



## Principles and Elements of Effective Executive Compensation Design

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# Foreword

Executive compensation (EC) is one of the most powerful – and expensive – tools an organization has for driving performance, fostering alignment, creating accountability and communicating priorities to stakeholders. As such, it is subject to significant oversight by boards, in-depth public disclosure, and intense scrutiny by investors and government regulators. Increasingly, Board committees responsible for executive pay are also responsible for broader human capital issues and incorporating environmental and social factors into executive incentives. Executive compensation today has become a frequent lightning rod for criticism and a symbol of how organizations govern themselves and respond to the concerns of stakeholders.

Clearly, there is no dearth of opinions on pay levels and practices today, and no lack of proposed cures for perceived problems and shortcomings. But is executive pay really broken, as some critics contend? And, if so, what should be done about it? And how can executive compensation be harnessed to help foster positive change and healthy, sustainable organizations?

To help answer those questions, Willis Towers Watson's market-leading Executive Compensation consulting practice embarked on an ambitious – and ongoing – project to research the full range of views on pay for senior executives to see if a consensus is emerging on what's working and what's not. We also conducted additional research on EC program effectiveness using our many proprietary surveys and databases and leveraging publicly available data. With this combined scan of the current landscape and our research as starting points, we then conducted a series of in-depth workshops to distill the insights and experience of more than 100 of our senior EC consultants. In parallel, we collected the views of hundreds of board members across various organizations and industries to develop core principles for the governance of EC. The collective results of these efforts: **Willis Towers Watson's Principles and Elements of Effective Executive Compensation Design**. These represent a detailed framework of recommendations and considerations for pay program design that can help EC practitioners, corporate management and boards make better decisions about what — and how — to pay their top executives.

## Many opinions, little guidance

One of the key steps in this process is to continually review the available literature, research and commentary on executive pay published over the past decade or more by a wide range of stakeholders: academics, institutional shareholders and other shareholder groups, regulatory agencies, leading business and professional groups (e.g., corporate directors), compensation consultants, and others. What is clear from this review is that opinions and prescriptions for sound executive pay practices abound, but clear, comprehensive and unbiased guidance to help organizations set pay appropriately is rare.

This is not to say that thoughtful positions on executive pay and the pay-setting process are nowhere to be found. On the contrary, the published literature offers a wealth of insights and ideas. For example:

- The Aspen Institute Business & Society Program's [Modern Principles for Sensible and Effective Executive Pay](#)

- The Business Roundtable's [Executive Compensation Principles and Commentary](#)
- Among the more influential reports (because they had the force of law for financial services companies that received government bailouts during the financial crisis) was the *FSB Principles for Sound Compensation Practices*, published by the Financial Stability Board (September 25, 2009).
- A number of academic studies have explored the escalation of executive pay from the perspective of the principal-agent theory, frequently concluding that systemic factors in the free enterprise model enabled corporate executives — the “agents” hired by shareholders (i.e., the “principal”) to run their organizations — to put their own interests first. However, we would note that others have demonstrated that executive pay, while high, is relatively stable, tied to performance and market-based.

However, none of these efforts dive into the details of design and ongoing implementation — the critical elements and specific decisions that drive pay program effectiveness.

## What's working — and what's not

While there is little consensus on the specific principles that should guide EC decisions, our review of the published literature suggests that the views of diverse stakeholders have coalesced around a loosely shared point of view on what's right and wrong with pay at the top of the house in major organizations today. Although not every stakeholder would concur with every statement on this list, some of the most common themes are summarized in the following table.

Subject	What's (generally) working	What's (generally) not
<b>Pay philosophy</b>	<ul style="list-style-type: none"> <li>■ Most organizations deliver the bulk of executive pay via incentive programs that are linked to business strategy and long-term shareholder value creation.</li> </ul>	<ul style="list-style-type: none"> <li>■ Compensation strategies are often piecemeal and static.</li> <li>■ The various components of EC are often set independently, with insufficient consideration as to how they interact with each other or with pay for the rest of the organization (although this is changing significantly at many companies).</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>■ Boards of directors and compensation committees in many organizations are devoting more care and attention to compensation issues.</li> <li>■ This trend is most pronounced in countries where legislation has made the role of the compensation committee increasingly visible and demanding.</li> <li>■ Compensation committee roles are expanding to include broader human</li> </ul>	<ul style="list-style-type: none"> <li>■ Compensation committees sometimes play a narrow compliance role when a more strategic view is needed.</li> <li>■ Committees often struggle with how to operationalize their expanding role.</li> </ul>

Subject	What's (generally) working	What's (generally) not
	capital issues, and compensation for environmental, social and governance ("ESG") factors.	
<b>Disclosure and shareholder communication</b>	<ul style="list-style-type: none"> <li>■ Organizations are increasingly sensitive to outside perspectives (e.g., shareholder views, voting guiding agencies, proxy advisors, public opinion).</li> <li>■ This trend is most pronounced in countries where organizations are required to conduct say-on-pay votes.</li> <li>■ This has also led to improved communication between organizations and shareholders and improvements in the quality of disclosure.</li> <li>■ In key markets globally, there's growing transparency in pay arrangements and design.</li> </ul>	<ul style="list-style-type: none"> <li>■ Overemphasis on the tests of voting guiding agencies and proxy advisors can result in undue conformity and a race to the middle in program design. Relatedly, many organizations focus too narrowly on short-term results, total shareholder return (TSR) alone and/or the compensation of the CEO (versus the broader executive cadre).</li> <li>■ Despite improvements, pay disclosure remains dense and is often not written in plain English.</li> </ul>
<b>Program design and benchmarking</b>	<ul style="list-style-type: none"> <li>■ Pay outcomes are generally determined in an active and competitive market for talent.</li> <li>■ Total pay is typically reviewed annually, and potential payouts are modeled under various scenarios.</li> </ul>	<ul style="list-style-type: none"> <li>■ Benchmarking can be misapplied or oversimplified and can contribute to a ratcheting up of pay.</li> <li>■ There's a temptation to cherry pick peer organizations or data points in setting market reference points. Organizations are forced to revert to the median, but the median might not be the ideal standard in all cases. Market practice, best practice and best fit are used synonymously, when in fact they are not synonymous.</li> <li>■ Incentive plan goal setting isn't consistently robust.</li> <li>■ Goal-setting processes are based primarily on budget, and there's a historical overreliance on TSR as a performance metric.</li> <li>■ Goals might not reflect true long-term performance requirements and expectations (i.e., insufficient stretch).</li> </ul>
<b>Performance-based pay</b>	<ul style="list-style-type: none"> <li>■ Executive pay is generally sensitive to performance — increasingly so over time.</li> </ul>	<ul style="list-style-type: none"> <li>■ Performance targets are often arbitrary and subject to negotiation and do not consider strategic and nonfinancial measures.</li> </ul>



Subject	What's (generally) working	What's (generally) not
	<ul style="list-style-type: none"> <li>■ Performance measures and targets are generally set in advance and are increasingly disclosed.</li> <li>■ ESG measures are increasingly incorporated into incentive plans, although some tend to be overly subjective.</li> </ul>	<ul style="list-style-type: none"> <li>■ Rigorous analyses of performance ranges and payout curves are often lacking.</li> <li>■ Pay-for-performance assessments are not widely conducted, especially outside the U.S., and are often too narrowly focused.</li> </ul>
<b>Risk mitigation</b>	<ul style="list-style-type: none"> <li>■ In major markets, including the U.S. and U.K., there's growing use of clawbacks and bonus deferrals (led by the financial services industry) to ensure that pay outcomes are aligned with long-term performance.</li> </ul>	<ul style="list-style-type: none"> <li>■ Despite share ownership guidelines, many executives still lack a true ownership mentality.</li> <li>■ Contractual provisions for special circumstances (e.g., executive contracts, CIC treatment, individual termination arrangements) often require closer scrutiny and attention.</li> </ul>

## Beyond executive pay levels

Of course, pay design rarely captures the headlines, but absolute pay levels tend to. Across markets globally, there are broadly held concerns about the magnitude of executive pay levels and increasing income and wealth disparities across segments of the population. However, as we move from the macro to the micro, these concerns appear to weaken — significantly. For example, in markets with say on pay and persistent complaints about excessive pay, the overwhelming majority of organizations still receive high levels of shareholder support for their executive pay programs. Admittedly, each year there are organizations that fail their say-on-pay votes or receive only tepid shareholder support, but these appear to be exceptions, even in times of weak economic performance.

While those engaged in setting executive pay levels must stay attuned to broader developments and perspectives, our research suggests that the organization-specific framework for setting executive pay is on the right path — or, at least, not on the wrong path — though we see the need for enhancements in pay program design and governance processes.

The unanswerable question, How much is too much? leads us back to our principles, in which we focus on pay, governance and process design and not on absolute levels of pay. Our experience is that with effective design and governance processes in place, appropriate pay levels will generally result and inappropriate outcomes can be readily addressed. The notion of “consideration” (or, in the parlance of the U.S., the exercise of “business judgement”) thus pervades our principles and commentary. Especially in today’s more robust governance environment, we believe that if decision makers in the EC process actively reflect upon and consider a range of thoughtful inputs and alternatives, they’ll generally make appropriate decisions and will also be able to refine their approaches over time.

Further, those who participate in this consideration-driven process as advisors can then focus on designs that are responsive to the organization's unique needs, rather than focusing heavily on external norms and standards.

## Driving positive outcomes

Indeed, we believe that this heightened focus on each organization's unique requirements, truly tailored decision making, and a more thoughtful and broader consideration of design inputs will translate to a range of beneficial outcomes for a range of stakeholders. Most fundamentally, we know that effective EC programs support the achievement of an organization's mission, vision and strategy as well as its short- and long-term objectives. This focus should help create value for shareholders, employees and customers alike. We also know that effective programs reinforce choices about the type of talent an organization wants to attract and retain as well as key values and behaviors that are expected of this talent. Thus, effective EC can help bring cohesion and congruence to both the ultimate objectives and ongoing processes of an organization. And the development and application of these principles should help boards and those involved in the EC process exercise sound business judgment.

Implicit in our approach to the principles is an encompassing definition of EC. It is far more than the dollars being delivered to executives. Our definition is holistic and covers the full range of rewards to an executive including benefits and career development as well as related issues of performance management and assessment, talent management, governance, communication and program implementation. Organizations that act holistically and marry their programs to an effective and well-implemented strategy are poised to capture the strongest outcomes.

## A note on applying the principles

The following principles, elements and considerations for EC design were distilled from our research and wealth of experience consulting to the world's leading organizations. They are intended to help organizations make sound and appropriate decisions about executive pay that help balance the interests of all stakeholders. While we believe that most of these principles can effectively be applied in all types of organizations in all parts of the world, their development was an outgrowth of the complex and highly visible pay issues facing publicly-owned nonfinancial services companies in North America and Western Europe. In particular, the principles regarding employment contracts (Section V: 11 through 16) and change-in-control benefits (Section VI: 9) are matters largely driven by local regulations and are not fully applicable outside of the U.S.

We encourage organizations to apply these principles thoughtfully and flexibly, rather than mechanically. As our consultants and board members debated and came to a consensus on these principles, there were many times when practitioners could cite valid exceptions to the general rules — practices that in many organizations appear problematic, while making perfect sense for a few. It's important to remember that no two organizations are alike and there will always be unique and highly successful outliers in the mix. In short, these principles are designed to be helpful, not prescriptive. We view them as *guidelines that will work for most organizations — most of the time*.

While striking this note of flexibility, we also want to provide some clear direction and preferences, and avoid banal statements of ideals. We thus adopted an effective hierarchy in which principles include either a “must,” “should,” or “could.” In effect, principles that include “must” are ones we feel strongly that almost all organizations should align with; it would be a true exception for an organization not to align and for the design to be appropriate. As we move to “should” and “could,” we expect the frequency of nonalignment to increase, while not necessarily implying that the design is inappropriate.

Yes, we are seeking to have our cake and eat it too. We want to be firm in our convictions about what’s essential in effective EC design, but at the same time our experience counsels us to be open to alternative points of view in a world of limitless business and executive circumstances.

Finally, we view these principles as reflecting a point in time. Organizations and their leaders change and evolve, and the external environment (e.g., legal, tax, social) is in constant flux. Our intention is to revisit these principles periodically to ensure that they remain relevant and reflect future research and experience.

We welcome your comments and suggestions. Send your views to [executive.pay.memo@willistowerswatson.com](mailto:executive.pay.memo@willistowerswatson.com).





# Overarching principles

In distilling the research and viewpoints collected during our research, we identified four overarching and comprehensive principles that board members in particular can view as the foundation of an effective EC program: purpose, alignment, accountability and engagement. We found that, while many board members dig into the details of EC, most desire a synthesized conceptual framework that captures the core elements of EC.

Each of the principles included in Willis Towers Watson's Principles and Elements of Effective Executive Compensation Design provide practical guidance toward achieving one or more of the four overarching principles. The *individual principles* are intended to help organizations make sound and appropriate decisions about executive pay. The *overarching principles* provide a powerful shorthand that allows boards and directors to weigh fundamental trade-offs and orient to a higher level of conceptual decision making. Below is a brief summary of each overarching principle.

