

Third
Edition

Understanding
Executive
Compensation
& Governance

A Practical Guide

Edited by
Irving S. Becker & William M. Gerek
Korn Ferry Hay Group

Understanding Executive Compensation & Governance

**A Practical Guide
3rd Edition**

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PROLOGUE

This third edition of our book has been retitled *Understanding Executive Compensation & Governance: A Practical Guide* to reflect our expanded scope on critical topics that boards of directors must address. Our book is a reference guide for compensation committees and other board members, HR professionals, corporate management and other decision makers. Its purpose is to furnish readers with easy access to a wide range of executive compensation and board governance topics by providing insight on current best practices, design techniques and trends.

Understanding Executive Compensation & Governance is a hands-on, practical guide that we hope helps in the evaluation and refinement of executive compensation programs and board governance. A major challenge confronting boards and executive compensation professionals today is establishing a consistent and transparent connection between pay and value added. This must be done in an environment in which regulators, shareholders and even lawmakers carefully scrutinize all aspects of executive compensation, benefits and perquisites — especially the relationship between pay and performance. In addition, boards need to both evaluate top executive talent and the board itself, while also managing succession for the CEO and board members in an orderly and thorough process.

We believe companies are well-positioned to respond to current challenges. The Dodd-Frank Wall Street Reform and Consumer Protection

Act of 2010 (Dodd-Frank) and rulemaking by the U.S. Securities and Exchange Commission (SEC) have raised the bar on governance standards. The SEC and various stakeholders will continue advancing this process, so ensuring board and senior-executive accountability is as important as ever. The requirements of the say-on-pay provisions under Dodd-Frank and enhanced compensation disclosure have improved transparency of the programs and facilitated competitive analysis, thus providing a clearer idea of how companies think and operate. In addition, accounting rules allow flexibility in designing compensation programs that better reflect pay-for-performance principles. Compensation expense no longer dictates plan preference. This level playing field provides compensation committees with additional vehicles to use in designing executive pay programs that meet business strategy needs.

These issues are only some of the topics we address in this new edition. The following chapters are a compilation of articles by Korn Ferry Hay Group consultants from *The Executive Edition* series, supplemented by material written specifically for this volume. This is not a technical reference per se; in focusing on what works best, we have avoided presenting too much detail on tax, accounting and regulatory issues.

This book is targeted mainly to a U.S. audience; nonetheless, with its focus on design, we believe it is a useful resource for non-U.S. companies operating in a pay-for-performance environment. In this edition, we have updated and expanded previous chapters with new material as well as developing several new chapters. Notably, we added two new parts to the book on topics that we have captioned the CEO Life Cycle and the Board Life Cycle. These address the issues of compensation, evaluation and succession of CEOs and board members, respectively. Other new chapters cover executive pay in bankruptcy proceedings, retention awards, sign-on bonuses and compensating executives at portfolio companies of private equity firms, as well as litigation regarding executive and director compensation.

The chapters are grouped in five sections:

- “Part I: Executive Pay Design and Strategy” examines issues relating to overall executive compensation strategy and includes design

issues relating to the basic components of pay — base salary, annual incentives, equity and non-equity long-term incentives — plus discussions of related topics, such as peer group selection, performance measurement, competitive benchmarking, stock ownership guidelines, executive benefits, equity retention and employment agreements.

