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3 KEY STRATEGIES

For Executive Compensation Committees

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A strong executive compensation committee is vital in helping your organization reach its goals, but it's not always an easy process.

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Executive Summary

With the continued focus on executive compensation and the evolving regulatory environment, the role of compensation committees is emerging as a key governance tool. The call for increased transparency has also led to increased responsibilities. Given this, it is more important than ever for executive compensation to work effectively. The following article highlights three key strategies - role definition, strategic planning, and process - for maintaining an effective executive compensation committee.

In This Whitepaper

Incorporate these three key strategies to ensure more efficient meetings and more effective decision-making:

1. Define the Role of the Compensation Committee and its Members
2. Integrate Compensation Committee workwith the Strategic Planning Cycle
3. Establish Effective Committee Processes

Key 1: Define Roles

There's no question that executive compensation continues to be a complicated mixture of emotional, value-laden issues.

An executive compensation committee's first step toward achieving success is defining its role in the board governance process and how it will work on behalf of the full board and the membership.

Executive compensation committees are typically comprised of three to five members. While a credit union usually appoints directors to the committee, a board should not hesitate to solicit additional volunteers to strengthen its collective expertise and knowledge. For example, human resource executives, academia, attorneys, and local business owners can add value to the process when a board seeks additional diversity. Committee members with different backgrounds can lead to better discussions and ultimately stronger decisions.

The committee chair should be a strong facilitator who stresses open discussion, transparency, and willingness to hear opposing viewpoints while being an effective communicator and consensus builder.

The Job of an Executive Compensation Committee Defined

The executive compensation committee shall discharge the responsibilities of the board relating to the compensation of the credit union's chief executive officer and produce the annual report on executive compensation for inclusion in the credit union's records.

The biggest red flag for an ineffective committee is where committee work is redone at the board level. In other words, the full board questions the committee's work to the point that it basically starts from scratch. The committee chair must stand strong to protect the integrity of the process by making sure the full board is prepared to make effective executive compensation decisions.

3 Things an Effective Compensation Committee Must Understand

Pay for Performance Linkage

Today it's not enough for a compensation committee to simply gather some pay data and recommend a pay increase. There is much more emphasis on the "what" a credit union rewards through its compensation programs and "how" an executive earns his or her compensation. The ability to understand a credit union's revenue engine, ALM strategies, and budget assumptions are more critical than ever as compensation committees need to document "why they pay what they pay" for regulators, the membership, and other stakeholders.

Total Executive Compensation

Executive total rewards today include base salary, incentive programs, benefits, and retirement programs. Each program is a piece of the puzzle that influences executive recruitment and retention. While some credit unions have separate compensation and benefits committees, we have found a credit union is best served having one committee that oversees all executive programs. In many cases, a committee deals with executives who are designated as highly compensated employees by the IRS, which means special considerations in how these executives are treated in a credit union's benefit programs.

Executive Compensation Benchmarking

There has always been a debate as to the merits of establishing meaningful peer groups and the lack of quality compensation information available in the market today. While banks can pull SEC disclosures to obtain valid executive compensation data, credit unions must rely on industry salary surveys and IRS 990 reports that are two years old at best. It's a delicate balance between identifying similar-sized credit unions to create a peer group compared to larger credit unions that might be targeting your executives. Each year a committee should evaluate the strength of its peer group definition and the utility of its compensation data sources to reaffirm that they are meeting the credit union's requirements.

Key 2: Strategic Planning

World-class executive compensation committees are committed to integrating their work into the strategic planning cycle through the following action steps:

1. **Review the executive compensation committee charter annually.**
   Ensure that the committee complies with its responsibilities and see if any changes are required based on regulatory changes or evolving practices.

2. **Review the annual calendar at the start of each year.**
   Highlight the key priorities for the year (e.g., SERP or annual incentive plan redesign).

3. **Allocate dollars to continuing education on emerging topics.**
   Continue studying the risk assessment process, succession planning, payfor-performance, and executive retention strategies. New committee members benefit greatly from education focusing on the credit union's historical executive pay practices and performance.

Key 3: Decision-Making Processes

The final step to ensuring world-class executive compensation decisions is worldclass decision-making and continuity year-to-year. Effective committee processes include:

- ☐ Set meeting dates with sufficient lead time to ensure full attendance by committee members, management, and external consultants.
- ☐ Preview formal meeting agendas and establish time limits for each topic.
- ☐ Preview meeting materials in advance of meetings to address all issues that may potentially arise.
- ☐ Schedule major decision issues to span two meetings to give the committee time to review and fully evaluate prior to final approval.
- ☐ Ensure ongoing communication with management to have context for decision-making.
- ☐ Evaluate each year's actions relative to established goals to ensure alignment - assess the need for any mid-plan modifications based on changes to the business plan.
- ☐ Monitor evolving regulatory and corporate governance practices by including the topic as an annual item for the committee and during the strategic plan meeting for the full board.
- ☐ Schedule formal feedback after each committee meeting with the committee chair, the chief executive, and external consultants.
- ☐ Conduct an annual self-assessment of the committee's effectiveness and assess the value contributed by external consultants.

About the Author

John W. Andrews, CCP, CSCP, SPHR, Executive Vice President, specializes in staff and executive compensation, board governance, sales and variable pay design, and strategic planning. John has worked for D. Hilton Associates since 1986 and for KPMG, the Center for Coastal Studies, and the National Association of Insurance Women. He has served as an expert witness and executive compensation consultant to regulatory agencies such as NCUA, the Pennsylvania State Department of Banking, and the California Department of Business Oversight. John has served as an executive compensation and organizational development consultant to numerous corporate, not-for-profit, and trade associations, including the Texas Methodist Foundation, the ELGA Mission Investment Fund, the Texas Municipal League, and The Woodlands Ballet Theatre. John is currently an Associate Director on the Houston Achievement Place's Board of Directors.

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