- **Purpose.** Captures why the organization exists, what its mission is with its various constituents, and its strategy and objectives. Purpose is the highest level of abstraction in corporate governance, incorporating the core governing questions that guide an enterprise. Purpose answers the questions: *Aligned* with what? *Engaged* toward what? *Accountable* for what?
- **Alignment.** Captures the essence of agency theory by ensuring that management is aligned with and acting in the best interests of shareholders — and possibly of other stakeholders. It prompts the question: Aligned with what? Thus, it can serve as a unifying theme tying together the purpose, mission, strategy and objectives of the organization with the interests of shareholders and using compensation as part of the system that creates and enforces this alignment of interests. Alignment also captures the unification of the entire company across business units, organizational levels and geographies to achieve a common purpose, mission, vision, strategy and objectives.
- **Accountability.** Captures the relationship between pay and both organization performance and individual actions. It also captures the relationships among employees, management, the board and shareholders. Management is accountable to the board, which, in turn, is accountable to shareholders and possibly other stakeholders. Employees are accountable to management. Management uses accountability as a primary tool for running the organization, including setting objectives, directing behavior, assessing performance, and determining rewards and consequences. Compensation is an element of accountability at all levels. Another part of accountability is clear and complete reporting and disclosure of EC principles, philosophy, programs, actions and results to shareholders, employees and other constituents.
- **Engagement.** Captures human motivation and the psychological implications of behavioral economics and self-determination theory. Engagement captures the core elements and objectives of compensation at all levels in an organization: motivating people, directing their behavior, attracting them to the organization, ensuring their retention and creating differentiation based on performance, responsibility, competence and experience.

Throughout this document, we have labeled each of the principles to indicate which overarching principle it helps to achieve: purpose, alignment, accountability or engagement. In some cases, a principle reflects more than one overarching principle. Among certain principles, there is a fundamental trade-off between two or more overarching principles, which makes that principle particularly dynamic. Those are also highlighted.

# The Principles and Elements of Effective Executive Compensation Design

## Section I: Governing objective and EC philosophy

1. EC must reinforce the responsible creation of sustainable long-term value and the activities organizations undertake to generate this value. [Purpose]

In fashioning EC programs, boards and management must comply with all relevant laws, regulations and standards of business ethics while taking into account how the organization's activities might affect various stakeholders. While the financial return to shareholders is a key measure of the value organizations create, benefits for other stakeholders (e.g., debt holders, customers, employees, the broader community) should also be taken into account. Ultimately, EC programs should incent and reward the behaviors and processes that reinforce the activities organizations undertake to create sustainable long-term value for multiple stakeholders. In assessing the extent to which EC programs support long-term value creation, it's important to recognize that there might be points in the business performance cycle at which intermediate compensation decisions produce pay outcomes that do not align perfectly with reported short-term performance.

2. To ensure the effectiveness of EC programs, organizations must undertake a holistic consideration of both pay and performance. [Alignment]

Unfortunately, there are no simple definitions of either pay or performance. In our view, the definition of pay should encompass all aspects of compensation, both tangible and intangible, including foundational rewards (e.g., benefits), performance-based rewards, and career and environmental rewards (e.g., culture, leadership style). For benchmarking purposes, total pay can be defined as one of the following four quantitative measures: (For more on these definitions, see the Appendix.)

- Target pay — focusing on the incumbent's target opportunity
- Actual pay — focusing on the actual short-term pay received plus value of long-term incentives (LTIs) awarded (referred to as Summary Compensation Table, or SCT, pay in the U.S.)
- Earned (realized) pay — focusing on pay earned and paid out during the period
- Realizable pay — focusing on the current value of outstanding awards

As for performance, the creation of value needs to be viewed from both quantitative and qualitative perspectives over multiple time frames in light of short- and long-term outcomes. For publicly listed organizations, relative TSR is a commonly used measure of historic and expected value creation over multiple business cycles. However, when used in isolation, TSR is an overly simplistic and insufficient measure of performance over any single period because of its volatility, reliance on the relatively limited information available to the market (versus that held by management) and the fact that it incorporates future expectations of the organization and broader market. While the creation of value

for an organization's shareholders is the overriding imperative for public companies, the creation of value for other stakeholders is an important means to this end. The creation (or destruction) of value for other stakeholders should also be considered.

To illustrate the challenge with a single period measure of performance, publicly traded organizations are continuously valued based on forward-looking assumptions and attendant expectations by shareholders. In this way, there is a potential for a timing disconnect whereby future management will need to deliver operating results driven by expectations set in the past and might receive rewards (cash from annual or long-term goal-based plans) disconnected from the then-current stock price movement.

3. Each organization's business and people strategies should align with long-term value creation and should drive the design and management of the organization's compensation programs. [Purpose, Alignment]

The design and management of EC should support the organization's particular business strategy and drive business performance by helping to build or reinforce competitive advantage and desired outcomes from employees. In short, designing effective EC programs is not a one-size-fits-all undertaking, instead demanding a best-fit approach.

4. EC programs should also be aligned with the organization's culture and individual employee characteristics and, when possible, consider stakeholder preferences. [Purpose, Alignment]

As a result, it is appropriate for EC program design and management to vary across business units and functions within organizations to align with varying business and talent strategies and cultures. Organizational culture elements typically relevant to EC program design include the degree of internal equity, teamwork and collaboration, risk-taking, centralization/decentralization, transparency and comfort with discretion. Individual employee characteristics that might shape design include the executive's career stage (e.g., duration of employment) and status (e.g., founder, new hire). Examples of stakeholder preferences include value creation, say-on-pay results, the role of unions, and others.

5. EC decisions should be informed by — but not driven by — market practices. [Engagement]

Market norms and benchmarks provide a helpful context for decision making and can serve as a starting point or baseline for consideration. Organizations should be aware of external practices, while recognizing that market practice might not be the best fit for each organization, and should not be the primary factor in compensation decisions. In fact, a convergence around prevalent market practice largely eliminates an organization's compensation program from being a competitive advantage in attracting, motivating and retaining talent.

Even wide deviations from market practice might be appropriate for some organizations based on other considerations, and it is imperative to be prepared to describe these other considerations and the rationale for choosing an approach that is in contrast with market norms. Major deviations from market norms that provide significant additional benefit to an organization's executives need to be considered carefully and should be supported by more rigorous governance, performance and risk mitigation requirements.

## 6. Organizations should articulate their reward strategies. [Purpose]

To help guide decision making about executive pay and ensure transparency, each organization should develop a comprehensive reward strategy that articulates overall goals for the program. Critically, the strategy should address not only the desired targeted reward positioning at varying levels of performance and relevant market reference points, but also the key performance areas it is designed to support and the required degree of emphasis on alignment with shareholders, attraction and retention of top talent and line of sight to performance objectives.

The strategy should cover the Total Rewards programs for the chief executive officer (CEO) and next two or three levels of management — or possibly four levels in larger organizations. For example, covered executives would include all direct reports to the CEO, functional leaders and heads of major divisions within the organization. In larger organizations, covered executives might also include the teams reporting to the functional leaders and business unit executives.

The strategy should explain the organization's desired approach to rewards in light of the key considerations identified above (i.e., business and people strategy, culture, stakeholder considerations and market practices) and must be informed by and address a wide range of components, including:

- Fundamental components of the business strategy
- Fundamental components of the people strategy (often articulated as part of the organization's employee value proposition for executives)
- Elements of the organizational culture that the organization is seeking to reinforce or change (this may include diversity, inclusion and pay fairness / pay equity)
- Relevant stakeholder considerations including environmental, social and governance issues
- The relevant competitive marketplace for EC recruiting
- Key elements of the reward package and how these are intended to align with the considerations above
- The desired relationship between reward, performance, risk and perceived value
- The extent to which awards should motivate outcomes

The reward strategy should be reviewed periodically as organizational strategies, culture, talent needs, stakeholders and market practices evolve. It should be communicated in detail to EC program participants and a summary should be available to other relevant stakeholders.



## Section II: Pay level reference group selection and benchmarking

Benchmarking — the comparison of an organization's current compensation levels to market norms — is a core element of EC management. The effectiveness of benchmarking is largely dependent on the appropriateness of the organization's market reference group or groups. Accordingly, organizations need to take care not only in selecting appropriate reference groups but also in ensuring that the market data sources they use are robust. At times, the quality and appropriateness of market data are not fully assessed by the compensation committee and management, and there is an undue focus on the assumed precision of the data (as well as on disclosed data). The adage that benchmarking is more art than science continues to apply even in this age of detailed compensation disclosure.

### Market reference group selection

1. Benchmarking analyses should be based on the most robust and credible data available and avoid an overreliance on a single data source. [Accountability, Engagement]

Generally speaking, there is no single source of compensation market data that can serve as a robust source of data for all regular benchmarking activities. For example, publicly disclosed pay data (proxy data in the U.S.) covers only prior compensation and performance periods and, aside from pay for the CEO (and in the U.S., chief financial officer, or CFO), might not provide robust data for other roles.

And it does not provide a consistent benchmarking reference for executives below the level of executives whose compensation is not disclosed (i.e., in the U.S., the named executive officers) or provide data on privately held companies.

While there are a number of robust compensation surveys available, they often include only a portion of the relevant peer organizations, while data samples might vary across jobs and are subject to year-to-year variance in survey participants.

A single survey source might be appropriate if it includes a large organization sample with robust data submissions and limited year-to-year variance. However, in most circumstances, organizations should consider publicly disclosed data in conjunction with data from two other survey sources. Organizations might distinguish between primary and secondary sources, using the latter to supplement or validate the data gleaned from the primary sources.

2. Compensation levels should be benchmarked against multiple market perspectives reflecting the market for talent, including: (a) direct competitors (a narrow peer group of close competitors against which the organization's performance would be most typically benchmarked), (b) industry competitors (a broader peer or reference group that shares industry characteristics) and (c) general industry (the broadest reference group). [Accountability, Engagement]

Benchmarking serves multiple purposes, including assessing the alignment between pay and performance, ensuring that pay opportunities support the organization's ability to attract and retain talent, and helping to align compensation with the organization's business strategy and cost model.

While an organization can choose a, b or c above as its primary benchmarking reference, it should ensure that its compensation is at least periodically benchmarked against other types of organizations and, potentially, modified accordingly. This helps to ensure that compensation reflects performance relative not only to an organization's closest peers but also to broader industry. This also helps to minimize the risks associated with organizations in adjacent industries poaching talent, and an organization's pay and cost structures becoming excessive or unsustainable.

3. Organizations must define and clearly disclose a market reference group or groups for use in assessing compensation design and levels. [Accountability]

The selection of a market reference group or groups, which might include a custom public data peer group and/or selected survey data, will have a significant impact on how compensation is set and regularly reviewed. It provides important context for the committee, management and shareholders. Organizations should clearly disclose a description of this market reference group, the rationale for its selection, the process for reviewing this group, and if and how they consider additional reference data.

4. There must be a thoughtful and objective but non-formulaic process for determining the organization's market reference group. [Accountability, Engagement]

As organizations have different business, talent and compensation strategies, they also can have varying approaches to market reference group selection. At a minimum, however, market reference groups must be built using baseline criteria, including revenue and industry, along with attention to market and survey data quality. A range of additional factors should also be considered, including similarity and scope of jobs, the competitive market for talent, relevant financial and market indicators (e.g., levels of growth, profit margins, market capitalization), capital structure, ownership profile and investor composition, business life cycle, complexity, differentiating organizational capabilities and, finally, geographic location and global reach.

Further, there can be differing definitions of market based on the role being assessed. Staff roles might rely more on general market sources, while operational roles might rely more on industry-specific sources.

And lastly, there might be situations where multiple reference groups are designated for benchmarking pay and performance. While this adds complexity in communications to stakeholders, it might be very appropriate in cases where industry competitors fall outside a reasonable size range for benchmarking compensation levels or are headquartered in a different country where disclosed pay information is not available.

Given this broad range of considerations and potential approaches, a formulaic approach is likely to generate a weak or distorted market reference group.

5. When selecting a primary market reference group for compensation benchmarking, an organization must provide a rationale for the inclusion of organizations that are significantly different from it in terms of revenue size. [Accountability]

Depending on the considerations identified in item 4 above, it might make sense for the market reference group to include benchmark organizations that vary significantly in scope from the organization itself. In such cases, the organization should disclose and explain these differences. The organization should also indicate how it takes these differences into account in its benchmarking analyses (e.g., size-adjusting the market data via regression analysis to account for differences in organization size). Differences in organization size (primarily revenue or market capitalization) that exceed a factor of three warrant particular attention and disclosure.

### Target pay level benchmarking

6. Organizations should consider a defined range, as opposed to a single data point, when assessing direct compensation competitiveness. [Accountability, Engagement]

Given the limitations inherent in market data sources and the wide range of factors influencing individual compensation levels, it's important to keep in mind that market data reflect merely an approximation of the overall market for a particular job. This is especially relevant in how organizations use market data.