- “Part II: Governance, Disclosure and Compensation Committee Initiatives” begins with a discussion of compensation committee governance followed by a chapter on the tools compensation committees use in overseeing executive compensation. We next discuss the basic principles affecting current executive compensation disclosure, followed by a chapter on the recent requirement to address potential risk in executive compensation programs.
- “Part III: The CEO Life Cycle” starts with a summary explaining the three core topics of CEO evaluation, succession and special compensation. Because much of the preceding chapters address executive compensation matters that are especially pertinent to CEOs, we devote a chapter to the often-neglected area of CEO evaluation and feedback before turning to the critical area of planning for CEO succession. Too often these topics are examined in isolation when a more effective approach is to consider them together. Finally, we discuss two special topics relating to CEO pay — compensation strategies related to various CEO transitions and CEO compensation when preparing for an IPO.
- “Part IV: The Board Life Cycle” identifies three core components of board evaluation, succession and pay, following a similar approach as was taken in Part III regarding CEOs. In today’s governance climate, the duties and responsibilities of directors have expanded significantly; boards cannot fall behind in addressing the challenges and opportunities presented in a fast-changing business world.
- “Part V: Executive Compensation in Special Settings” addresses the compensation issues that arise in extraordinary situations, such as mergers and acquisitions, initial public offerings, bankruptcy, private equity portfolio companies, and other special situations. We also include a chapter on executive and board compensation in tax-exempt organizations. Finally, we end with a chapter on

international compensation which addresses executive pay issues in ten major countries: Australia, Brazil, Canada, France, Germany, Italy, Mexico, the Netherlands, Singapore and the United Kingdom.

I would like to thank WorldatWork for publishing this third edition of our book and Korn Ferry for its ongoing support of our executive compensation and board initiatives. Korn Ferry acquired Hay Group in December 2015 and our executive and board compensation consulting team is now a part of Korn Ferry Hay Group. I also want to thank our clients who furnished insights in working together on executive pay and board projects.

Special thanks once again go to Bill Gerek, my co-editor. As the long-time editor of Hay Group's *The Executive Edition*, he has created a consistent theme and tone for our executive compensation and board publications over the years. Most of all, I would like to thank the consultants who have contributed their time, effort and intellectual capital to making this book possible.

A handwritten signature in black ink, reading "Irv S. Becker". The signature is fluid and cursive, with a long horizontal stroke at the end.

— Irving (Irv) S. Becker
North American Leader —
Executive Pay & Governance

Praise for *Understanding Executive Compensation & Governance: A Practical Guide*

In this book, Irv Becker and Bill Gerek have charted a course that delivers practical guidance and focuses on what readers need to know on executive pay. In this 3rd edition, they have broadened their scope to include discussion on new topics, with more attention on some of the governance challenges surrounding executive and board compensation that I, as a board member, face regularly. They provide innovative guidance on some of my favorite topics, including the CEO lifecycle, succession planning and performance evaluation. When I face a challenge, this book is one of the places I turn to.

— Sarah Raiss, Compensation Committee Chair, Commercial Metals Co., and Corporate Director of Loblaw Companies and Vermillion Energy

In a well-organized and understandable manner, Irv Becker and Bill Gerek address the key considerations involved with paying top executives and board members. Each chapter begins with a helpful summary of what is covered, enabling readers to quickly determine whether to proceed. The fundamentals of each component of this increasingly complex area are discussed and valuable insights are provided, all while avoiding technical details that could easily become outdated or be distracting. Written with a lengthy shelf-life in mind, this book is an invaluable reference for anyone with responsibilities relating to executive or director compensation, especially compensation professionals and board members.

— Jeffrey Blair, Vice President-Total Rewards, Ingersoll-Rand plc

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This book provides an understandable and practical guide to the broad scope of topics that can impact executive and director pay. Just as the 2nd edition updated and expanded the topics addressed in the original publication, this 3rd edition builds on that strong foundation with new or updated material and an increased focus on governance concepts. The book is easy to use, with illustrative tables, sidebars and examples that clarify areas covered in the text. Each topic is thoroughly discussed, but without getting sidetracked by tangential points, and it helps the reader get things done. Of particular importance, the book is relevant to issues I encounter and can be especially helpful in reaching decisions amid time constraints. I recommend having this book nearby whenever you need to consider questions in this challenging area.

— Doreen E. Lillienfeld, Practice Group Leader, Compensation Governance & ERISA, Shearman & Sterling LLP

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