Watson Wyatt Worldwide

Watson Wyatt's Compensation Fixes for 2007

Watson Wyatt's consultants have been recommending that clients rethink the structure of their existing severance and change in control provisions in light of their intended effects. These are changes all Boards should be considering, and we've seen several CEOs voluntarily relinquish these benefits. Boards should request top executives to consider giving up these benefits, and should discontinue providing them for promotions and new hires. Our recommendations in these areas are as follow:

1. ***Consider Adding Sunset Provisions to Severance Agreements***: Where a CEO has been on the job for several years and has accumulated significant equity gains and/or pension value so that the "security" of a cash severance provision may no longer serve a valid economic purpose, Boards should consider asking their top executives to forego cash severance. We think it is shareholder friendly for companies to review annually their severance provisions and practices. A best practice that companies may wish to consider for new hires is to implement a five-year sunset provision and to ask current executives to voluntarily sunset existing agreements.

2. ***Eliminate Single Triggers for Equity Vesting at a Change in Control:*** Current prevalent practice is to provide full acceleration of unvested equity at the date of a change of control. Boards should consider substituting double triggers for existing single triggers, with the second trigger being (a) severance, or (b) the earlier of severance and one additional year of service, or if the acquiring company does not assume or replace the awards. Board also should consider eliminating so called "delayed single triggers" where executives could terminate for any reason soon after a change in control and enjoy immediate option vesting.

3. ***Eliminate Full and Perhaps Partial Excise Tax Gross-Ups at a Change in Control***: Because of the wide range of circumstances where excise tax gross-ups would have no influence on executive behavior, and due to the corporate cost of providing this benefit, full excise tax gross-ups rarely are warranted. There may be some circumstances where modified gross-ups would be appropriate, perhaps in those situations where executives will not reap large gains due to stock price appreciation.

4. ***Consider Reducing or Eliminating SERP Enhancements Where Significant Cash Severance is Paid following a Change in Control:*** Reduce or eliminate SERP enhancements at a change in control where cash severance is significant, with the magnitude of the reduction dependent on the value of the cash severance being provided. SERP compensation definitions should not be based on inflated compensation definitions (e.g., those that count all W-2 compensation, including options gains), nor should they be calculated at change in control on future bonus or LTIP payouts that may never be realized.

5. ***Cash Severance Should be Offset from Equity Values Realized at a Change in Control***: Where the in-the-money value of unvested options or the value of restricted stock following a change in control exceeds the value of the cash severance, cash severance should be reduced based on the equity gains. This is because the severance relative to the equity gains no longer serves the purpose of protecting executives from a corporate change of heart at termination.