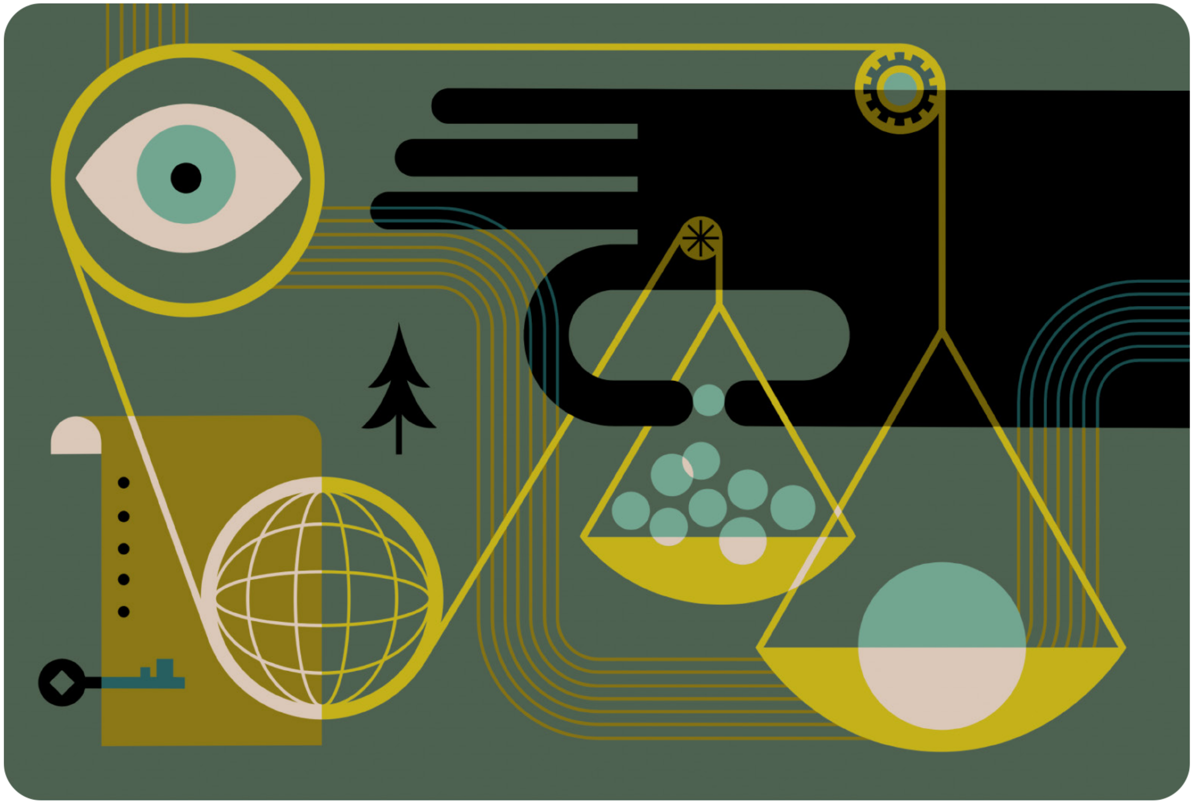
MODERN PRINCIPLES *for* SENSIBLE *and* EFFECTIVE EXECUTIVE PAY



The Modern Principles for Sensible and Effective Executive Pay are designed to advance fresh thinking in boardrooms about executive compensation given new market priorities, shifting public attitudes towards equity, fairness and the role of business, and fundamental changes in the role of the CEO and executive teams. These Principles are written with publicly traded companies in mind; however, each principle is relevant for non-public organizations as well.

Companies are evolving to meet the demands of a highly complex and disruptive economy. The expectations of business leaders have also changed. The CEO is not just leading a business; he/she is leading a more integrated community of employees, suppliers and producers working to respond effectively to customers, investors and, increasingly, to those acting on behalf of significant and growing environmental and local needs.

The current crisis exposes these trends but did not create them—and serves to accelerate conversations already underway regarding executive pay. To successfully lead the company and address societal challenges that affect the business environment, the CEO creates the conditions for a productive workforce and innovation, and fosters collaboration and partnership, even with competitors. This leadership model is much more inclusive than the command and control frameworks of the past. **We have come to understand that the organization performs best when its workers and host communities thrive and when the conditions for the license to operate are well understood, and met.**

Said another way, the investor-centric economy of the last decades is opening up to other priorities, including employee well-being and other commitments to ensure long-term business success. Given these new realities it stands to reason that how we measure and reward leaders needs to evolve.