The defined range should reflect the quality of the underlying market data. Potential ranges in instances where robust market data is available could be:

- A range of  $\pm 10\%$  around the targeted market position for base salary benchmarking
- A range of  $\pm 15\%$  for target cash compensation to recognize differences in short-term incentive design across organizations
- A range of  $\pm 20\%$  for total direct compensation (TDC), with the larger range for TDC reflecting year-to-year additional variability in LTI market data

For an assessment of a group of jobs and assuming expected distributions above and below market, we would suggest that the overall competitive range would be narrower (i.e.,  $\pm 5\%$ ).

Note: these ranges are illustrative. Each company should determine its own acceptable range for each component of pay and level within the organization. Acceptable ranges may also vary by country and geography.

With a focus on ranges instead of single data points, organizations should generally avoid the need to “age” survey data for sources with effective dates within 12 months or less of the analysis date. The practice of aging survey data can be inflationary and distort the picture of the actual market. Aging can be appropriate to align data with effective dates greater than 12 months from the date of the analysis and in combining data from multiple surveys with different effective dates. (In such cases, the aging factor should merely align with the effective date of the most recent source.) Aging data also might be appropriate when benchmarking pay in high-growth or inflationary markets.

## Holistic view of pay

7. EC levels should be analyzed and considered holistically, including all elements of direct and indirect compensation. [Accountability, Engagement]

Compensation levels are typically established and managed within a broader organizational context, taking into account indirect compensation elements (e.g., benefits, perquisites and relevant employment provisions such as severance protection) as well as organization culture and job risk.

Organizations should consider these elements in their regular assessments of compensation appropriateness. Moreover, given the explicit objective of most organizations to align pay and performance, organizations should assess compensation not only on a target or expected basis but also on an earned (actual) and/or “realizable” basis. Trade-offs among reward elements should be considered to the extent that certain elements are generous or exceed market norms.

There are clearly challenges and costs associated with benchmarking benefits and other forms of indirect compensation, as well as conducting analyses of earned and realizable compensation. Thus, we would suggest that such analyses can be conducted every second or third year for positions below the level of the CEO. With respect to the benchmarking of benefit values, especially for defined benefit retirement plans, if a detailed and job-specific assessment cannot be completed, then organizations should consider the overall design of the plan compared with market norms.

## Adjustments to individual compensation to align with market norms

8. While individual adjustments to align with market levels are entirely appropriate, organizations should avoid effectively making automatic adjustments solely to align with a single market data point. [Accountability, Engagement]

Currently, we observe that organizations apply simple adjustments to base pay to achieve a specific market positioning (e.g., increase pay for an executive by 3% to meet the 50th percentile data point). This approach does not reflect that the market is a range rather than a single data point. Instead, organizations should recognize that compensation that falls within the defined market range is competitive and aligned with the market. Thus, any increases should be based not on a gap to the market, but rather on other factors such as performance, development and retention needs.

9. Compensation increases for senior executives, especially the CEO, must take into account the potential multiplier effect on both direct and indirect compensation as well as external scrutiny. [Accountability]

Given the significant costs associated with senior executive employments as well as the disclosure of executive pay and say-on-pay votes, organizations should exercise particular care and prudence when increasing the compensation of the CEO and other senior executives. When current compensation falls within market ranges, there should be compelling reasons for increases.

In many organizations, annual and LTI award levels are set as a multiple of base salary. Other benefits might also be set as a percentage or multiple of base salary. In such cases, organizations

should understand the total dollar impact when making adjustments to base pay. (For example, a 5% salary increase for a CEO with a \$1 million base salary could translate into not just a \$50,000 base pay increase but also a TDC increase of \$300,000, assuming multiples of 2x and 3x for annual and LTIs, respectively.) Indeed, it might be appropriate for organizations to separate decisions on other elements of compensation from base pay, especially as compensation mixes in the market evolve over time. Additionally, internal equity within the organization should be considered, taking into account the entire employee population.



### Section III: Performance-based pay

Performance-based pay design is one of the most fundamental and, arguably, the most important aspects of EC. It encompasses a wide range of considerations — from establishing incentive objectives and the mix of incentives (e.g., annual, long-term) to selecting incentive vehicles and, ultimately, to determining incentive payouts. Given the range of considerations, their complexity and the potential trade-offs among various decisions, effective performance-based pay design belies simple conclusions (e.g., “options are not performance-based,” “the same incentive measures should not be found in multiple incentive plans”). The assessment of incentive program effectiveness requires in-depth analysis. In this section, we address the full range of performance-based pay design issues and offer perspectives that reflect their complexity and importance.

Beyond design, pay-for-performance assessment (i.e., how actual total pay compares with actual performance on an absolute and relative basis) is an issue that continues to gain increased attention, as it’s becoming a key focal point for shareholders in organization disclosures. We view this as a positive development because it has helped to crystallize relationships between relative pay and



relative performance while also expanding the definitions of pay being considered by organizations and shareholders (e.g., realizable pay). This growing attention to alternative definitions of pay not only yields insights for shareholders and stakeholders about EC program structure and effectiveness but also can provide important insights that promote better pay program design. We believe we're still relatively early in the evolution of pay-for-performance measurement and encourage organizations to explore and embrace the emerging analytics to help enhance program designs for all senior executives and pay disclosures in applicable jurisdictions.

We believe that certain components of performance-based pay design warrant particular attention. Specifically, we believe that organizations with above-median pay philosophies have a responsibility to consider pay-for-performance analyses to ensure that pay outcomes are appropriate across all levels of performance, especially poor performance. The lack of such analyses can perpetuate scenarios in which pay levels outpace actual performance. Additionally, organizations should be more thoughtful about their determination of incentive objectives (e.g., line of sight, shareholder alignment, retention), which should support the selection of more effective vehicles and performance measures. Finally, organizations should also seek to improve the rigor in certain design areas that often receive too little attention, namely target and range setting, testing of incentive payouts relative to performance and the effective use of discretion.

### Mix, measures and funding

1. For senior executives, a majority of Total Rewards should be in the form of incentive compensation; a majority of incentive compensation should be in the form of LTIs; and a majority of LTIs should be focused on shareholder alignment and/or line of sight (i.e., retention-focused incentives should be the smallest LTI component). [Engagement]

To link pay and performance, compensation should be heavily weighted toward variable components, ideally with a longer-term focus to promote sustainable performance over time. In exceptional circumstances of heightened retention risk (e.g., restructurings, changes in control, succession situations), retention-focused incentives (deferred or restricted cash or stock) can play an important role. However, on an ongoing basis, incentive compensation should be focused primarily on performance, as through alignment or line-of-sight-related incentives.

For reference, Total Rewards should include both direct and indirect compensation including retirement, health and welfare benefits, and perquisites. In assessing the reward mix, nonoverlapping LTI awards and one-time awards should be annualized, and the value of perquisites and benefits should at least be estimated.

2. The proportion of Total Rewards allocated to target and expected levels of variable compensation should increase with each executive level within the organization. [Accountability]

As the level of impact and accountability for performance outcomes increase, we believe the percentage of Total Rewards linked to these outcomes should increase accordingly. Organizations should be mindful not only of incentive levels but also of the impact of non-variable benefits that might weaken alignment with this principle.

3. The incentive plan design should reflect the organization's desired balance of shareholder alignment and line-of-sight-related objectives through the selection of LTI vehicles and the weighting and selection of incentive measures. [Trade-off between Alignment and Engagement]

Organizations should carefully evaluate and define the objectives associated with their incentive plans and should align plan features (e.g., vehicle and performance measures) with these objectives. We sometimes see organizations focus too much attention on the selection of a particular vehicle to align with market practices or on the design of a single incentive plan on a stand-alone basis. Instead, organizations should put greater emphasis on establishing well-conceived incentive objectives and considering their short-term and LTI plans in totality as part of an overall portfolio. The concepts of retention, alignment and line-of-sight-related objectives can help organizations crystallize their priorities and align their programs with these priorities.

Implicit in this principle is the concept of balance. Organizations should ensure an appropriate balance through the weighting of incentive vehicles and the overall emphasis on organization, business unit, team and individual performance. In our experience, the use of a single LTI vehicle can mean an imbalance of the objectives associated with line of sight to key business and financial outcomes and alignment with shareholders. Possible exceptions might include the use of:

- A single LTI vehicle in the form of performance shares with internal performance measures
- Performance stock units with only relative TSR in conjunction with a highly leveraged annual bonus plan with internal performance measures
- Market stock units, with the number granted varying based on internal performance criteria

Beyond these core concepts, organizations should also consider whether their LTI grant cycles (i.e., end-to-end/multiyear approach versus an overlapping/annual approach) are aligned with the desired incentive objectives. In addition, organizations can consider adjusting the size of the annual LTI pool based on performance to reinforce line-of-sight objectives. Overall, design choices need to be sensitive to business and people goals.

4. For long-term performance plans, the performance measurement period (as distinct from the vesting period) should be at least three years. [Accountability]

The vesting period and performance period for LTI plans can be established independently of one another. While three years might be viewed as more mid-term than long-term, the realities of forecasting limitations often challenge the ability to lengthen performance periods beyond three years. This is where stock options and plans that measure performance on a relative basis (e.g., TSR) play a useful role.

5. Performance measures, while subject to periodic validation, should be selected in light of the organization's long-term strategy. [Purpose]

The choice of incentive performance measures signals the most important business variables on which executives will be assessed and held accountable. In most circumstances, these measures should be consistent from year to year and should reinforce the unique business strategy that the

organization has adopted to generate sustained performance. These measures should be transparent, and plan participants should understand how they can directly influence the outcomes with regard to the measures.

Performance measures should be material, relevant, easily and timely measured, accurate, comparable, influenceable and cost-effective to measure.

6. Organizations should include multiple measures across their incentive plans to promote a holistic view of organization performance. [Alignment]

There's no single perfect measure that encompasses the many factors that should be considered in assessing executive performance. Even measures such as net profit and TSR have weaknesses. For example, profit measures do not account for gearing of the balance sheet and TSR reflects many factors beyond executives' control.

In addition, many organizations fail to consider nonfinancial measures that might indicate future organization performance, such as service and product quality, customer satisfaction, market share, and product development and innovation. Increasingly, companies are incorporating sustainability measures, including environmental impact and human capital management.

As a result, organizations should include multiple measures across their short- and LTI plans to provide a broader lens by which to assess performance. In selecting the appropriate number of measures, organizations need to balance the many financial and nonfinancial factors important to the organization against the limited range of factors that plan participants can simultaneously focus on and impact. In short, having too many measures dilutes impact and focus, while having too few provides an overly narrow lens for evaluating performance. It's for this reason that incentive plans covering a short list of measures coupled with "structured discretion" to apply a wider range of measures (including nonfinancial measures) are often most effective.

Given this need for balance, we believe that it can be appropriate for annual and LTI measures to overlap in some cases, especially if performance is measured over different periods.

7. Organizations must consider the strengths and weaknesses of each performance measure, including TSR. [Trade-off between Alignment and Engagement]

Given the lack of an effective all-encompassing measure, organizations should thoughtfully consider the pros and cons of all measures selected and ensure that they effectively mitigate the potential risks associated with a focus on any one measure. While currently declining in popularity, TSR is still a common measure and warrants special consideration. TSR can be an effective measure of

performance, but organizations must consider its inherent limitations in incentive design. TSR's limitations include its volatility, point-to-point measurement, limited line of sight and imperfect comparability to other organizations, especially those with different risks, industries or market multiples.

8. Individual performance should be considered in performance-based pay decisions at all organizational levels. [Engagement]

To promote individual accountability and line of sight, it's important that individual performance, which is distinct from the performance of the unit for which the executive is accountable, be a clear factor in all performance-based pay decisions. This can be implemented in a number of ways. For example, in addition to traditional base salary merit adjustments, it can take the form of an explicit individual performance weighting in an incentive payout formula, a factor in determining annual LTI grant levels, a modifier on incentive payouts or a circuit breaker when making payouts (e.g., performance below a certain level negates payouts).

While the CEO is accountable for the totality of an organization's results, his or her individual performance, as distinct from the organization's aggregate results, should also be a consideration. Potential considerations for the CEO might include succession planning, leadership team development, specific innovation, and growth or restructuring objectives.

9. For variable compensation plans, relative performance must be considered implicitly through incentive target setting or explicitly through performance measurement. [Accountability]

An organization's internal performance measures, including financial and nonfinancial measures, provide an important but incomplete lens for assessing performance because they generally do not capture elements of performance relative to the organization's market competitors. While external comparisons are often challenging or incomplete, they nonetheless offer important reference points and mitigate against an overly internal focus of the executive team and/or incentive performance targets and payouts that are excessive or unduly conservative.

In light of the challenges of relative performance assessments (e.g., the selection of an appropriate peer group, external data that might not be timely, data that might not be entirely comparable or "apples to apples"), there's no single approach that's appropriate for all organizations. When possible and appropriate given the organization's incentive objectives, we believe that an explicit relative performance factor should be included in an incentive plan, such as through a relative performance plan. At a minimum, we believe that organizations should regularly test and validate their annual and LTI targets and ranges versus historical market performance levels. Differences between the organization's targets and ranges, and norms found in the market over time should be well understood, as should their implications for plan payouts.

