COMPENSATION COMMITTEE FUNDAMENTALS GUIDE

The Compensation Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by FW Cook.

CORPORATE BOARD MEMBER®

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About This Guide

Compensation Committee Fundamentals Guide

The Compensation Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by FW Cook.

FW Cook is a nationally recognized executive compensation consulting firm that serves publicly traded and privately held organizations in developing compensation plans for their executives, key employees and non-employee directors. FW Cook's comprehensive service offerings are designed to help clients attract and retain key employees, motivate and reward them for achieving performance objectives and align their interests with shareowners.

FW Cook adds value to the executive pay programs and processes by closely partnering with directors and companies in the development and administration of meaningful and effective compensation programs that align with the company's business strategy and culture.

Director Fundamentals Knowledge Center

The Compensation Committee Fundamentals Guide is part of Corporate Board Member's Director Fundamentals Knowledge Center, an innovative resource for public company boards that provides directors with a multi-faceted learning experience through concise guidebooks and interactive training courses. The goal of the Knowledge Center is to arm new directors with the fundamental training needed to be an effective director from day one.

The Director Fundamentals Knowledge Center consists of the following suite of resources:

- **Director Fundamentals Guide & Training Course**
- **Audit Committee Fundamentals Guide & Training Course**
  Content provided to you with support from PwC
- **Compensation Committee Fundamentals Guide & Training Course**
  Content provided to you in partnership with FW Cook
- **Nominating/Governance Committee Fundamentals Guide & Training Course**
  Content provided to you in partnership with Spencer Stuart

SECTION 1:
COMPENSATION COMMITTEE RESPONSIBILITIES

Publicly traded companies are required to have a compensation committee composed of independent directors that is responsible for certain compensation-related actions. The committee's general responsibility is approval of compensation programs that it believes are in the best interests of the company.

Rules & Requirements

The U.S. Securities and Exchange Commission (SEC), the New York Stock Exchange (NYSE), and NASDAQ Stock Market (NASDAQ) require publicly traded companies to have a compensation committee composed of independent directors that is responsible for certain compensation-related actions. The committee's general responsibility is approval of compensation programs that it believes are in the best interests of the company.

COMPENSATION COMMITTEE MEMBER INDEPENDENCE RULES

The NYSE and NASDAQ generally require that compensation committee members be independent. The determination of independence must be made by the board and publicly disclosed, after considering whether the director has any material relationship that would impair the director's independence from management in connection with the duties of a compensation committee member. The rules specifically require consideration of the source of compensation received by the director, whether the director is an affiliate of the company and whether the affiliate relationship places the director under control of the company or management. In general, a director will be determined to be independent if the director is a non-management director free from any material family relationship or material business relationship, other than board membership and stock ownership, with the company or management and has been free from any such relationship for three years.

NYSE LISTING REQUIREMENTS

Publicly held companies listed on the NYSE are required to have a compensation committee composed entirely of independent directors and have a written charter that addresses its purposes and responsibilities.

At a minimum, the committee's responsibilities must include:

- Chief executive officer (CEO) compensation and performance: reviewing and approving corporate goals and objectives as they relate to CEO compensation, evaluating the CEO's performance in light of those goals and objectives and, either as a committee or together with the other independent directors, determining the CEO's compensation based on the performance evaluation;
- Other compensation: making recommendations to the board with respect to non-CEO executive compensation and incentive compensation and equity compensation plans that are subject to board approval;
- Compensation Discussion & Analysis (CD&A): preparing the compensation committee report required by Regulation S-K, which encompasses a review of the CD&A; and
- Annual evaluation of committee performance.

While the NYSE rule only requires the committee to recommend to the board approval of non-CEO executive compensation, the board is permitted to delegate its authority for such actions to the compensation committee.

In addition, pursuant to rules under the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the committee may, in its sole discretion, retain or obtain advice from a compensation consultant, outside legal counsel or other adviser. The committee shall be directly responsible for the appointment, compensation and oversight of the outside adviser(s), and the company must provide appropriate funding as determined by the committee. Before retaining or receiving advice from an outside adviser, the committee must evaluate certain independence factors with respect to the adviser. While many committees endeavor to retain an independent consultant, the NYSE rule does not preclude retaining a consultant with a real or perceived conflict of interest.

NASDAQ LISTING REQUIREMENTS

Publicly held companies listed on the NASDAQ must have a compensation committee consisting of at least two independent directors.

The company must adopt a written charter, which must specify:

- the scope of the committee's responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements;
- that the committee shall determine, or recommend to the board for determination, the compensation of the CEO and all other executive officers of the company; and
- that the CEO may not be present during voting or deliberations on his or her compensation.