The Modern Principles for Sensible and Effective Executive Pay have emerged from over two years of research and outreach to directors, executives, investors and asset managers, and in consultation with experts in corporate governance, executive compensation, labor relations and the behavioral sciences. They offer a holistic and common-sense perspective on executive pay at a time when societies demand it more than ever.

We hope these Principles serve as a guide to board room dialogue about the roles and expectations of business leaders in the rapidly evolving relationship between business and society—and may help define and reward excellence among individuals and executive teams leading from the front lines of business.

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*The **Aspen Institute Business & Society Program** partnered with **Korn Ferry** whose decades of expertise in executive pay added immeasurably to the research and drafting of this document. We are grateful to Korn Ferry for investing the time and expertise of Senior Partners Irv Becker, Don Lowman, Tierney Remick and David Wise. Individually and as a team they have contributed greatly to the ideas and execution of this document. We'd like to thank the members of our Working Group for their contributions and feedback.* *Please see Page 8 for a listing.*

BUSINESS & SOCIETY
THE ASPEN INSTITUTE

PRINCIPLE ONE

Pay is unambiguously tied to the company's purpose and the drivers of its long-term success.

WHAT DO WE MEAN?

- Executive pay varies meaningfully with both financial results and non-financial drivers of long-term company value.
- The pay program avoids excessive focus on total shareholder return as a measure of performance.
- The Board defines the success profiles for key leadership roles and assures that fixed and variable pay are set appropriately to attract the talent needed to fill those roles.

KEY QUESTIONS FOR COMPENSATION COMMITTEES

- Have the Board and management discussed, confirmed, and communicated to all key constituents the company's annual, medium-term, and long-term objectives?
- Are the links between executive compensation and the company's mission, vision, values and culture evaluated and reconfirmed each year?
- Has the Board established clear guidelines for determining which metrics of performance require compensation beyond base salary?
- Are the metrics and performance standards in incentive plans designed with the company's stated purpose and business objectives in mind?
- Is the rationale for equity grants and any associated performance conditions articulated?
- Are the key non-financial drivers of value given sufficient weight in determining incentive awards?

RELATED RESEARCH:

- How To Escape the Short-Termism Trap, Davis (2005)
- Corporate Governance and the Rise of Integrating Corporate Social Responsibility Criteria in Executive Compensation, Flammer, Hung and Minor (2018)
- The Error at the Heart of Corporate Leadership, Bower and Paine (2017)
- 181 Top CEOs Have Realized Companies Need a Purpose Beyond Profit, Gartenberg and Serafeim (2019)

PRINCIPLE TWO

Executive pay outcomes are fair.

WHAT DO WE MEAN?

- Fairness is assessed internally across at least three dimensions:
  - » The pay for the CEO is appropriate relative to that of the rest of the executive team.
  - » The balance of pay between the executive team and the rest of the employee population is reasonable.
  - » Rewards for company financial success are shared fairly with and between workers and shareholders.
- External pay benchmarking is treated as an input; it is not the sole basis for setting executive pay levels.
- Executive pay program design is consistent with the company's compensation strategy for all employees.

KEY QUESTIONS FOR COMPENSATION COMMITTEES

- Has the Board and executive team assessed the reasonableness of the pay relationship between the CEO and his/her direct reports, and relative to all other levels of employees?
- Has the Board considered the appropriate basis for sharing company profits between the company and its shareholders?
- Has the Board thoroughly evaluated and approved the financial impact of its executive pay obligations in the event of executive terminations, for any reason?
- Has the Board adopted useable and adequate clawback provisions to protect the company in the event of executive misconduct or malfeasance?
- Do the results of our decisions appropriately reflect our company's values?

RELATED RESEARCH:

- Overpaid CEOs and Underpaid Managers: Fairness and Executive Compensation, Wade, O'Reilly and Pollock (2006)
- Executive Superstars Peer Groups and Over Compensation, Elson and Ferrer (2012)
- Getting The Right Measure on CEO Comp, Becker and Fisher (2016)

PRINCIPLE THREE

Goals used in incentive plans are credible and their outcomes difficult to manipulate.

WHAT DO WE MEAN?

- Goals are challenging but achievable and are clearly aligned with core strategic priorities.
- Goals focus on objective measures of non-financial and financial performance that are within the executive's ability to impact and influence.
- The financial rewards for achieving/exceeding targets are reasonable and do not encourage excessively risky behavior.
- Incentives include meaningful financial downside for under-performance.
- Long-term incentives align with at least a full business cycle for the company or industry.
- Incentives for executives in charge of compliance, risk management and audit functions are designed to curb rather than encourage risk-taking.