10. While there is no predefined set of measures that are appropriate for a particular type of organization, incentive plan funding and design must consider each of the following types of financial measures: (i) earnings, (ii) revenue growth, (iii) balance-sheet-linked financial returns, (iv) cash flow and liquidity, and (v) cost of capital. [Accountability]

Sustainable organization performance has many financial dimensions (and nonfinancial dimensions as well). There's often significant focus on the income statement, especially revenue and earnings, but much less focus on other financial variables that have a fundamental and lasting impact on overall performance such as the quality of the balance sheet, the ability to generate cash and returns versus accounting profits as well as the ability to maintain a low cost of capital. Executives should be held accountable for and rewarded against all of these dimensions.

However, considering all of these factors in an incentive plan can be counterproductive. Acknowledging the limitations of incentive plan measures and the benefits of limiting the number of measures to a sharply focused few, it is helpful for organizations to distinguish between performance measure selection, target and range setting, and payout determinations or funding. By distinguishing between these processes in applying various measures, organizations can factor in all five of the key variables identified above without creating too many measures across incentive plans.

Beyond including each of these types of measures in the performance measure selection process, organizations can use some metrics as performance measures and others as incentive modifiers, circuit breakers or within a framework of discretion (i.e., in the payout determination process). They can also ensure that the incentive targets and ranges they establish factor in balance sheet stewardship, including cost of capital.

Each organization should establish its own specific framework for including these five areas (at a minimum) in their incentive designs.

### Targets, ranges and discretion

11. A rigorous process must be applied in setting performance targets and ranges that should consider: (i) the organization's long-term strategic plan, (ii) enduring standards reflecting historical norms of financial performance for the organization, industry and relevant peer organizations, (iii) analyst and economic forecasts, and (iv) the organization's budget. [Purpose]

The thoughtful determination of the incentive plan's targets as well as its performance and payout ranges are critical for the plan's effectiveness. Internal organization budgets, which are frequently the product of internal negotiation as opposed to rigorous analysis, are typically the primary or only basis for the incentive plan targets. These can lead to performance or payouts that are not aligned with performance levels common in the market or comparisons to an organization's own historical results.

Ranges around these targets are often set in a subjective or arbitrary manner, without due regard to the target's degree of stretch (or lack thereof) and the measure's volatility. However, while overreliance on an internally focused budget-based exercise is problematic, so is a process that's overly dependent on short-term shareholder expectations, which tend to vary considerably over even short periods of time.

Targets and ranges should be set with the medium term in mind and should avoid reliance on a single factor. Targets and ranges that consider each of the four objectives identified above are most effective over time. Indeed, organizations should create their target and range-setting baselines in light of their long-term strategy and enduring standards (i.e., performance levels that, if sustained over time, would likely be deemed favorable by shareholders given the market's development and an organization's cost of capital). An example might be an implied return on invested capital several percentage points above the organization's cost of capital. Organizations can then fine-tune their targets and ranges in light of shorter-term forecasts and budgeting requirements.



12. The incentive payout curve and range should vary based on the volatility and sensitivity of the underlying performance measures, probability of achievement, affordability of outcomes and how corresponding payouts will compare with market and historical results. [Accountability]

Performance ranges often lack rigor in their determination. By applying basic statistical models based on the organization's and market's historical performance, stress testing above- and below-target payouts and comparing these — as well as the target — with market compensation levels, organizations can develop more rigorous ranges. Such rigor can help ensure that underperformance doesn't translate into above-market compensation levels and that over performance is fairly rewarded.

13. For senior executives, a reasonable minimum level of organization-level financial performance (i.e., circuit breaker) must be achieved before incentives can be funded. [Accountability]

Most organizations reset their incentive targets and ranges each year in light of the prior year's performance. In such instances and following a decline in organization performance or a major miss versus performance expectations, it's possible for subsequent targets and ranges to reward executives who preside over weak performance that falls well below shareholder expectations or financial returns that are even below the organization's cost of capital.

To mitigate against this risk, organizations should establish a reasonable floor or minimum standard below which incentives will not be paid to senior executives and priority will be given to other funding needs, such as the organization's broader employees, its shareholders and/or its investment requirements. This also helps to ensure that incentive plans for senior executives don't become a stealth form of fixed pay.

The determination of this minimum level will vary by organization and the performance context. It might be set lower for organizations undergoing restructuring or early-stage growth organizations versus organizations with a longer track record of performance.

14. Discretion is a critical tool for ensuring a holistic assessment of sustainable performance and quality of outcomes, and it should be applied to incentive funding and allocation decisions based on a predefined framework. Compensation committees should consider how best to disclose and explain their use of discretion. [Accountability]

The effective use of discretion can help address the limitations of incentive plans that focus on a limited number of measures. At minimum, discretion can reflect the decisions by the committee or management to reduce incentive payouts below their formulaic value for any of a number of typically ad hoc reasons (i.e., negative discretion). Beyond this, discretion can be exercised using a predefined framework, potentially even a simple scorecard, in which specific factors are identified at the outset of the incentive period and it's agreed how these factors might either positively or negatively affect incentive payouts. Such factors might include nonfinancial factors, such as customer-, quality- or brand-related issues, human capital factors like diversity, pay fairness, retention, talent development, environmental factors, or financial factors, such as variations in planned investment and R&D spending, exchange rate changes, unplanned M&A or divestment activity.

Typically, incentive measures are based on certain financial outcomes (e.g., profitability) that reflect numerous factors and assumptions regarding key inputs (e.g., investment-related spending). On the

downside, discretion can help organizations avoid making incentive payouts that result from under-investing or fail to reflect negative customer, quality, brand or human capital performance. On the positive side, structured discretion provides the committee or management a framework for increasing incentive payouts when such factors warrant it.

The need for discretion is generally mitigated by the diversity and number of performance measures affecting incentive outcomes. And for U.S.-based companies subject to Section 162(m) of the tax code and seeking tax deductibility of incentive awards, care would need to be taken to ensure incentive plans comply with IRS regulations.

## Pay-for-performance assessment and incentive program review

### 15. Organizations must annually review pay-for-performance alignment. [Alignment]

An analysis of pay-for-performance alignment provides valuable insights about the effectiveness of pay programs that cannot be determined using more common benchmarking approaches, such as comparing target and actual pay to market pay ranges.

We believe that such analyses must be conducted annually to support effective pay program design and disclosure. Organizations that must comply with regulatory requirements (as in the U.S.) should consider ways to analyze and disclose pay for performance in ways that most closely align with their specific pay program objectives.

### 16. To inform compensation program design changes, organizations must review the pay-for-performance alignment of proposed changes on a retrospective and prospective basis. [Alignment]

Given the importance and increasing prominence of pay-for-performance analyses, organizations should model the impact of potential compensation design changes on a forward- and backward-looking basis to promote alignment with desired outcomes.

### 17. For purposes of assessing pay-for-performance alignment and EC program design changes, pay-for-performance analyses must: (i) include NEOs, (ii) be conducted over a multiyear basis, (iii) include both the direct market reference group for compensation benchmarking and a broader market perspective, (iv) consider both percentile ranking and sharing-rate analyses versus peers, (v) consider TSR as well as the financial performance measures used in the organization's incentive plans, and (vi) use either earned or realizable pay frameworks. [Alignment]

While pay for performance is simple in name and concept, it reflects a number of complex decision points. This principle outlines our perspective on minimum analytical requirements. We note that at least for public disclosure purposes in the U.S., a narrower set of analytics would be expected. Given the powerful insights that a pay-for-performance analysis can generate, we believe it is incumbent on organizations to conduct analyses that extend beyond these requirements. In particular, while pay-for-performance disclosure in the U.S. is primarily focused on CEO pay, we believe the concept has applicability to a broader set of executives, including at least NEOs.

Several components of this principle merit comment:

- For (ii), we believe a multiyear analysis provides the greatest insights, while acknowledging that the period should be tailored to the organization in light of the tenure of the CEO and other relevant issues, such as the cyclical nature of the industry and any significant changes to the organization or peer organizations (e.g., due to M&A activity).
- With regard to (iv), principle 16 in Section III above discusses how sharing-rate analyses can provide insights about absolute dollar values of pay that are not highlighted in percentile rankings.
- Principle 16 in Section III offers perspective on (v) and the role of TSR in incentive plans, including its limitations that should preclude it from serving as the sole criterion for assessing performance.
- Finally, with regard to (vi), we acknowledge that there are pros and cons associated with each pay definition. While we believe realizable pay analyses provide a clearer picture of compensation alignment (because they aren't affected by option exercise decisions), we understand why many stakeholders prefer earned pay scenarios that provide a more definitive and easily understandable pay concept.

Finally, we believe that pay-for-performance analyses (if feasible) can be helpful in reviewing program effectiveness and making design decisions even where such disclosure is not required.

18. Organizations that effectively target compensation above the market median must demonstrate how this positioning will vary across different business cycles and levels of performance. A prospective pay-for-performance analysis (reflecting percentile rank and sharing ratio) should be conducted to help support target positioning. [Accountability]

In certain situations, there are valid reasons for organizations to establish above-median market pay philosophies or to set their compensation programs to consistently deliver pay above the median. In our view, however, organizations that adopt such philosophies have additional responsibilities to ensure that the philosophy and the corresponding pay program design are appropriate over time.

More specifically, above-median positioning should be supported and validated by additional analytics — and, ideally, expanded disclosure (where applicable) — to ensure the appropriateness of the positioning.

Clearly, some stakeholders, including some shareholders, oppose above-median pay targets on principle — describing them as “excessive.” Beyond this emotional reaction, however, the real challenge with an above-market positioning is ensuring that pay varies effectively with performance, especially in periods of weak performance. For example, if an organization combines a high target pay positioning with easily achievable incentive targets and significant retention-oriented pay, its compensation could exceed that of its peer organizations despite poor performance. This would not only violate the objectives of pay-for-performance alignment, but it could weaken the organization's ability to respond to weak performance and a trough in its business cycle. In short, the organization could be paying more than it can afford.

Pay-for-performance analyses on a range of scenarios can identify potential areas of misalignment, whether in pay levels and mix determination, incentive vehicle selection, target setting or payout determinations. The analyses should then be used to construct a robust EC program that helps to ensure that the pay positioning works over time and across a wide range of performance scenarios.

19. Organizations must assess incentive programs frequently (at least every two years) using a clearly defined market perspective (custom peer group, industry or broader market perspective).  
[Accountability]

Given ongoing changes in market norms for incentive design and compensation levels as well as changes in organization performance and market positioning, organizations should conduct regular reviews of their incentive programs, including such features as program and plan objectives, incentive and pay mix, performance measures, targets and ranges, payouts, vesting, and governance and decision-making processes. In-depth reviews need not occur annually, but reviews every three years might be too infrequent, permitting programs that are not aligned with objectives, shareholder expectations and/or market norms to continue. Two years is a reasonable review cycle, especially since reviews need not always trigger plan changes.

20. In benchmarking and reviewing incentive payout levels, organizations should not only consider payouts as a percentage of target on an aggregate and job-specific basis but should also compare payouts as a percentage of value created (i.e., a sharing-rate analysis). [Alignment]

Frequently, organizations benchmark their incentive payouts by comparing actual payout levels with actual payouts of other organizations. This approach provides insights on an individual job basis but doesn't scale the payouts in relation to organization performance and doesn't reflect how an organization's plan participation levels vary from the market. Sharing-rate analyses help address these gaps and can help ensure that the organization's incentive payouts are aligned not only by job but also for the level of organization performance and overall incentive plan participation.



## Section IV: Governance

For public companies in the U.S. and certain other markets, listing exchanges require that compensation for selected senior executives be set or approved by a compensation committee made up of independent (outside or nonexecutive) directors. Our guiding principles for EC governance focus primarily on the role and operations of such committees and their advisors. Our consulting experience suggests that many private organizations and nonprofit organizations are also adopting more formal governance structures, albeit without the legal and regulatory requirements that public companies face. These organizations might also benefit from the following guidance.

### Role of the compensation committee

1. The committee must be directly accountable for making decisions about the compensation of the CEO and the senior executive team, and for monitoring the implementation of EC programs. Increasingly, committees are expanding their mandates to include oversight of a broad range of human capital issues, and incorporation of environmental and social factors into incentive plans. [Accountability]

These accountabilities are common to effective committees and reflect active deliberation and engagements. While common, the use of incentive formulas and employment contracts should not replace the exercise of judgment by the committee, which should use discretion to avoid pay outcomes that are unforeseen and/or not aligned with shareholder or program objectives. Obviously, the committee's use of discretion should be guided by a well-thought-out framework and be mindful of specific tax and legal constraints (e.g., Section 162(m) of the tax code in the U.S.) and the optics of specific practices and awards in view of the organization's business, economic or political context.