The NASDAQ rules also contain similar requirements to the NYSE with respect to the committee's ability to retain an outside adviser, along with the requirement to consider certain independence factors prior to retaining or obtaining advice from an outside adviser.

Independence Factors for Evaluation of an Outside Adviser

1. Provision of other services to the company by the adviser's employer
2. Amount of fees received from the company by the adviser's employer, as a percent of the total revenue of the adviser's employer
3. Policies and procedures of the adviser's employer that are designed to prevent conflicts of interest
4. Any business or personal relationship of the adviser with a member of the committee
5. Any company stock owned by the adviser
6. Any business or personal relationship of the adviser or the adviser's employer with an executive officer of the company

The NYSE rule also includes a "catch-all" for any other factors relevant to assessing the adviser's independence.

Key Responsibilities

While the SEC and stock exchanges provide for minimum requirements of compensation committees (discussed below), the scope of the committee's duties has been expanding since the passage of Dodd-Frank in 2010 and associated introduction of mandatory say-on-pay votes in 2011. The committee charter has evolved to encompass strategic oversight of compensation programs, administration of executive pay actions and other related disclosure, regulatory and governance requirements.

Typical responsibilities now include:

- establishing and approving the company's executive compensation philosophy, including the design and relative mix of pay elements and overall competitive positioning of executive pay relative to market.
- reviewing and approving the corporate goals and objectives relevant to the CEO's and other executive officers' compensation and evaluating the performance of the CEO and other executive officers in light of such goals and objectives.
- approving the CEO's compensation (including salary, incentive-based and equity-based compensation levels); such a review may include input from other independent board members.
- reviewing and approving the compensation of the company's other executive officers (which could be only Section 16 officers or expanded to a broader group).
- reviewing and approving the companies selected as comparables for competitive market comparisons of the company's executive (and often director) compensation levels (referred to as the "peer group").
- approving all employment agreements, severance agreements, change-in-control agreements or any other special benefit/perquisites provided to any executive officers (CEO pay and agreements are sometimes subject to full board approval).
- reviewing and recommending to the board the amount and form of director compensation.
- reviewing the potential risk to the company from its executive and non-executive compensation policies and practices.
- reviewing, approving, overseeing and/or administering policies covering ownership of company stock by executives and directors, hedging or pledging of company stock and recoupment of incentive compensation.
- administering the company's equity incentive plans, including approval of all stock, option and other incentive awards under such plans.

  The committee is typically permitted to and will often delegate authority to management to issue awards below a certain level and in accordance with applicable law and the company's equity grant policies.

- reviewing and approving, or recommending to the board for its approval, reports on compensation matters required to be included in the company's annual proxy statement or annual report.
- overseeing proposals to shareholders on executive compensation matters, including advisory votes on executive compensation and the frequency of such votes, incentive and other executive compensation plans, and amendments to such plans and in conjunction with the board or other committees and management, the engagement with proxy advisory firms and other shareholder groups on executive compensation matters.
- appointing and overseeing the work of a compensation consultant, outside legal counsel, or other adviser to the committee.
- reviewing the committee's performance and adequacy of its charter.

Increasingly, the compensation committee also oversees broad human resources strategy, including management development, succession planning and diversity and inclusion initiatives.

