

TOPIC: Sibson Consulting Report on Executive Compensation and Governance

COMMITTEE: Organization and Compensation

DATE OF MEETING: August 22, 2017

SUMMARY: Sibson Consulting completed their report to the USM on Executive Compensation and Governance. The Committee on Organization and Compensation will vote on whether to accept the report. The vote to accept the report does not necessarily mean that the Committee agrees with all provisions and recommendations in the report.

ALTERNATIVE(S): The Regents could not accept the report or they could request further changes to the report.

FISCAL IMPACT: No direct fiscal impact at this time.

CHANCELLOR'S RECOMMENDATION: The Chancellor recommends that the Committee recommend that the Board of Regents accept the report from Sibson Consulting on Executive Compensation and Governance.

COMMITTEE ACTION: Recommend Approval

DATE: August 22, 2017

BOARD ACTION:

DATE:

SUBMITTED BY: Janice Doyle, jdoyle@usmd.edu, 301-445-1906

University System of Maryland

**EXECUTIVE COMPENSATION AND
GOVERNANCE**

**Executive Summary of Assessment Findings and
Recommendations**

September 15, 2017

Introduction and Project Purpose

The University System of Maryland (“USM”) engaged Sibson Consulting (“Sibson”) to perform a comprehensive assessment of the executive compensation and governance practices for the System Chancellor and Presidents. Our analyses cover the following areas:

- **Peer Group of Comparable Institutions:** Developed groups of similar institutions for each executive to ensure a suitable comparison market for executive compensation
- **Market Analysis for Chancellor and President Compensation:** Assessed executive compensation levels and practices, including:
 - Base salary
 - Bonus/incentives
 - Retirement and deferred compensation
 - Perquisites
- **Governance and Oversight of Executive Compensation:** Reviewed and provided commentary on USM oversight practices, including
 - Contracts and employment agreements
 - Goal Setting and Executive Evaluation
 - Presidential Recruitment and Selection
 - Governance Tools and Process

This report provides the Committee an analysis of the competitive marketplace of similar public institutions and a series of directional recommendations for its consideration.

Key Terms and Definitions

Key Compensation Terms Used Throughout This Report:

- **Total Cash Compensation (TCC):** Reflects the sum of base salary and bonus / incentive compensation
- **Total Remuneration (TR):** Reflects the sum of total cash compensation and retirement and deferred compensation
- **Percentile:** Reflects a competitive position within the group. A percentile is a measurement indicating the relative positioning within a group of observations. For example:
 - The 20th percentile is the value below which 20% of the observations may be found
 - If a value is at the 86th percentile, it is higher than 86% of the data points

Today's Higher Education Executive Compensation Environment

To set the context for the assessment findings, it is helpful to understand current executive compensation trends and issues being discussed among boards and leadership teams.

- **Competitive Market Intelligence:** Increased demand for data and analysis frequency; many institutions experiencing “survey fatigue”
- **Peer Groups:** Debate on appropriate comparison markets for talent (e.g., size, geography, and appropriate criteria)
- **Pay Levels:** Rising executive pay levels driven by competitive markets for talent, increased pay transparency¹, and broader market practices in the private sector
- **Pay Vehicles:** Increasingly complex plan designs/contracts (e.g., incentives, deferred compensation/SERPs, post termination arrangements)
- **Performance Management:** More rigorous goal setting and performance management approaches/discussions
- **Governance:** Examination of, and changes to, Board/Compensation Committee governance practices and tools
- **Optics:** A vigilant focus on optics and how programs will be perceived, both within the institution and externally
- **Succession Planning:** Exploration of succession planning practices. *Note: few institutions have formalized succession planning approaches*

¹ While counterintuitive, greater transparency of compensation frequently leads to increasing pay levels across the market as leaders strive to be paid at or above the median. It is related to the Lake Wobegon Effect, which is defined as a natural human tendency to overestimate one's capabilities, where all or nearly all of a group claim to be above average.

