AGENDA

Opinion

The Future of the Compensation Committee

Don Delves is Willis Towers Watson's executive compensation practice leader for North America.

Ryan Resch is a managing director in Willis Towers Watson's Toronto office.

We are at a tipping point in corporate governance. For a number of years, compensation committees (CCs) have received greater scrutiny and an expanded remit to address say on pay, shareholder engagement, pay for performance, CEO pay ratio and related disclosure.

However, the role of the board's CC is rapidly evolving at many companies across North America and in other developed economies. The CC is fairly quickly becoming much more of a human resource committee (HRC) with oversight for broader human resource issues. This transition is viewed as a way to mitigate potential human-capital-related risks that have surfaced at many companies (e.g., reputational challenges) and to create long-term sustainable value through effective oversight of the organization's human capital.

The push for these increased responsibilities is coming from stakeholders that include investors, employees, customers and regulators, and even internally from a more diverse board. It is also being positioned within a broader environmental, social and governance (ESG) framework, with a large number of organizations — usually with support from large institutional investors — pushing for change, with particular attention paid to the "S," which folds in human capital management.

For instance, the 2018 annual letter to CEOs from BlackRock's CEO, Larry Fink, focused on the importance of the organization's social purpose and broader human capital oversight. Also, the U.K. and other jurisdictions have requirements for calculating and disclosing gender pay equity, and California recently passed legislation requiring much greater board diversity.

As part of our board advisory work, we have seen committee members ask a variety of human-capital-related questions covering a range of topics and issues in addition to the executive-compensation-specific questions on how to incorporate ESG initiatives within executive-compensation incentive designs. Most commonly, workforce diversity and the programs in place to support greater gender diversity are of interest. There is also a need to understand if there are any gender-related pay gaps. Committee members are also increasingly concerned about whether the organization's culture encourages the right behaviors and minimizes the risk of unwanted behaviors associated with potential human-capital risks (e.g., employee health and safety, respect at work, anti-bullying and whistle-blower activity).

Finally, committees are looking at their talent pools to ensure that they have the right people in the right roles to adapt to the rapidly changing and disruptive environment. They are also assessing whether they have any attraction and/or retention challenges in roles critical to the successful execution of their strategy.

We believe that CCs will need to spend some time to determine how best to respond to these pressures and to look at human capital management with the same rigor and discipline as financial capital. As a first step, we encourage CCs to closely review their charters to see if there are areas that should be expanded, how this greater oversight should be defined and when those items should be added to the annual agenda. This process can encourage a positive dialogue among committee members and management so that they prioritize important organizational issues and prepare everyone to address these items — with the right level of analytics — at future meetings.

Effective oversight will require the CC to leverage deep analytics to understand these issues throughout the organization. As an example, our research indicated that in the future, leading organizations will measure their total rewards programs to reflect program costs and their programs' impact on engagement, attraction and retention. A data-driven approach — leveraging high-quality human-capital dashboards — will help organizations oversee their significant investments in human capital and drive greater efficiency and effectiveness.

CCs will then be prepared to share their human-capital oversight processes and key metrics with shareholders as a way to demonstrate effective risk management and long-term sustainability.