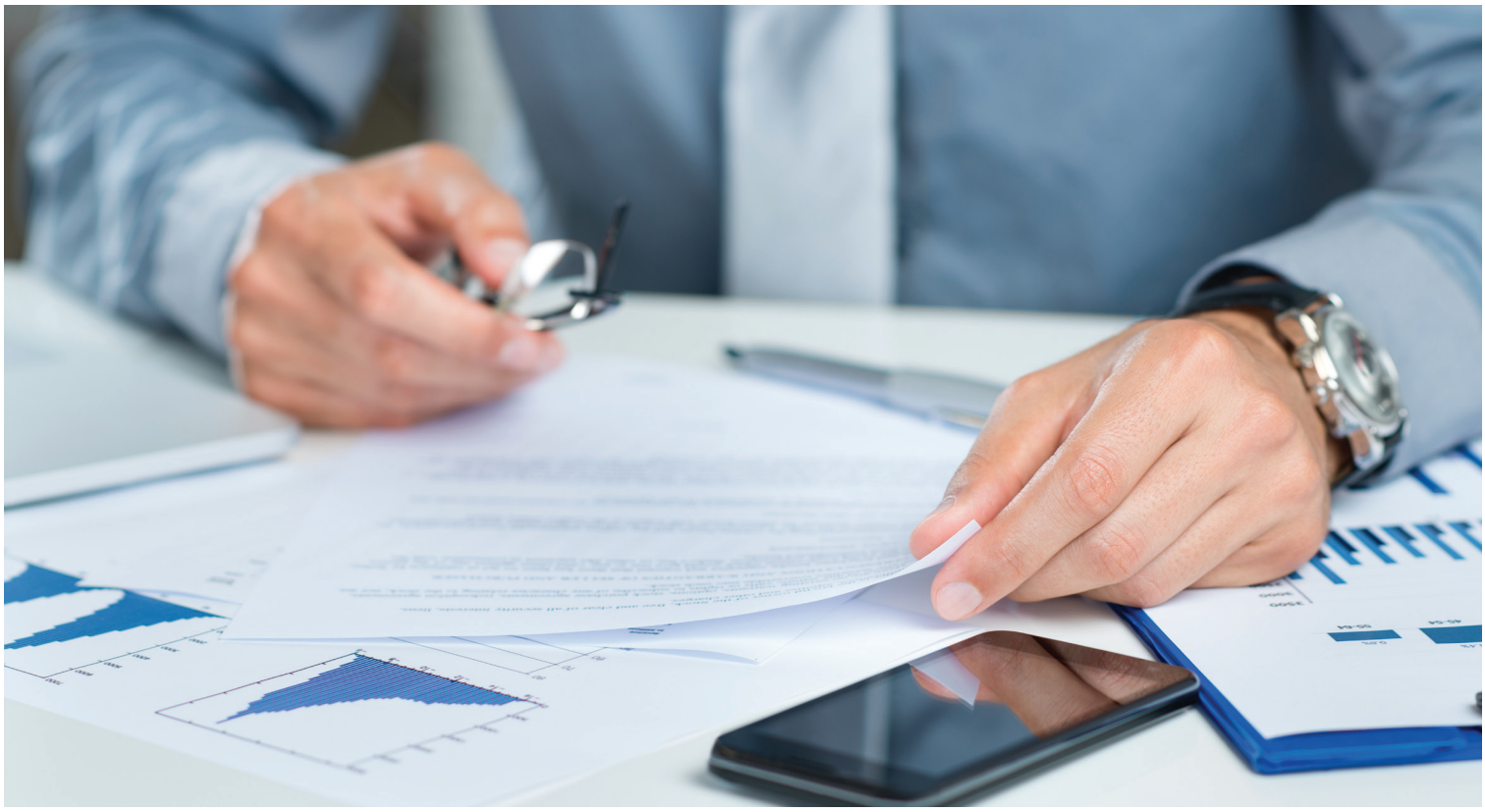
COMPENSATION PHILOSOPHY

The committee should establish a compensation philosophy to serve as a guide for evaluating and making compensation decisions. The philosophy will ideally tie compensation program objectives (e.g., pay-for-performance, shareholder alignment, attraction and retention, etc.) with the compensation vehicles and policies at the company's disposal (e.g., fixed versus variable pay). It may reference a targeted competitive position for the program versus market or may use market data along with other factors to determine compensation levels, without competitive positioning. An effective compensation philosophy also links the company's business strategy to its compensation program. The committee should regularly review the pay philosophy to ensure it continues to be appropriate for the stage of business; compensation strategies naturally evolve with development.

The CD&A in the annual proxy statement must include a discussion of the company's executive compensation philosophy. The philosophy is often a point of emphasis when explaining the committee's compensation decisions and their appropriateness to shareholders.

DISCLOSURE RULES

SEC and stock exchange rules require extensive disclosure of executive officer and director compensation. Compensation committees are required to prepare the Compensation Committee Report in a company's annual proxy statement or annual report on form 10-K. The committee report must state whether the committee reviewed and discussed the CD&A with management and based on such review, whether the committee recommended to the board that the CD&A be included in the proxy statement or annual report.



For More Information

The information in this guide is by no means exhaustive. If you wish to dive deeper into the topics in this guide, we encourage you to visit FW Cook's website, where you can find more information and also request a meeting for your board or compensation committee. We also recommend that you discuss questions and issues with your company's general counsel or corporate secretary.

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FW COOK

FW Cook is an independent consulting firm specializing in executive and director compensation and related corporate governance matters. Formed in 1973, FW Cook has served more than 3,000 companies of diverse size and business focus from its offices in New York, Chicago, Los Angeles, San Francisco, Atlanta, Houston and Boston. FW Cook currently serves as the independent advisor to the compensation committees at a substantial number of the world's leading companies. Learn more at: **www.fwcook.com**

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