Key Assessment Findings

- 1. Lack of Consensus Among Presidents:** While Presidents shared a variety of views on compensation and governance, the pervasive theme was the lack of a defined compensation philosophy and desire for greater clarity surrounding decision-making and rationale.
- 2. Aggregate Compensation is Competitive:** In the aggregate, USM's total remuneration for all executive positions is 108% of the market median¹.
- 3. Individual Executive Competitiveness Varies:** Executive pay positioning within their peer groups varies considerably, but the majority are above median, and no executive is below the 25th percentile.
- 4. Incentives are Prevalent, but not Predominant in the Market:** For doctoral institutions, incentive pay is available at ~20-30% of peers; for master's institutions, it is available at ~5-15%. Levels vary significantly.
- 5. Deferred Compensation Appears to be a Function of Institutional Size and Pay:** Deferred pay is more prevalent among institutions with larger operating budgets. As President pay packages tend to be larger within these institutions, there is greater tendency to provide a retention and/or tax-sheltered vehicle.
- 5. Improvements in Governance Tools and Processes Would Serve the System Well:** The System's governance structure of a single Board overseeing all institutions is consistent with most public systems², but also challenging for compensation management and oversight due to the scope of work. The breadth of the System necessitates a more uniform set of tools and approaches to improve the efficiency and quality of governance.

¹ Includes the 11 executive positions which had a custom peer group study; excludes Presidents of UMCES and UMB which relied on published survey data

² Our research shows that of the peers systems included in this study, only Florida and North Carolina have institution-specific boards.