The committee's oversight role includes equity plans and other compensation programs, although the committee can delegate administration and pay decisions for individuals outside of the senior executive team. In addition, the committee should play an oversight role with regard to compensation decisions for individuals whose activities pose material risk to or can have a material impact on organization business.

2. The committee must ensure that there is an appropriate Total Rewards philosophy for executives and consider the need for its alignment with the broader reward strategy of the organization as a whole. [Engagement]

The philosophy should inform all pay decisions and be reviewed regularly to ensure its continued alignment with the organization's business and strategies. When circumstances dictate that exceptions to the strategy be made, independent judgment should be used and the exceptions should be disclosed and transparent.

3. The board, with the committee's involvement, must conduct an annual review of the CEO's performance and should ensure there is an effective process for conducting formal performance reviews of other senior executives. [Accountability]



CEO performance reviews are required by exchange listing rules in the U.S. and numerous other jurisdictions. What is critical and sometimes missing, is a rigorous, impartial review of the CEO's performance. The review should involve a holistic review of organization and individual performance that includes both actual results and the key behaviors and competencies associated with those results, including input from multiple assessors and, potentially, the use of targeted developmental objectives.

For other executives, the board should ensure a robust assessment process and periodically review its effectiveness. The process should support thoughtful succession planning, generate feedback to current and future leaders, assess individual strengths, and identify organizational leadership gaps and needs. It should also include a system to identify high-performing and high-potential employees.

4. In addition to ensuring that EC programs comply with relevant regulatory requirements, the committee should ensure that its EC and performance-related programs are regularly assessed against relevant market practices and trends. [Accountability]

Especially in an environment of enhanced disclosure and say-on-pay votes, insights on EC effectiveness continue to expand. The committee should ensure that it receives regular updates on relevant practices and market developments, including research and thinking from market-leading organizations to ensure program effectiveness. It is also important to regularly review elements of the compensation program that might not be typically covered in trend reports, such as benefits, LTI provisions, share ownership and retention guidelines, and executive contracts. Increasingly, committees are providing oversight and receiving information on various human capital factors such as culture, employee wellbeing, diversity and inclusion, pay fairness and talent development.

## Ensuring proper governance

5. The committee should include members who have practical experience with and/or detailed knowledge of EC and other human capital issues. [Purpose]

The complexity of EC issues has grown significantly over the past decade and continues to grow; depth of understanding of these issues is clearly an important attribute for an effective committee. At least one committee member should have relevant EC experience, and new members at a minimum should complete an in-depth orientation for compensation committee members.

6. The committee must be led by an informed and engaged chair, and committee members must demonstrate independent views and advocate for change when necessary. [Purpose]

In our experience, the most effective committees are among the most engaged and are comfortable expressing independent views. The committee must be willing to constructively challenge thinking and recommendations, and raise contentious or difficult issues.

For the committee to be effective, the chair must maintain good working relationships and the trust of the board, the CEO (and other senior executives) and other stakeholders. The stewardship of the committee depends on the chair's ability to effectively set the tone and agenda for all key compensation decisions.

7. The committee should use a comprehensive toolkit of resources to ensure that it effectively fulfills its role. [Purpose]

The tools and analyses available to committees and practitioners continue to expand. The committee should ensure that it can take advantage of these resources. Among the most important resources are:

- A detailed calendar of meetings covering all key duties outlined in the formal committee charter
- A regular assessment of the process covering the committee and compensation advisors (both those retained by the committee and by management, as appropriate)
- Appropriate director of education in EC design, market practices, trends and governance External market reference data
- Additional analyses, including tally sheets, pay-for-performance reviews, accumulated wealth analyses, and others, to validate pay outcomes against the reward philosophy
- Results from succession-planning processes and performance management

8. The committee must meet frequently enough (in person or virtually) and dedicate sufficient time to prepare for meetings to carry out its key responsibilities effectively. [Accountability]

In many jurisdictions (the U.S.), the complexity of the committee's role and duties generally require that the committee meet at least four times a year. The frequency and number of meetings should reflect the specific circumstances of the organization (e.g., corporate transactions or leadership changes will demand more attention than a steady-state process).

Information and documents to support the committee's deliberations should be provided to the members a week in advance of meetings to provide adequate time to prepare. We would also note that management plays a critical role in providing information and perspective on the operation and effectiveness of compensation programs and, ideally, should be fully engaged in committee processes while permitting the committee opportunities to render independent judgments.

Finally, sufficient time should be dedicated to engaging meaningfully with other stakeholders, especially shareholders, to inform committee decisions.

9. The committee must have direct and independent access to external advisors (e.g., legal, consultants) and organization executives beyond the CEO (e.g., HR, legal, finance). [Accountability]

This principle focuses on the notion of committee access to advisors and executives but does not mandate the degree to which the committee uses such third parties. While the committee might direct its compensation advisors to work with management, these advisors should be accountable to the board. Moreover, the use of external advisors does not alter the committee's ultimate accountability for its decisions.

Unfiltered access to key organization personnel is critical to the committee's ability to carry out its oversight responsibilities and ensure that it has a complete understanding of the organization's business and pay issues. This interaction can inform committee views on target and goal setting, pay outcomes and succession planning. The committee should also ensure that it is well informed about external perspectives on compensation and governance issues.

10. EC advisors must serve the organization and act in the best interests of its long-term health, regardless of who formally retains them. [Accountability]

Regardless of whether the compensation advisor is retained by management or the board, it should view the organization as its client. Advisors should not represent the interests of any one individual, nor serve as an advocate for the board, management or any single party.

Advisors should consider the views and expectations of multiple stakeholders and provide holistic and independent perspectives informed by views of market norms and best practices.

We acknowledge there might be instances outside of the scope of this principle in which advisors are engaged to support a specific executive (e.g., a lawyer engaged by the CEO to revise his or her contract).

## Robust public disclosure

11. Consistent with local market standards and requirements, committees at public companies should ensure that the public disclosure of the total compensation philosophy and pay design for all members of the senior executive team and their rationale is presented concisely — but comprehensively — in plain language without the use of legalese. [Accountability]

Consistent with local regulations and listing requirements, public disclosures should include a description of the pay programs, their purpose and how pay is linked to the business strategy and measurable performance outcomes. As a general rule, disclosures should articulate the business case for the chosen approach to pay and will need to be sufficiently rich to do so effectively. Transparency and simplicity are critical. The rationale and context should be clearly explained.

Note: in some countries, public companies are required to disclose material information on their human capital asset as well as their environmental policies and practices. While these disclosures may fall under the purview of the compensation committee, they are not covered in this document.

12. Public disclosures should clearly communicate the link between historical pay outcomes and performance. [Accountability]

In countries that require say-on-pay votes, in particular, the committee should ensure that pay disclosures are adequate to enable shareholders to make an informed vote regarding compensation. But, while multiple analyses might be conducted to support the committee's decision making or to validate pay-for-performance alignment, the public disclosures should generally be limited to summarizing key pay and performance information. The disclosure of future performance targets can

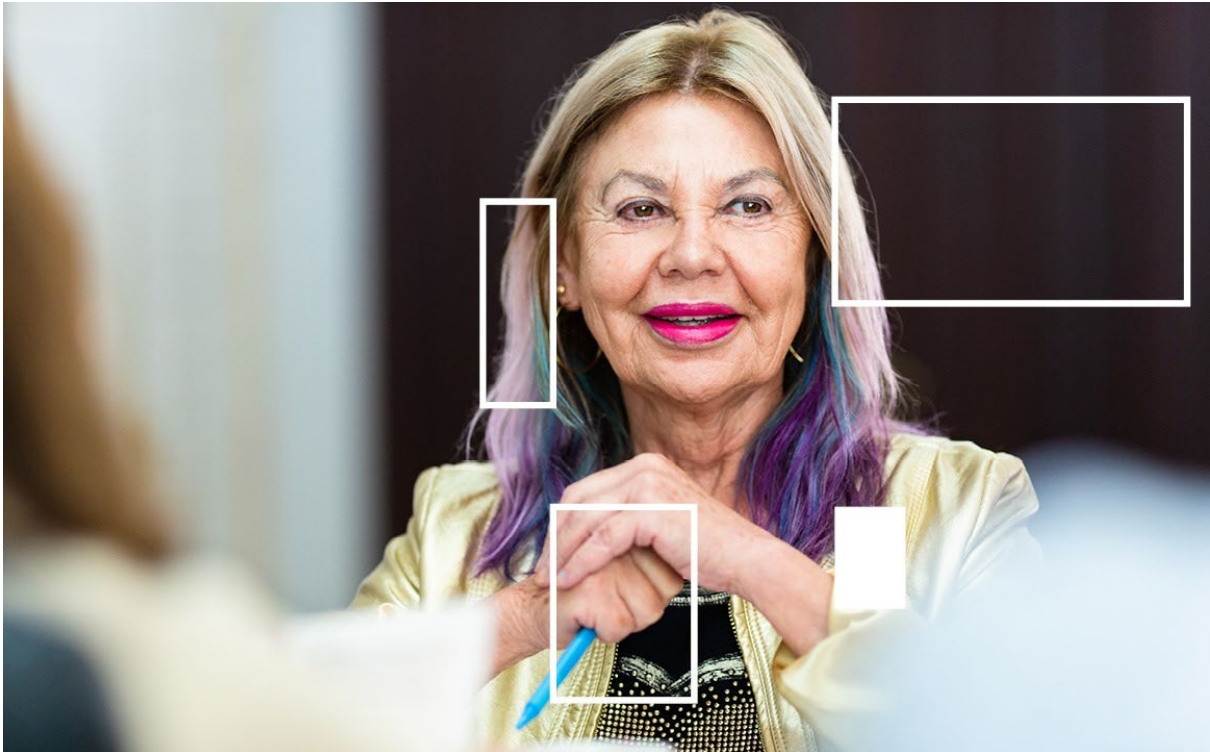
reinforce and support the theme of transparency with shareholders; however, adherence with the theme of transparency might be balanced with concerns about potential competitive harm.

13. Public companies should ensure there is ongoing communication with shareholders and consider external feedback on compensation. [Engagement]

Engagement with shareholders about the organization's compensation program should be ongoing, but it is critical where proposed changes in programs are significant or the programs raise other concerns. Whether the committee is directly involved in shareholder engagement efforts will depend on the local regulatory framework and market practice. In some markets, shareholders might view discussions with management as sufficient.

14. In cases when an organization's pay programs elicit notable opposition from shareholders, voting guiding agencies, proxy advisors or others, the committee must be accountable for considering the concerns and ensuring an appropriate response. [Accountability]

In these situations, further shareholder engagement will generally be viewed as necessary by shareholders. In general, shareholder and regulatory perspectives should take precedence over the views of other stakeholders (e.g., voting guiding agencies, proxy advisors, labor unions)<sup>1</sup>



<sup>1</sup> In the U.S., this might be the case when shareholder support in say-on-pay votes falls below the 80% level.

## Section V: Other terms and conditions

In addition to the programs that provide regular compensation opportunities to executives, organizations also offer additional programs and policies necessary to recruit new executives, ensure continued retention and effectively manage various kinds of risk. An ever-changing regulatory landscape coupled with increasing shareholder scrutiny require that organizations and compensation committees proactively review their risk mitigation programs, perquisites, and employment terms and conditions to ensure that these elements align with shareholder interests and the organization's evolving business objectives.

As a general rule, whenever practical, we believe that organizations should endeavor to shift away from individualized contractual arrangements in favor of consistent policies covering broader employee segments and should differentiate their reward programs through direct compensation, rather than via these other terms and conditions.

### Risk mitigation programs in general

1. Organizations must adopt a variety of risk mitigation programs, including, at a minimum, share ownership guidelines and clawbacks, linked to both delivered compensation and future compensation. Risk mitigation programs should help ensure that EC programs do not create incentives for counterproductive behavior or outcomes. [Accountability]

Risk mitigation techniques such as deferrals, clawbacks and post-termination equity retention periods help ensure appropriate levels of risk-taking by executives and seek to align compensation outcomes with long-term sustainable results. They also help to balance risk in the overall compensation program.

In recent years, additional focus has been placed on various risk mitigation procedures, including clawback programs. While organizations must ensure that they satisfy applicable local regulations, they should also consider additional safeguards tailored to their particular compensation programs and business needs.

Compensation committees should proactively monitor these programs and revisit them on a regular basis to ensure continued compliance and effectiveness. Shareholder disclosures should clearly describe such programs and their key terms.

### Share ownership guidelines

2. If organizations provide equity compensation, they must adopt share ownership guidelines and should scale them to reflect the value of the equity compensation levels. [Alignment]

For organizations that deliver compensation in the form of equity-based awards, minimum share ownership guidelines (defined broadly to also include retention and holding requirements) help ensure that executives' interests remain aligned with shareholders' interests over the longer term.

Share ownership levels should reflect the value of equity awards and the prominence of equity incentives in the overall pay package. Currently, required ownership levels at many organizations are generally quite low relative to the level of compensation and the size of executive equity awards.