KEY QUESTIONS FOR COMPENSATION COMMITTEES

- Are incentive plan metrics consistent with and clearly linked to business strategy?
- Do incentive metrics and goals adequately balance short-, medium-, and long-term business priorities?
- Has the Board carefully considered the behavioral risks inherent in aggressive goals?
- Have goals been "stress-tested" to assess difficulty and probability of achievement?
- Has the board implemented adequate guardrails and monitoring mechanisms to mitigate behavioral risks?
- Has the board evaluated whether the incentives for executives in charge of risk, compliance and audit functions are suitably structured for these job functions?

RELATED RESEARCH:

- Intrinsic Motivation and Extrinsic Incentives Jointly Predict Performance, Ceresolli, Nicklin and Ford (2014)
- Goals Gone Wild: The Systemic Side Effects of Overprescribing Goal Setting, Ordonez, Schweitzer, Galinsky and Bazerman (2009)
- Beyond Economics in Pay for Performance, Belinfanti (2012)

PRINCIPLE FOUR

The executive pay program is fully described in clear, jargon-free language.

WHAT DO WE MEAN?

- A well-designed executive pay program can be summarized in two pages or less, to include an outline of the overall structure, intent and key features of the pay program.
- Pay disclosures promote transparency and understanding of executive pay.
- Boards actively seek to reduce complexity in pay packages—e.g. avoid inclusion of too many incentive metrics and/or methods for delivering pay.

KEY QUESTIONS FOR COMPENSATION COMMITTEES

- Does the pay program focus executives on a manageable number of the highest priority goals?
- Are all the elements of the executive pay program truly necessary? If not, what purpose do they serve?
- Have we clarified how the executive pay program connects with the overall talent strategy?
- Have we described a clear and defensible rationale for any discretionary payouts and/or adjustments to metrics?
- Is the rationale for severance provisions disclosed clearly and easily understood?

RELATED RESEARCH:

- CEO Bonus Plans: How To Fix Them, Murphy and Jensen (2011)
- Simplicity, Transparency, and Sustainability: A New Model for Executive Compensation, Edmans (2017)
- Policies on Executive Compensation, Council of Institutional Investors (2019)
- Remuneration of the CEO: Asset Manager Perspective, Norges Bank (2017)

PRINCIPLE FIVE

The Board bears ultimate accountability for making decisions about executive pay and for aligning pay with the long-term health of the enterprise.

WHAT DO WE MEAN?

- Pay levels are determined by an independent Board committee that assesses the role, responsibilities and the contribution of each executive.
- All directors understand the executive pay program before approving it.
- The perspectives of qualified outside advisors inform but do not dictate the Board's decisions.
- Proxy advisors' expectations do not override the Board's judgment about pay.
- The Board thoroughly evaluates the key metrics and performance standards used in incentive plans to ensure they reflect business priorities, and uses discretion, as appropriate, to set associated rewards.

KEY QUESTIONS FOR COMPENSATION COMMITTEES

- Are members of the Compensation Committee briefed on all relevant regulations and governance requirements affecting executive pay?
- Do members of the Compensation Committee stay current on research and trends that impact the executive pay program?
- Does the Board have access to its own independent advice and expertise?
- Has the Compensation Committee engaged the rest of the Board, the CEO, CFO, and CHRO in a thorough review and discussion of prior year results and incentive payouts?
- Has the Compensation Committee validated the goals and targets proposed by management for the next performance period and signed off on the full range of potential award payouts?
- Has the Compensation Committee reviewed and signed off on the degree of alignment between the goals used in the executive compensation program and those used for the rest of the employee population?

RELATED RESEARCH:

- The Group Dynamics Theory of Executive Compensation, Dorff (2007)
- Performance for Pay? The Relation Between CEO Incentive Compensation and Future Stock Price Performance, Cooper, Gulan and Rao (2016)
- Global Corporate Governance Guidelines and Engagement Principles, BlackRock (2019)
- Pay Without Performance: The Unfulfilled Promise of Executive Compensation, Bebchuk and Fried (2004)

PRINCIPLES OF PAY WORKING GROUP

The Aspen Institute Business & Society Program and Korn Ferry would like to thank the members of our Working Group for their expertise and insight as these Principles were assembled. This listing does not imply endorsement, but rather involvement in the project and a commitment to fresh thinking in the boardroom. Their reactions and feedback informed revisions and the content of this final version.

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