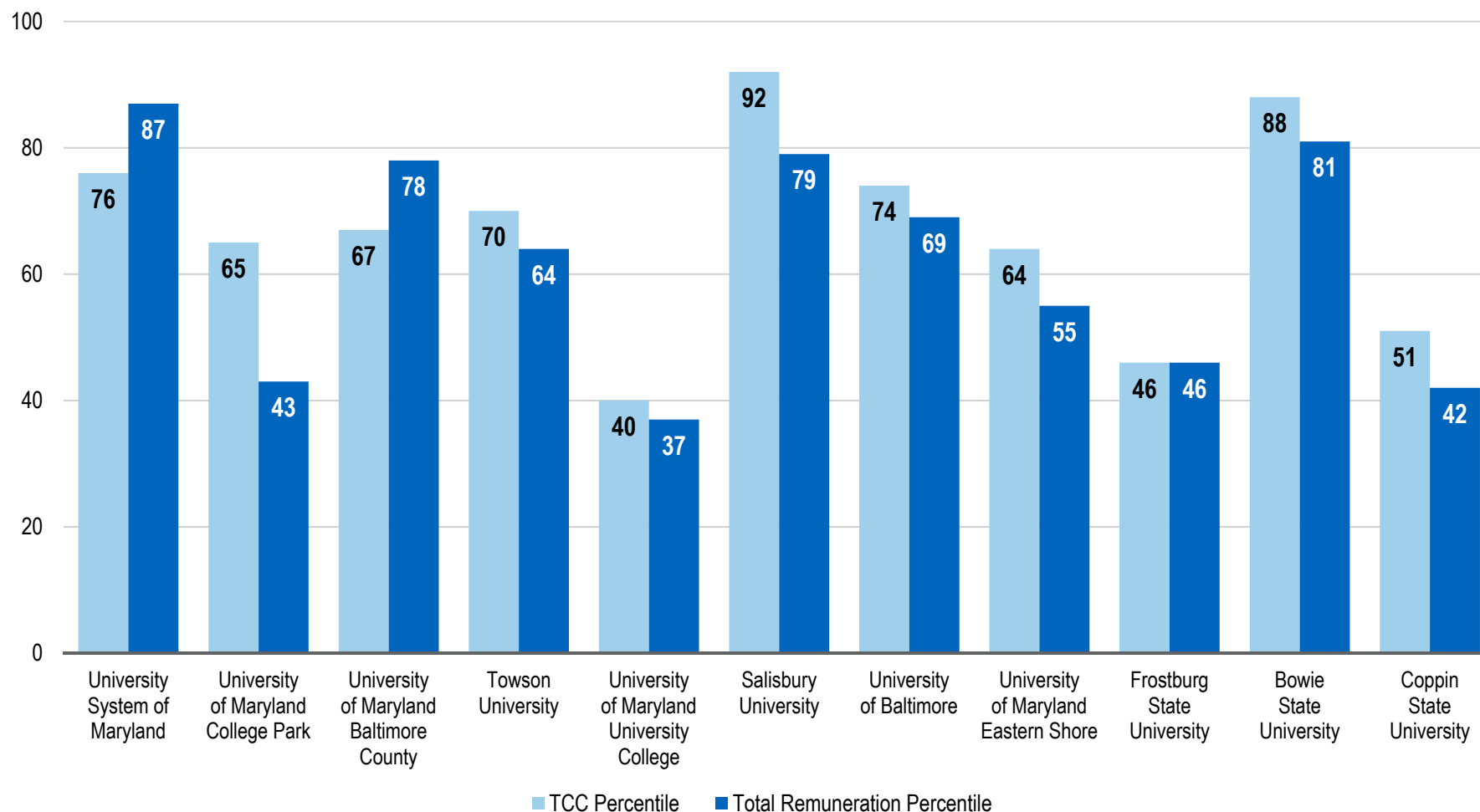
Directional Recommendations

1. **Develop Compensation Philosophy:** Create an executive compensation philosophy that outlines the goals and desired objectives of the executive compensation program, compensation elements, peer group, desired pay positioning, etc. This philosophy should expand on any existing USM policies.
See page 9 for Sibson's compensation philosophy framework
2. **Streamline Goal Setting and Evaluation Approach:** Develop a standard template and process for goal development and performance evaluation to allow for a simpler, quicker assessment. This approach should appropriately balance the Presidents' desire for personalization with the System's needs for greater consistency. Said template may also incorporate scorecard / longitudinal metrics currently used at the System and longer-term strategic planning measurement.
3. **Enhance Governance Tools and Process:** Implement the following best practices in executive compensation oversight:
 - a) Expand and formalize the charter for the Committee on Organization and Compensation. Current responsibilities are outlined in a few bullets in the bylaws.
 - b) Create Chancellor and President tally sheets to provide year-over-year detailed compensation information to Regents in a consistent format.
See page 10 for sample tally sheet
 - a) Develop an annual calendar of key actions required in performance assessment and compensation administration (*either document current state or consider changes to better align with business calendar*).
 - b) Conduct education sessions for the Committee and/or Board on current topics in executive compensation and governance such as governance, performance evaluation, and succession planning (i.e., at a greater level of detail beyond this report)
See Appendix C for illustrations of additional governance tools and frameworks
4. **Conduct Periodic Total Remuneration Reviews:** Supplement annual base salary reviews (of recently developed peer groups) with regular (e.g., triennial) total remuneration assessments to ensure continued market competitiveness of the full compensation package.

Percentile Comparison

Total Cash Compensation & Total Remuneration

The percentile comparison chart below shows where USM's TCC & TR falls on a percentile basis when compared against their respective peer groups^{1,2,3}



- 1 UMB and UMCES do not have percentile comparisons because market data came from published surveys.
- 2 UMB's President was assessed using data from AAMC's 2015-2016 Report on Compensation of Medical School Deans and Sibson's 2016 Executive Compensation in Public Institutions Study. The President is positioned at 96% and 125% of the median for total remuneration, respectively, against each survey. (See page 40)
- 3 UMCES President was benchmarked to the Dean of Forestry and Environmental Science from the CUPA Administrators Survey, which reports base salary only. The President is positioned at 137% of median for base salary. (See page 50)

Select Governance Frameworks

Elements of a Compensation Strategy

A compensation strategy documents the institution's perspectives/strategy, typically with regard to the following components:

Institutional Alignment	<ul style="list-style-type: none"> • How compensation supports and reinforces the strategic objectives of the institution and its values
Elements of Rewards	<ul style="list-style-type: none"> • What rewards are used, the purpose for each, relative emphasis and eligibility
Comparison Markets	<ul style="list-style-type: none"> • The criteria and rationale used for selecting comparator institutions / organizations to benchmark compensation • The institutions selected, including any custom or unique views
Performance Measurement and Goal Setting	<ul style="list-style-type: none"> • How to measure performance on an institutional and individual basis • The vehicles and processes to use to measure and communicate performance and how they link to compensation outcomes
Compensation Prominence	<ul style="list-style-type: none"> • The relative prominence of pay in the rewards model • The role of pay in attracting and retaining talent versus other factors
Pay Positioning	<ul style="list-style-type: none"> • The target pay positioning relative to the comparison markets (in aggregate and for certain roles if they differ) • The factors influencing individual pay positioning and decision making
Program Administration	<ul style="list-style-type: none"> • Decision-making roles and accountabilities of the Board (as a whole), Compensation Committee, President, executive team, human resources, and others
Communication/ Transparency	<p>The degree of openness in sharing information on pay including:</p> <ul style="list-style-type: none"> • Explanation of compensation strategy • Explanation of compensation program design • Expectations setting • Performance evaluation process and results • Consequences

Select Governance Frameworks

Illustrative Tally Sheet

EXAMPLE OF MULTI-YEAR TALLY SHEET FOR A SINGLE EXECUTIVE

	2010	2011	2012	2013
Base Salary	\$310,000	\$325,000	\$330,000	\$335,000
Bonus and Incentive				
• Performance-Based	\$10,000	\$50,000	—	\$25,000
• Discretionary	—	—	\$25,000	—
• Retention	\$50,000	—	—	—
Other Taxable Cash Compensation				
• Car / Car Allowance	\$10,000	\$10,000	\$12,000	\$12,000
• Medical Waiver	\$5,600	\$6,000	\$6,400	\$6,750
• Sports Tickets	\$2,000	\$2,000	\$2,500	\$3,000
• Moving & Housing	\$20,000	—	—	—
• Imputed Life Insurance Premium	\$560	\$750	\$850	\$975
Total Cash Compensation (TCC)	\$408,160	\$393,750	\$376,750	\$382,725
Retirement & Deferred Compensation				
• Pension / Retirement Contribution	\$31,000	\$32,500	\$33,000	\$33,500
• Deferred Compensation - Set Aside	\$25,000	\$25,000	\$25,000	\$25,000
• Deferred Compensation - Paid	—	—	—	—
Non-taxable Benefits				
• Employer Provided Benefits incl Health, Dental, Life Ins	\$15,650	\$17,550	\$19,675	\$21,675
• Housing	\$36,000	\$36,000	\$40,000	\$40,000
• Club Membership	\$10,000	\$10,000	\$10,000	\$10,000
• Tuition Remission	—	—	—	\$12,500
Total Remuneration (TR)	\$525,810	\$514,800	\$504,425	\$525,400

Committees are increasingly using Tally Sheets to help inform decision making.

Additional Considerations

1. **Explore Use of Incentives and or Deferred Compensation Vehicles:** As part of the development of the compensation philosophy, consider implementation of a/an:
 - a) Annual incentive program that is clearly and directly tied to specific institutional performance metrics (which are, in turn, aligned with the goals for the system)
 - b) Deferred compensation packages aimed to attract and retain key executives

The use of incentive pay has been increasing across higher education, and we expect this trend to continue for the following reasons:

- Gradual transition to a traditional business-oriented management model
- Financial constraints, competing interests for capital, and the need for efficiency
- An influx of talent from outside of higher education; these leaders are accustomed to variable pay
- Boards of Trustees, many of whom have members with corporate backgrounds, support variable pay
- A desire to increasingly differentiate compensation for the institutions' best performing executives

In our experience, approximately 20-30% of institutions provide incentives to executives. This has risen from 10–20% over the last ten years. Incentives are used more prevalently in private vs. public institutions, and of those institutions that offer incentives, award levels vary widely. As non-profit organizations, the funding of incentives is typically a line item in the budget, as opposed through a financial formula. However, funding may be increased / decreased at year-end based on financial results.

2. **Create Succession Planning Process Across the System:** Succession planning can help alleviate the future expected competition over scarce resources; USM can be proactive and begin developing processes now for incumbent assessment, leadership development, and board measurement / reporting.