Share ownership guidelines are generally expressed as a percentage of base salary or a fixed share amount, with greater ownership required for more senior executives. In the U.S., multiples of five (or more) times base salary for CEOs and three times base salary for other NEOs have become the norm over the past decade; organizations should review these guidelines regularly to ensure they reflect changes in compensation and equity levels since they were introduced. An initial grace period can be allowed for newly hired or promoted executives to reach required ownership levels.

3. The forms of equity that are counted to determine whether executives satisfy a share ownership guideline should include only fully vested or owned equity (including equity held in qualified and nonqualified deferred compensation plans). [Alignment]

Share ownership guidelines should specify the types of equity used for determining whether or not the guidelines are met and should include only shares that the executive has a current right to transfer for value. For maximum risk mitigation, share ownership guidelines should be satisfied only with unrestricted shares owned outright by the executive. Organizations also might want to consider including a portion of vested, in-the-money stock options in cases where options represent the major component of equity compensation.

4. In conjunction with share ownership guidelines, organizations should implement share retention requirements set as a percentage of equity awards until the required level of ownership is achieved. [Alignment]

Retention requirements are an important complement to traditional share ownership guidelines and are typically expressed as a fixed percentage of delivered shares that must be retained. While some organizations impose retention requirements only until required share ownership levels are achieved, a stronger approach to promote shareholder alignment is to supplement share ownership guidelines with additional retention requirements that continue beyond the satisfaction of the minimum ownership level. These requirements balance the financial planning needs of executives with the need to promote sustained value creation.

5. Holding requirements (share ownership guidelines and retention requirements) should remain in place for at least 12 months after employment for senior executives. [Alignment]

For maximum effectiveness, holding requirements should be enforced beyond termination for a period of at least 12 months. This ensures that executives have a stake in the period following termination in which the results of their decisions and actions during their tenure are realized. This extended retention period also supports effective transitions and succession planning activities and reflects the enduring nature of strategic business decisions. A 12-month post-termination holding period also ensures the closing of one full accounting period after employment termination. For businesses with longer “ails to their decisions, longer holding periods might be appropriate. In cases of retention periods greater than 12 months, a drawdown might be permissible.



For purposes of enforcing holding requirements, termination events should be defined to include voluntary and involuntary termination, including retirement, while excluding death and long-term disability.

### Clawback policies

6. All organizations must adopt clawback policies; these policies should cover all forms of incentive compensation, including vested, paid and unpaid awards. [Accountability]

Clawback policies should focus both on previously vested or paid compensation and the forfeiture of future unpaid awards. At a minimum, the triggering events for a clawback should meet applicable local regulations, and some organizations might want to impose a lower threshold. For instance, triggers might include financial or other misstatements beyond those over which the executive has direct control to include any material issues affecting the amounts reported in financial statements or the performance metrics used to determine incentive payouts.

In the wake of the Dodd-Frank Act, U.S.-listed companies will be required to adopt clawback policies when SEC regulations are issued, and those policies will be publicly disclosed to shareholders. While most U.S. companies have already adopted clawback policies, those policies should be reviewed to ensure compliance with new listing requirements, and organizations might want to consider stronger policies that go beyond the listing standard requirements (e.g., enabling a clawback for restatements or types of misconduct that are not intentional).

Clawback policies might also be appropriate for organizations not subject to relevant local regulations. The design of such policies should reflect the magnitude of incentive compensation provided to executives.

### Pledging and anti-hedging policies

7. Organizations should adopt, and where appropriate, disclose pledging and anti-hedging policies. [Accountability]

Whether or not subject to disclosure rules (as in the U.S.), organizations should adopt a comprehensive pledging and anti-hedging policy for executives and directors. Recent revisions to U.S. disclosure rules require that organizations disclose whether or not they have in place a pledging and anti-hedging policy. While organizations must adhere to the requirement to state whether or not a policy is in fact in place, they should, in fact, adopt such a policy. Specifically for pledging policies, they should ensure that share ownership, share retention and/or holding requirements cannot be violated through pledging.

### Deferred short-term incentive compensation

8. For senior executives, if short-term incentive compensation is the largest component of pay and/or is highly leveraged, organizations should defer a portion of the payouts. [Accountability]

For organizations in which short-term cash compensation is highly leveraged, a mandatory deferral might be appropriate. Highly leveraged generally refers to short-term incentive programs that are significantly above market norms (e.g., 300% of base salary and/or uncapped). In such circumstances, deferrals should ideally be required for the entire amount of the short-term incentive payment that exceeds market norms. When this amount is not readily determinable, a fixed percentage required for deferral can be established.

## Perquisites and tax gross-ups

9. Perquisites in excess of those provided to a broader employee population should be provided only on a limited basis and have a direct link to a clearly defined business need or benefit to the organization.[Alignment]

While perquisites can provide an effective recruitment and retention tool, they should be provided to executives only when a clear business rationale exists. Otherwise, EC programs should emphasize direct compensation, especially incentive compensation.

Given the close shareholder scrutiny of executive perquisites, organizations must review their programs carefully to ensure they are appropriately tailored to their unique business needs. Organizations should have a clear definition for business need, and the link to business need should be transparent to all stakeholders. Business need could include, for example, personal safety, efficiency and productivity, or the ability to meet client demands. Market competitiveness alone should not be considered a business need. In some jurisdictions outside of North America, we acknowledge that certain perquisite practices are predominant in the market or are tax advantaged. While it is preferable to provide EC through TDC opportunities, this preference needs to be balanced with market norms.

Beyond the business need, organizations should also consider the relative costs and benefits of any perquisites. For example, companies in certain industries might be more likely to provide perquisites based on the nature of their product or service offering (e.g., personal security for tobacco or firearms manufacturers). With respect to specific perquisites that remain somewhat common today, our perspectives are as follows:

- Personal aircraft and automobile use should not be provided at the organization's expense, although car service for business purposes might be appropriate.
- Home security should be provided only when the committee has conducted a risk assessment and determined that there is unusual potential for executives to be harmed.
- Private health screenings or physicals should be limited to critical senior executives whose absence could result in material hardship for the organization.
- While tax preparation and planning might be appropriate in some cases, given the complexities of the compensation plan certain executives receive and their global mobility, broad generic financial planning services are not necessary from a business perspective and should be paid for by the executive, if desired, or offered as part of an organization-wide program.

Flexible perquisite allowances provide for easy administration. However, these programs are inconsistent with the principle that perquisites must have a direct link to a clearly defined business need. The only situations in which flexible perquisite allowances might be appropriate are during a transition period in which previously offered perquisites are being eliminated. And when an executive declines the use of an organization-provided perquisite, the cost or value of that perquisite should not be reallocated to pay or other benefits.

10. Tax gross-ups should be provided only as part of a broader organization-wide policy (e.g., for expenses incurred as a result of relocating to assume another role within the organization).  
[Alignment]

Overall, we believe that gross-ups should be in the form of organization-wide policies and support specific business objectives (e.g., mobility of key talent), as opposed to addressing personal or individual needs. Gross-ups, especially in the case of incentives, perquisites or change-in-control (CIC) awards, are highly scrutinized by shareholders, distort performance-aligned compensation and should generally be avoided. However, it might be appropriate to make executives whole from a tax standpoint with regard to relocation and/or expatriate benefits, and other benefits that might be provided to support a specific business need.

### Employment contracts (U.S. only)

11. Individual employment contracts should be limited to instances of compelling business need or competitive rationale. [Engagement]

In general, it is preferable to offer compensation and benefit arrangements via an offer letter or broad-based program, as opposed to one-off executive employment contracts. Broad-based policies allow for easier administration because amendments do not require negotiations with individual executives. In our experience, policies tend to mitigate the problem of having different executives “carved out” of a broader program, weakening internal equity. Policies can be easily tiered to structure more generous benefits for executives, reducing the need for individual contracts. Organizations should perform regular reviews to confirm that provisions across plans and policies are consistent and aligned with their business needs.

However, there are certain situations in which the use of employment contracts might be beneficial to the organization, including, for example:

- Those in which the organization is trying to recruit an executive into a turnaround or otherwise uncertain business situation where an individual contract might provide additional security and protection required to get the best candidate
- Those involving smaller organizations that pay less for talent and whose talent is perennially at risk, especially in industries dominated by larger organizations with more aggressive pay programs

12. Individual contractual severance (in excess of an organization's executive severance policy) may be appropriate if justified by business need or reward philosophy, but should "sunset" over no more than three years and revert to the organization's overall executive severance policy. [Engagement]

Often, additional severance in excess of the organization's policy can serve as a recruitment tool and reflect differences in reward philosophy for executives versus the broader employee population. This can apply to both CIC and non-CIC severance.

As a recruitment tool, however, contractual severance terms should not exceed three years because the risk that the new organization or role will not work out should be passed by this time. Ideally, in these cases, sunset provisions should be written into the agreement to reduce the severance amount over the three-year period to align with the organization's severance policy. However, if an organization does not have a formal severance policy, it might be appropriate to forgo a sunset provision.

13. The effective term for a contract, offer letter or any language with individual provisions should be three years or less and should not provide for automatic rollover (i.e., be "evergreen"). Also, nonrenewal provisions in an employment contract should specify that nonrenewal does not constitute constructive termination of employment. [Engagement]

Employment contracts can be an important component of the value proposition when bringing new executives into an organization with a sense of security. However, contract guarantees offer a less compelling business rationale with regard to longer-tenured executives. Evergreen features can result in a lack of governance and proper review, as boards and stakeholders might be effectively absolved of the responsibility to review such contracts regularly. Consistent with these perspectives, the term of an employment contract should not exceed three years. In addition, in most circumstances, failure to renew an agreement should not be used to trigger severance payments or other financial incentives.

14. Restrictive covenants are usually desirable. If severance is provided, the non-compete and non-solicitation period should be at least as long as the severance period. [Accountability]

Restrictive covenants serve as an additional safeguard to protect the interests of the organization and should go hand in hand with supplemental severance benefits. Organizations should discuss and clearly articulate the business rationale for the duration and level of benefits and the length of restrictive covenants. Restrictive covenants can include:

- Confidentiality
- Noncompetition
- Non-solicitation of employees and/or customers
- Non-disparagement

In theory, restrictive covenants cover the period during which executives will face challenges in finding similar employment, although we note that often, this is not the case. While confidentiality and non-disparagement covenants should endure indefinitely, the enforceable period for additional covenants (especially greater than one year) can vary.

Ongoing or phased severance payments following termination might be preferred over lump sum payments because they give the organization some recourse in the event that the executive violates the restrictive covenants. However, there might be legal constraints that need to be considered.

Additionally, it might be appropriate and effective to combine restrictive covenants with a clawback provision on previous LTI awards.

15. Executives should not be carved out for separate or unique incentive plan design arrangements unless justified by very specific business reasons. These exceptions should be clearly explained and have a compelling rationale. [Alignment]

Often, particularly in cases specific to CEOs, employment contracts specify criteria by which to measure performance for the executive. However, these arrangements might not align with other incentive programs currently in place or that might be introduced in the future, which can make it difficult to communicate a consistent message via performance plans. Such one-off arrangements can create unnecessary or distracting noise in the executive incentive plans and become difficult to manage over time. As a result, they should be avoided.

16. Organizations should review the potential termination payments resulting from employment contracts and policies annually when assessing their senior EC programs. [Accountability]

Organizations should annually review potential termination-related payments and benefits for the broader executive population, especially in light of evolving market norms and total compensation levels. An easy and systematic approach is the use of robust executive tally sheets.

In reviewing executive tally sheets, organizations should consider employment and severance arrangements as part of the analysis to determine the total amount an organization might be required to pay in the event of a change in control or termination. To receive the maximum benefit of tally sheet reviews, organizations should also incorporate scenario testing (e.g., changes in stock price, performance levels).

In situations where the levels of termination payments vary from organization norms or represent a significant burden, especially when coupled with already high or above-market compensation, organizations should carefully review their programs and amend them accordingly, especially for new employees or new program participants.

As part of annual proxy statement preparation, U.S. companies must disclose potential termination payments for their NEOs.

## Retirement arrangements

17. Executive retirement benefits should be consistent with broad-based programs. Additional benefits, including individual arrangements, should be avoided. In cases of termination with follow-on consulting arrangements, these arrangements should provide payment only for actual services rendered. [Alignment]
18. Retirement benefits are an important element in the overall Total Rewards package and should be viewed holistically with other forms of compensation. However, individually negotiated benefits should be avoided in favor of broad-based programs. Organizations should avoid providing additional age or service credits to newly hired or promoted employees.

Additional retirement benefits might be appropriate where, as in the U.S., regulatory or tax policies limit the value of broad-based retirement programs for executives. In such situations, supplemental retirement benefits should be documented in a retirement policy, should align with tax-qualified plans and be designed solely to make executives whole for benefits lost as a result of the applicable tax limits on qualified plan contributions and benefits.

For senior executives, the organization might benefit from receiving additional services from the executive following retirement. In such cases, a postemployment consulting arrangement might be appropriate, but only if it provides payments for actual services rendered. In the spirit of shareholder alignment and transparency, fixed consulting fees should be avoided and consulting arrangements should not serve as a substitute for additional retirement benefits.





