Employee Benefit News

Swimming with the big fish - Crafting executive total compensation brings challenges

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New attitudes on corporate governance and executive rewards mean some HR professionals managing total compensation programs for executives are expanding their roles. Employees in the C-suite want total compensation and rewards programs just like the rank and file. However, for top executives, these programs - which generally constitute many components - are more likely to include complex combinations of cash, equity, perquisites, benefits, work-life programs and short- and long-term incentives.

HR professionals must walk a delicate line, ensuring that their company does not overdeliver in executive packages, as well as adhering to the Securities and Exchange Commission's rules requiring publicly traded companies to provide detailed information on executive compensation.

Given the new playing field, compensation experts say that to maximize their total compensation program for executives, employers must evaluate each offering in light of the whole program. In addition, they need to provide more education and tools for HR professionals to successfully manage executive comp.

New regs, new duties

First came the corporate scandals of the late 1990s and early 2000s, then investor activism and finally recent SEC reforms make executive compensation more transparent.

The agency requires companies to submit a tally sheet and other documents that summarize - under a variety of scenarios - all executive compensation elements, such as cash, equity, perquisites and benefits. The material must also outline the annual delivery of compensation from all sources.

At some public companies, the top human resources/benefits manager works with general counsel to draft and organize the proxy and compensation disclosure documents for a compensation committee to review.

"Top HR/benefits executives at publicly traded companies now have the opportunity to play a much more critical role in interfacing with the board and the compensation committee," remarks Ed Speidel, the senior vice president at Radford Surveys + Consulting, a San Jose, California-based firm specializing in compensation consulting for hi-tech and life sciences firms.

Keep in mind, the senior HR person's obligation is to the company and its shareholders, even though the position reports to the chief executive officer, he adds.

"Ideally, you want the HR person to work with the comp committee by offering background information as to what management might by thinking, collecting corporate data and outlining general strategies that have worked in the past and those that have not," Speidel says.

In reality, though, particularly at large employers, some HR/benefits managers are not heavily involved with compensation committees on a regular basis.

"Yet in smaller and midsized companies, we are starting to see the human resources/benefits executive get much more involved with the compensation committee, taking on a different role than in the past," he explains.

This forces the human resources benefits executive to learn much more about corporate governance, the financial underpinnings of the company, its important strategies and how compensation fits into all of that.

"I am not going to take away from soft skills, but the HR/benefits manager who is running the total compensation program for executives must bring to the table a quantitative understanding of how compensation works," says Eric Turzak, a senior consultant at the Hay Group, a Philadelphia-based business consulting firm.

"You have to be able to get your head around the financials of the company and how those financials can tie appropriately into executive pay, understanding the mechanics behind where all the numbers come from."

Preaching total rewards

Meanwhile, the tally sheets and new SEC proxy disclosure rules likely will have many compensation committees re-evaluating their total compensation for their executives, focusing on all of the interlocking parts.

Traditionally, they tend to look at the program in pieces, rather than holistically.

Cash compensation has often been looked at separately from long-term incentives and benefits, but employers are starting to understand how, in some cases, each component may have a signicant impact on the other, Speidel observes.

Employers have to take a total awards approach, similar to what they have done in the employee population, and apply it to executive pay, experts suggest.

"In general, there is a lot of talk around a total remuneration approach to executive pay, but in years past, it's been hard to do because you had limited information in the proxy," Turzak says.

"But now you have everything, so you will be able to actually look at total remuneration more readily" than before.

The new rules will bring to light employers' different approaches to executive total compensation programs, especially regarding retirement benefits.

As companies offer wealth creation and accumulation opportunities to their top executives, they will begin to see a great deal of overlap between what was traditionally called compensation and what was traditionally called benefits, explains Scott Olsen, an expert on executive compensation at PricewaterhouseCoopers, a consulting firm.

"Right now, people think of compensation as income, and benefits as long-term. Well, the [time frame for] benefits is getting shorter. We certainly know from the rank and file that employers have and are looking at defined contribution arrangements, and that will eventually flow up to the C-suite at some point," he says.

Dancing around disclosures

Recently the HR consulting firm Watson Wyatt found that 46% of large, publicly traded companies did not report to the SEC the actual goals on which they based rewards under their 2006 annual incentive plans.

Moreover, 45% of them did not disclose the goals for their long-term incentive plans.

"Whether to disclose specific performance goals may be the biggest decision companies must make under the new SEC rules," says Ira Kay, the global director of compensation consulting at Watson Wyatt.

Still, he notes, investor activism and the new rules will force employers to disclose how they underwrite executive compensation programs.

"As these programs become more transparent, we anticipate more companies will change the mix of pay components to maximize the connection between pay and performance," Kay concludes.

Details on CEO pay practices

83% of comp committee directors thought their committee was effective in properly overseeing CEO compensation, but 72% of independent directors believe U.S. company boards are having trouble controlling the amount of CEO compensation.

88% see the new SEC proxy disclosure on compensation as a positive step, and 70% are not concerned at all about providing the new proxy disclosures.

Only 47% were sure their comp committee or board uses tally sheets when computing total CEO compensation.

20% don't know what the CEO would collect if terminated, retired, or if there was a change in control.

Source: PricewaterhouseCoopers. - L.C.B.