance pay on a company’s total compensation?
- Are there steps that compensation committees can take that go beyond the disclosure in the Compensation Discussion and Analysis to communicate the reasoning behind their companies’ compensation plans?

Echoing the question above, Chapter Chief Operating Officer PJ Blankenhorn adjourned the October 12th program with a reminder about the next NACD New England Chapter Breakfast Event on Tuesday, November 9, 2010: *Board-Shareholder Communications – Speak Now or Forever Wish You Had*. The event will be held at the Newton Marriott Hotel.