## Section VI: Special circumstances

Compensation committees are often faced with a number of special circumstances that require particular attention and planning, including hiring new executive officers, executive terminations and corporate transactions such as mergers and acquisitions. In planning for these events, organizations should keep in mind the same key objectives that underlie the design of the EC program — to incent and reward the behaviors and processes that reinforce the activities the organization undertakes to create sustainable long-term value for multiple stakeholders.

### Incoming executives — ongoing compensation

1. Before entering into discussions about the offer to a senior executive new hire, the compensation committee (or HR, as appropriate) should identify the expected offer and a reasonable range as well as other key terms and conditions it would consider. [Engagement]

Recruiting new executive talent is a critical role of the committee. Additionally, the process and compensation amounts are generally disclosed to shareholders and might set precedent for future negotiations as well as incumbent executives. As a result, particular care and preparation are required, involving the input of many constituents, including HR, legal, finance and public relations.

Committees should be involved at the outset of critical searches to identify desired compensation parameters and expectations and to avoid being boxed in by committing themselves to a single candidate before establishing expectations on compensation. The committee should outline the details of the offer and determine maximum ranges or “gives” they are willing to concede to prior to engaging in negotiations.

2. The compensation and benefits for newly hired or promoted executives should generally be structured in the same manner as the programs for current executives. [Alignment]

Ensuring internal equity, in addition to external market competitiveness, is highly relevant in determining the compensation of newly hired or promoted executives. Individual employment contracts should be avoided, but when they must be offered to land a superior candidate, they should be consistent with the organization’s practice. In addition, severance practices, incentive plan designs and the like should not vary from programs for other executives.

The rare exceptions to this general rule could include cases where the one-time difference in pay is meant to eliminate poor pay practices and/or introduce new structures or pay programs that will eventually be adopted by the organization for all executives. Additionally, the structure of CEO compensation might vary from that of other executives in light of extraordinary circumstances (e.g., restructuring, CEO brought in to generate change).

## Incoming executives — recruitment compensation

3. Compensating newly hired executives for forgone compensation is a reasonable acquisition cost. However, compensation provided should be within the existing pay programs of the new organization or a more performance-oriented form of compensation. [Engagement]

It is often necessary and a common practice to provide newly hired executives with replacement awards (as opposed to sign-on awards, which are discussed in the next principle) to offset amounts they forfeited when leaving the former employer. If structured properly, these awards provide a valuable recruitment tool.

Where possible, organizations should use performance-based equity to offset forgone compensation to provide maximum incentive and alignment value. These replacement awards should have retention features (e.g., time-based vesting) similar to the forfeited compensation, if reasonable, given the organization's current compensation program structure.

Perquisites, contract terms and the like, provided by the executive's former employer, should not be provided if they are not part of the organization's current programs.

4. Recruitment compensation that does not replace foregone compensation should be in the form of equity and/or performance-based cash. [Accountability]

Recruitment compensation that's not meant to replace forgone compensation (e.g., sign-on equity, special cash payments or incremental cash incentives) might be required to attract a new hire.

However, these sign-on awards should be used only when justified by business circumstances, and the business rationale should be clearly disclosed in public filings.

Sign-on awards should be in the form of performance-based awards (with requirements for incremental performance improvement) and preferably performance-based equity. One-time cash awards and bonus guarantees should be avoided as they do not promote alignment with shareholders' interests. Additionally, sign-on awards should follow the organization's general compensation program parameters to minimize administrative and internal equity issues.

## Retention awards

5. Special one-time retention awards should be infrequent and used only when exceptional business circumstances or a shortage of highly specialized and difficult-to-replace critical skills create a clear retention risk. Retention award values should be reasonable in light of the competitiveness of the executive's Total Rewards. [Engagement]

Retention awards should only be considered when justified by exceptional business circumstances, which can include:

- A potential change in control, turnaround or restructuring
- A shortage of highly specialized talent (e.g., chief nuclear scientists, cybersecurity)

If offered, retention awards should have a clear and articulated rationale, and award values should be reasonable in light of that rationale. Additionally, award structures and values should be tailored to each executive, taking into account individual retention risk, outstanding award values and other organization programs.

## Involuntary termination, death, disability and retirement

6. Termination without cause should typically trigger cash severance; equity should not be accelerated in full except in compassionate circumstances (i.e., death or disability).  
[Accountability]

Cash severance payments are a common practice and represent a reasonable cost of transition for involuntary terminations. For an involuntary termination, outstanding equity awards should not become fully vested. Instead, vesting should be prorated for the portion of the vesting period worked or the award should be forfeited in its entirety. This approach is consistent with a pay-for-performance orientation. Substantial severance payments should be delivered over time (rather than in lump sums) and should be discontinued if the executive finds another job during the initially prescribed payout period.

In cases of compassionate circumstances (death or disability), cash severance should not be offered but equity acceleration might be considered in full or prorated. In the case of retirement and termination for cause, cash severance generally should not be offered and unvested equity awards should be forfeited.

## CIC provisions

7. Organizations should have in place an executive CIC program and/or CIC provisions in organization plans in order to promote shareholder value, but the program should be designed with the broader EC program in mind, especially organization severance practices and the equity program. [Alignment]

CIC benefits provide a degree of security to executives during times of uncertainty and are considered an appropriate transaction cost. These benefits provide retention for a transition period to preserve business continuity and facilitate orderly changes in the executive management team. However, the CIC plan must be designed to ensure that is in line with other EC program practices and does not provide additional or duplicative benefits that have not been contemplated.

8. CIC benefits should be provided only under a formal program for participants who are likely to have a direct impact on the transaction and whose job might be subsequently at risk. Individual CIC agreements that are inconsistent with the organization's formal program should be avoided.  
[Engagement]

CIC benefits should be offered through a formal program that provides varying benefit values, terms and conditions based on job level. Having a formal program helps to limit negotiations with executives seeking special provisions not consistent with the organization's reward strategy or philosophy.

A formal program is also easier to administer since amendments won't require negotiations with individual executives.

Participation in the program should be limited to key executives likely to have a direct impact on the transaction's completion or success.

### CIC benefits (U.S. only)

9. The terms of a CIC program should generally align with effective governance models and best practices (not necessarily market practice). Benefits should be limited to equity acceleration, cash severance, health benefit continuation, and outplacement provided at a multiple or for a period

that's aligned with the duration of the non-compete agreement. Going forward, Internal Revenue Code section 280G excise tax gross-ups should be eliminated, and organizations might consider implementing a best-net provision in their place. [Accountability]

CIC benefits continue to come in for close shareholder scrutiny, magnified by enhanced U.S. disclosure requirements and the Dodd-Frank requirement for say-on-parachute votes. As a result, program parameters should align with good governance models and best practices, and market practices should receive minimal consideration.

CIC protection is meant to help bridge the gap in employment and is not meant to help executives maintain a standard of living. In the current environment, appropriate design features include the following:

- Cash severance multiples should not exceed three times current compensation for senior executives and should be scaled down for lower levels within the organization.
- Benefits (including cash severance and equity acceleration) should only be provided following double-trigger events (e.g., involuntary termination within a specified period before or after a CIC).
- Performance awards should be accelerated at pro rata levels based on target unless it's possible to measure the actual performance payout.
- Voluntary walk-away rights should be avoided.
- Elements such as perquisites and additional retirement credits that don't help bridge the gap to employment should be avoided.

In addition, 280G excise tax gross-ups are considered a poor pay practice and should be avoided. Existing gross-up provisions should be eliminated or phased out over time. Organizations might consider implementing a best-net provision calling for severance payments to either be paid in full (with the executive bearing responsibility for all taxes) or reduced to avoid triggering the 280G excise taxes, whichever gives the executive the best net (after-tax) position.

## Key definitions

**Alignment** is a quality of an incentive plan assessing the extent to which compensation is linked to shareholder value creation (e.g., stock options).

**Executives** are the individuals who drive, contribute to and influence the establishment of strategic plans of the organization and/or its major functions or business units, as well as other senior-level staff who have a significant and ongoing impact on the organization's results.

- Definitions of executive vary by organization and market, but generally refer to the CEO and the next two to three layers of management (or four layers in very large organizations).
  - Executives would include the direct reports to the CEO, functional leaders and major profit center heads.
  - In larger organizations, executives might also include the teams reporting to functional leaders and business unit executives.

**Executive compensation (EC)** is concerned with all aspects of pay, tangible and intangible benefits, promotion and development opportunities, perquisites, employment terms and conditions, and associated policies and processes to determine EC, including the assessment of performance, for an organization's executives.

- EC encompasses most aspects of foundational rewards, performance-based rewards, and career and environmental rewards outlined under the Willis Towers Watson Total Rewards Framework.
- The Guiding Principles address primarily considerations surrounding performance-based rewards and terms and conditions under foundational rewards, and place special emphasis on the governance process of EC decisions.
  - EC is, in other words, more than just compensation in its narrow sense but rather the broader management of various forms of executive ties to the organization.
  - EC and Total Rewards can be fungible terms in this document.
  - Policies and processes associated with executive rewards also include, for example, broader program elements such as performance management and assessment, narrower elements such as stock ownership guidelines, reward-related CIC policies, and overall organizational governance framework and procedures.

**Line of sight** is a quality of an incentive plan assessing the extent to which participants perceive that the performance metrics that determine pay outcomes are within their control to influence (e.g., business unit LTI plan for a business unit leader). Conversely, where plan participants believe they are unable to affect the level of performance achieved under the metric and, therefore, unable to affect the pay outcome, we would say that the plan does not possess line of sight.

**Long-term** refers to the duration of time extending multiple years and business cycles over which an organization's strategy is executed, realized or evolved.

**Market reference group** refers to a broad range sample of organizations that serve as a reference point to market.

- Peer groups are a subset of specific organizations that serve as a separate reference point to market.

**Performance** is defined broadly and reflects assessment from multiple perspectives, including (but not limited to):

- Returns to shareholders
- Financial and nonfinancial results (including performance against key strategic milestones, customer, operational, ESG and broader stakeholder objectives)
- Results relative to internal targets
- Results relative to competitors and peers
- Qualitative and quantitative assessment of processes to achieve results
- Performance as assessed at organization, business unit, function or team, and individual levels
- Performance as assessed over varying time frames

This broad definition reflects the fact that no single perspective provides a comprehensive and definitive view of performance.

**Retention** is a quality of an incentive plan assessing the extent to which compensation is focused on continued service (e.g., time-based restricted stock or stay bonuses).

**Senior executives** are the CEO and members of the organization's leadership team (in most U.S. organizations, this extends beyond the NEOs and generally includes all direct reports to the CEO).

**Stakeholders** generally refer to parties beyond the individual executive and the organization's board, including shareholders (e.g., parent companies, institutional investors), all employees, shareholder advisors, regulators, politicians, the media and the public.



# Appendix: Principles list

## Section I: Governing objective and EC philosophy

1. **Sustainable:** EC must reinforce the responsible creation of sustainable long-term value and the activities organizations undertake to generate this value. [Purpose]
2. **Holistic:** To ensure the effectiveness of EC programs, organizations must undertake a holistic consideration of both pay and performance. [Alignment]
3. **Long-term:** Each organization's business and people strategies should align with long-term value creation and should drive the design and management of the organization's compensation programs. [Purpose, Alignment]
4. **Organizationally aligned:** EC programs should also be aligned with the organization's culture and individual employee characteristics and, when possible, consider stakeholder preferences. [Purpose, Alignment]
5. **Market-informed:** EC decisions should be informed by — but not driven by — market practices. [Engagement]
6. **Transparent:** Organizations should articulate their reward strategies. [Purpose]

## Section II: Pay level reference group selection and benchmarking

### Market reference group selection

1. **Robust data:** Benchmarking analyses should be based on the most robust and credible data available and avoid an overreliance on a single data source. [Accountability, Engagement]
2. **Multiple reference groups:** Compensation levels should be benchmarked against multiple market perspectives reflecting the market for talent, including: (a) direct competitors (a narrow peer group of close competitors against which the organization's performance would be most typically benchmarked), (b) industry competitors (a broader peer or reference group that shares industry characteristics) and (c) general industry (the broadest reference group). [Accountability, Engagement]
3. **Transparent market references:** Organizations must define and clearly disclose a market reference group or groups for use in assessing compensation design and levels. [Accountability]
4. **Thoughtful peer selection:** There must be a thoughtful and objective but non-formulaic process for determining the organization's market reference group. [Accountability, Engagement]

5. **Clear rationale for outliers:** When selecting a primary market reference group for compensation benchmarking, an organization must provide a rationale for the inclusion of organizations that are significantly different from it in terms of revenue size. [Accountability]

### Target pay level benchmarking

6. **“Market” is a range:** Organizations should consider a defined range, as opposed to a single data point, when assessing direct compensation competitiveness. [Accountability, Engagement]

### Holistic view of pay

7. **Direct and indirect compensation:** EC levels should be analyzed and considered holistically, including all elements of direct and indirect compensation. [Accountability, Engagement]

