Anatomy of a Good Compensation Study

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INTRODUCTION/TOPICS TO BE COVERED

• Identifying disqualified persons for the study
• Appropriate sources and uses of market data
• Essential components to meet Section 4958 requirements
• When to obtain a reasonableness opinion and why
• **Multiple purposes of compensation study:**
  • Support compliance with regulatory requirements (e.g., 4958)
  • Good governance practice
  • Ensure that the compensation program is competitive and aligned with the organization’s philosophy to support attraction/retention
CONTEXT FOR COMPENSATION STUDIES

• Implications
  • Multiple audiences for the study (Board/Committee, other decision-makers, potential regulators)
  • Content of executive compensation study needs to be appropriately balanced to meet multiple stakeholder requirements
  • Study should ensure that Board/Committee members are apprised of risks so they have full awareness of potential outcomes of compensation program
CONTEXT FOR COMPENSATION STUDIES

- Who is the client? Considerations about potentially utilizing Attorney-Client privilege
  - Entering into a “Kovel” letter with legal counsel for the organization so that the report is issued to counsel who then shares it with the trustees of the organization
WHAT ARE THE REQUIREMENTS OF SECTION 4958?

- 4958 requirements
  - Potential liability for sanctions
  - Rebuttable presumption
  - Need to review total compensation
HOW ARE DISQUALIFIED PERSONS IDENTIFIED?

• Disqualified persons
  • Definition
  • How to determine who is a disqualified person

• Considerations for organizations not covered by 4958 (e.g., associations and foundations)
WHICH INDIVIDUALS SHOULD BE INCLUDED IN THE STUDY?

- **Reference to disqualified persons**
- **Including others in the study**
  - Other leaders of the organization who are not DPs
  - Others reported on Form 990 (e.g., “key employees”)
  - Relatives of DPs, some of whom are themselves DPs, by definition
What are the requirements for market data under 4958?

• Appropriate comparability data; relied upon by the governing body prior to making its decision

• Sources of comparability data include
  • Compensation paid by similarly situated organizations
  • Functionally comparable positions
  • Current compensation surveys compiled by independent firms
SOURCES AND USES OF MARKET DATA

• How should organizations develop appropriate peer groups?
  • Guidelines for peer group selection
    • Mission
    • Industry
    • Size
    • Operating character, complexity
  • Special issues
    • Taxable vs. tax exempt
    • Performance as selection criteria
What are the sources of market data for use in a compensation study?

- Published compensation surveys
- Custom surveys
- Form 990/Form 990-PF (Guidestar)
- Scope of surveys should include both cash and benefits
How should the market data be compiled and used?

- Matching positions to benchmark jobs based on
  - Functional responsibility
  - Comparable sized organization
  - Include premiums/discounts, as appropriate
SOURCES AND USES OF MARKET DATA

• Compiling range of market data (e.g., p25, 50, 75, 90)
  • Aging data to current date (note issue of defining “current” survey)
  • Showing each element of pay
    • Base salary
    • Total cash
    • Total compensation
• Comparing each position to the market data to show market position
• Identifying outliers
SOURCES AND USES OF MARKET DATA

• Considering multiple perspectives (compensation philosophy, competitive needs, regulatory requirements)
• In addition to value of compensation, which is critical for regulators, other market assessments may be provided for audiences
  • Use of incentives
  • Prevalence of benefits
  • Design of benefits programs
  • Severance arrangements
SOURCES AND USES OF MARKET DATA

• What special issues arise when using Form 990/Form 990-PF data?
  • Reporting differences of Form 990/Form 990-PF
  • At best, only titles reported, so may require supplemental research to see if the positions are appropriate matches
  • Age of Form 990s
  • Impact of one-time payments
  • Items where disclosure may not be complete (e.g., housing)
  • Explanatory notes
THE ESSENTIAL COMPONENTS OF MEETING SECTION 4958 REQUIREMENTS

• Market assessment of total compensation for each position
  • Including each element of pay - cash and benefits
• Findings and implications
THE ESSENTIAL COMPONENTS OF MEETING SECTION 4958 REQUIREMENTS

• Description of the methodology
  • Peer groups
  • Sources of data, including description of surveys used
  • Position matches
  • Valuation approach for benefits
  • Aging of data

• Timing – ensure reviewed by governing body in advance of pay decisions
WHAT ARE UNIQUE/SPECIAL ISSUES TO LOOK OUT FOR?

• Employment contracts
• Valuing severance levels/contingent liabilities
• Sign-on awards/relocation
• Multi-year arrangements
  • Long term incentives
  • Retention awards
  • Deferred compensation
WHAT ARE UNIQUE/SPECIAL ISSUES TO LOOK OUT FOR?

• Compensation opportunity (i.e., assuming maximum incentives are earned)
• Benefits valuation (e.g., large retirement/deferred compensation payments)
• Housing arrangements
  • Taxable
  • Tax-free
WHY SHOULD THE ORGANIZATION OBTAIN A REASONABLENESS OPINION?

- Why obtain an opinion
  - Benefits/protection from sanctions for the compensation committee
- Circumstances in which it is appropriate to obtain one:
  - All compensation studies
  - Outlier arrangements
WHY SHOULD THE ORGANIZATION OBTAIN A REASONABLENESS OPINION?

- **What content should be included?**
  - Needs to be reasoned and written
  - Background on organization and incumbent
  - Methodology for analysis
  - Findings of analysis (total compensation)
  - Opinion as to the reasonableness
  - For arrangements at upper end of market, business judgment factors
  - Certification of the consulting firm’s qualifications to provide the opinion as a valuation expert
OTHER ISSUES

• What other content could be included in the report, beyond the minimum requirements for 4958?
  • Tally sheets of total compensation/contingent liabilities

• Should a separate report be prepared for the CEO position?

• What are best practices for interactions between management, the Committee and the external advisor (consultant, attorney)?
CONTACT INFORMATION

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