### Adjustments to individual compensation to align with market norms

8. **Avoid automatic adjustments:** While individual adjustments to align with market levels are entirely appropriate, organizations should avoid effectively automatic adjustments solely to align with a single market data point. [Accountability, Engagement]
9. **Consider incentive multiplier effect:** Compensation increases for senior executives, especially the CEO, must take into account the potential multiplier effect on both direct and indirect compensation as well as external scrutiny. [Accountability]

## Section III: Performance-based Pay

### Mix, measures and funding

1. **Favor line-of-sight and alignment rewards:** For senior executives, a majority of Total Rewards should be in the form of incentive compensation, a majority of incentive compensation should be in the form of LTIs, and a majority of LTIs should be focused on shareholder alignment and/or line of sight (i.e., retention-focused incentives should be the smallest LTI component). [Engagement]
2. **Align incentives with organizational level:** The proportion of Total Rewards allocated to target or expected levels of variable compensation should increase with each executive level within the organization. [Accountability]
3. **Balance incentives:** The incentive plan design should reflect the organization’s desired balance of shareholder alignment and line-of-sight-related objectives through the selection of LTI vehicles and the weighting and selection of incentive measures. [Trade-off between Alignment and Engagement]

4. **Three or more years:** For long-term performance plans, the performance measurement period (as distinct from the vesting period) should be at least three years. [Accountability]
5. **Align to strategy:** Performance measures, while subject to periodic validation, should be selected in light of the organization's long-term strategy. [Purpose]
6. **Measure holistically:** Organizations should include multiple measures across their incentive plans to promote a holistic view of organization performance. [Alignment]
7. **Weigh pros and cons:** Organizations must consider the strengths and weaknesses of each performance measure, including TSR. [Trade-off between Alignment and Engagement]
8. **Consider individual performance:** Individual performance should be considered in performance-based pay decisions at all organizational levels. [Engagement]
9. **Consider relative performance:** For variable compensation plans, relative performance must be considered implicitly through incentive target setting or explicitly through performance measurement. [Accountability]
10. **Multiple funding considerations:** While there is no predefined set of measures that are appropriate for a particular type of organization, incentive plan funding and design must consider each of the following types of financial measures: (i) earnings, (ii) revenue growth, (iii) balance-sheet-linked financial returns, (iv) cash flow and liquidity, and (v) cost of capital. [Accountability]

### Targets, ranges and discretion

11. **Rigorous target setting:** A rigorous process must be applied in setting performance targets and ranges that should consider: (i) the organization's long-term strategic plan; (ii) enduring standards reflecting historical norms of financial performance for the organization, industry and relevant peer organizations; (iii) analyst and economic forecasts; and (iv) the organization's budget. [Purpose]
12. **Tailored incentive curves:** The incentive payout curve and range should vary based on the volatility and sensitivity of the underlying performance measures, probability of achievement, affordability of outcomes, and how corresponding payouts will compare with market and historical results. [Accountability]
13. **Include circuit breakers:** For senior executives, a reasonable minimum level of organization-level financial performance (i.e., circuit breaker) must be achieved before incentives can be funded. [Accountability]
14. **Apply informed discretion:** Discretion is a critical tool for ensuring a holistic assessment of sustainable performance and quality of outcomes, and should be applied to incentive funding and allocation decisions based on a predefined framework. Compensation committees should consider how best to disclose and explain their use of discretion. [Accountability]

## Pay-for-performance assessment and incentive program review

15. **Annual and retrospective:** Organizations must annually review pay-for-performance alignment. [Alignment]
16. **Assess impact of changes:** To inform compensation program design changes, organizations must review the pay-for-performance alignment of proposed changes on a retrospective and prospective basis. [Alignment]
17. **Broad scope:** For purposes of assessing pay-for-performance alignment and EC program design changes, pay-for-performance analyses must: (i) include NEOs, (ii) be conducted over a multiyear basis, (iii) include both the direct market reference group for compensation benchmarking and a broader market perspective, (iv) consider both percentile ranking and sharing-rate analyses versus peers, (v) consider TSR as well as the financial performance measures used in the organization's incentive plans, and (vi) use either earned or realizable pay frameworks. [Alignment]
18. **Justify above-market positioning:** Organizations that effectively target compensation above the market median must demonstrate how this positioning will vary across different business cycles and levels of performance. A prospective pay-for-performance analysis (reflecting percentile rank and sharing ratio) should be conducted to help support target positioning. [Accountability]
19. **Frequent:** Organizations must assess incentive programs frequently (at least every two years) using a clearly defined market perspective (custom peer group, industry or broader market perspective). [Accountability]
20. **Multiple analyses:** In benchmarking and reviewing incentive payout levels, organizations should not only consider payouts as a percentage of target on an aggregate and job-specific basis but should also compare payouts as a percentage of value created (i.e., a sharing-rate analysis). [Alignment]

## Section IV: Governance

### Role of the compensation committee

1. **Accountable:** The committee must be directly accountable for making decisions about the compensation of the CEO and the senior executive team, and for monitoring the implementation of EC programs. [Accountability]
2. **Oversee reward philosophy:** The committee must ensure that there is an appropriate Total Rewards philosophy for executives and consider the need for its alignment with the broader reward strategy of the organization as a whole. [Engagement]

3. **Annual performance review:** The board, with the committee's involvement, must conduct an annual review of the CEO's performance and should ensure there is an effective process for conducting formal performance reviews of other senior executives. [Accountability]
4. **Regular program reviews:** In addition to ensuring that EC programs comply with relevant regulatory requirements, the committee should ensure that its EC and performance-related programs are regularly assessed against relevant market practices and trends. [Accountability]

### Ensuring proper governance

5. **EC expertise:** The committee should include members who have practical experience with and/or detailed knowledge of EC issues. [Purpose]
6. **Committee leadership and independence:** The committee must be led by an informed and engaged chair, and committee members must demonstrate independent views and advocate for change when necessary. [Purpose]
7. **Committee resources:** The committee should use a comprehensive toolkit of resources to ensure that it effectively fulfills its role. [Purpose]
8. **Frequent meetings:** The committee must meet frequently enough (in person or virtually) and dedicate sufficient time to prepare for meetings to carry out its key responsibilities effectively. [Accountability]
9. **Access to advisors and executives:** The committee must have direct and independent access to external advisors (e.g., legal, consultants) and organization executives beyond the CEO (e.g., HR, legal, finance). [Accountability]
10. **Effective advisors:** EC advisors must serve the organization and act in the best interests of its long-term health, regardless of who formally retains them. [Accountability]

### Robust public disclosure

11. **Clear and comprehensive:** Consistent with local market standards and requirements, committees at public companies should ensure that the public disclosure of the total compensation philosophy and pay design for all members of the senior executive team and their rationale is presented concisely — but comprehensively — in plain language without the use of legalese. [Accountability]
12. **Transparent pay-for-performance:** Public disclosures should clearly communicate the link between historical pay outcomes and performance. [Accountability]
13. **Ongoing shareholder engagement:** Public companies should ensure there is ongoing communication with shareholders and consider external feedback on compensation. [Engagement]

14. **Responsive to shareholders:** In cases when an organization's pay programs elicit notable opposition from shareholders, voting guiding agencies, proxy advisors or others, the committee must be accountable for considering the concerns and ensuring an appropriate response. [Accountability]

## Section V: Other terms and conditions

### Risk mitigation programs in general

1. **Required programs:** Organizations must adopt a variety of risk mitigation programs, including, at a minimum, share ownership guidelines and clawbacks, linked to both delivered compensation and future compensation. Risk mitigation programs should help ensure that EC programs do not create incentives for counterproductive behavior or outcomes. [Accountability]

### Share ownership guidelines

2. **Guidelines a must:** If organizations provide equity compensation, they must adopt share ownership guidelines and should scale them to reflect the value of the equity compensation levels. [Alignment]
3. **Based on vested or owned equity:** The forms of equity that are counted to determine whether executives satisfy a share ownership guideline should include only fully vested or owned equity (including equity held in qualified and nonqualified deferred compensation plans). [Alignment]
4. **Retention requirements:** In conjunction with share ownership guidelines, organizations should implement share retention requirements set as a percentage of equity awards until the required level of ownership is achieved. [Alignment]
5. **Postemployment holding requirements:** Holding requirements (share ownership guidelines and retention requirements) should remain in place for at least 12 months after employment for senior executives. [Alignment]

### Clawback policies

6. **Clawbacks a must:** All organizations must adopt clawback policies; these policies should cover all forms of incentive compensation, including vested, paid and unpaid awards. [Accountability]

### Anti-hedging and pledging policies

7. **Pledging and anti-hedging:** Organizations should adopt, and where appropriate, disclose pledging and anti-hedging policies. [Accountability]



## Deferred short-term incentive compensation

8. **Deferrals for high bonuses:** For senior executives, if short-term incentive compensation is the largest component of pay and/or is highly leveraged, organizations should defer a portion of the payouts. [Accountability]

## Perquisites and tax gross-ups

9. **Limit perquisites:** Perquisites in excess of those provided to a broader employee population should be provided only on a limited basis and have a direct link to a clearly defined business need or benefit to the organization. [Alignment]
10. **Limit gross-ups:** Tax gross-ups should be provided only as part of a broader organization-wide policy (e.g., for expenses incurred as a result of relocating to assume another role within the organization). [Alignment]

## Employment contracts (U.S. only)

11. **Limit individualized contracts:** Individual employment contracts should be limited to instances of compelling business need or competitive rationale. [Engagement]
12. **Sunset individual severance terms:** Individual contractual severance (in excess of an organization's executive severance policy) might be appropriate if justified by business need or reward philosophy, but it should sunset over no more than three years and revert to the organization's overall executive severance policy. [Engagement]
13. **Avoid evergreen contracts:** The effective term for a contract, offer letter or any language with individual provisions should be three years or less and should not provide for automatic rollover (i.e., be evergreen). Also, nonrenewal provisions in an employment contract should specify that nonrenewal does not constitute constructive termination of employment. [Engagement]
14. **Align restrictive covenants and severance:** Restrictive covenants are usually desirable. If severance is provided, the non-compete and non-solicitation period should be at least as long as the severance period. [Accountability]
15. **Avoid individual incentive arrangements:** Executives should not be carved out for separate or unique incentive plan design arrangements unless justified by very specific business reasons. These exceptions should be clearly explained and have a compelling rationale. [Alignment]
16. **Review termination provisions:** Organizations should review the potential termination payments resulting from employment contracts and policies annually when assessing their senior EC programs. [Accountability]

## Retirement arrangements

17. **Ensure consistency among participants:** Executive retirement benefits should be consistent with broad-based programs. Additional benefits, including individual arrangements, should be avoided. In cases of termination with follow-on consulting arrangements, these arrangements should provide payment only for actual services rendered. [Alignment]

## Section VI: Special circumstances

### Incoming executives — ongoing compensation

1. **Informed approach to offers:** Before entering into discussions about the offer for a senior executive new hire, the compensation committee (or HR, as appropriate) should identify the expected offer and a reasonable range as well as other key terms and conditions it would consider. [Engagement]
2. **Avoid individual deals:** The compensation and benefits for newly hired or promoted executives should generally be structured in the same manner as the programs for current executives. [Alignment]

### Incoming executives — recruitment compensation

3. **Make-whole awards:** Compensating newly hired executives for forgone compensation is a reasonable acquisition cost. However, compensation provided should be within the existing pay programs of the new organization or a more performance-oriented form of compensation. [Engagement]
4. **Inducement awards:** Recruitment compensation that does not replace foregone compensation should be in the form of equity or performance-based cash. [Accountability]

### Retention awards

5. **Limit special retention awards:** Special one-time retention awards should be infrequent and used only when exceptional business circumstances or a shortage of highly specialized and difficult-to-replace critical skills create a clear retention risk. Retention award values should be reasonable in light of the competitiveness of the executive's Total Rewards. [Engagement]

### Involuntary termination, death, disability and retirement

6. **Reasonable benefits:** Termination without cause should typically trigger cash severance; equity should not be accelerated in full except in compassionate circumstances (i.e., death or disability). [Accountability]

## CIC provisions

7. **Effective design:** Organizations should have in place an executive CIC program and/or CIC provisions in organization plans in order to promote shareholder value, but the program should be designed with the broader EC program in mind, especially organization severance practices and the equity program. [Alignment]
8. **Targeted eligibility:** CIC benefits should be provided only under a formal program for participants who are likely to have a direct impact on the transaction and whose job may be subsequently at risk. Individual CIC agreements that are inconsistent with the organization's formal program should be avoided. [Engagement]

## CIC benefits (U.S. only)

9. **Reasonable benefits:** The terms of a CIC program should generally align with effective governance models and best practices (not necessarily market practice). Benefits should be limited to equity acceleration, cash severance, health benefit continuation, and outplacement provided at a multiple or for a period that's aligned with the duration of the non-compete agreement. Going forward, 280G excise tax gross-ups should be eliminated, and organizations might consider implementing a best-net provision in their place. [Accountability]

## About Willis Towers Watson

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