“The Consultants Speak” on What You Need to Do Now (10/12/06)

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Restore Integrity	Improve the Process	Avoid Liability
• Eliminate perks	• Designate an executive compensation “expert” on the Compensation Committee	• Implement proper controls and processes over compensation administration (including written documentation and training)
• Strip equity gains out of the final average earnings calculation used in determining pension benefits	• Utilize independent advisors	• Have internal audit conduct in-depth reviews of such controls and processes every year and have them report their findings to both the Audit and Compensation Committees
• Other than base salary and benefits, ensure that all of the senior executives’ remaining pay is performance-based	• Encourage all non-employee directors to participate or provide feedback in the compensation decision process	• Make sure no one person is responsible for all aspects of executive compensation
• Tighten up stock ownership requirements; review what counts towards ownership and consider adding retention requirements that extend beyond attainment of the ownership standard (e.g., to “hold until retirement” provisions)	• Have the full Board approve CEO pay, not just the Compensation Committee	• Carefully document compensation decisions in meeting minutes, resolutions, written reports and analyses

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• Alter severance agreements to eliminate the "pro-executive" provisions, and replace them with a more balanced approach (e.g., use target not maximum bonus, scale back to safe harbor, and eliminate the excise tax grossup or use "modified" grossup language)	• Conduct written evaluations of the CEO and other top executives' performance	• Be sure all statements in the CD&A can be fully supported with source documents, analyses, minutes, etc. (See Attachment)
• Eliminate above market interest crediting rates on deferred compensation	• Use multiple data sources to evaluate pay levels	• Ensure the corporate secretary and where appropriate, legal counsel are involved in the compensation decision cycle
• Establish wealth accumulation targets; evaluate what actions, if any, are needed once the target levels are attained (e.g., cap pension accruals, stop awarding additional equity and/or reduce severance benefits)	• Conduct a dry run of the CD&A and proxy now; take corrective action where appropriate	
• Provide shareholders with a clear explanation of how pay relates to performance in the CD&A	• Conduct a "clean slate" review of the existing compensation program. Be able to justify/articulate each element of pay, the level of compensation and the performance standards being used	
	• Fully review tally sheets and address large or unusual payments upon termination	

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	• Provide Committee members with a summary of the executive compensation program, including the reasons for each element, the performance metrics and benchmark methodology	
	• Prepare sensitivity analyses of payouts before approving a new incentive plan	
	• Solicit input from investors on the performance metrics and pay practices they value most	

Topic	**Required Documentation**
1. Compensation Philosophy	• Written compensation philosophy • Meeting materials and minutes evidencing: – Summary of discussion(s) – Compensation philosophy of competitors – Analysis of how the Company's program fits the philosophy. For example, is the Company's 75th percentile pay philosophy supported by 75th percentile performance? – Best practices information (e.g., NACD Blue Ribbon Commission) • Copies of reports prepared by outside advisors.
2. Peer Group and Survey Sources	• Peer data reviewed by the Committee to assess the appropriateness of the proposed peer group. Data should include revenue, market capitalization, net income, total shareholder return, etc. • Survey sources used, and an understanding of the benchmarking methodology (for example, what revenue size was used, was the data regressed, which companies participated in the survey, is the survey the same as last year, are multiple surveys used, are both industry and general industry data being used, how many position matches are there?) • Copies of consultants' reports recommending or approving a peer group. • Analysis, where appropriate, of including or excluding companies from the peer group's competitive pay benchmarks (for example, if two substantially larger companies were excluded from the analysis, would it have a material impact on the median?) • List of surveys considered, but not included in the analysis, and the reasons for their exclusion.

Topic	Required Documentation
3. Pay Mix	• Peer group and survey analysis of competitive pay mix. • Meeting materials evidencing a discussion of the desired pay mix. Is the Company largely following competitive practice, or does it have a specific objective (e.g., "50% cash and 50% equity" or "30% fixed and 70% variable"?) • Documentation for the key objectives of each pay element (base salary, annual incentive, long-term incentive, benefits and perquisites) and how they all fit together. • Documented rationale for each long-term incentive vehicle being used (e.g., why is the Company granting stock options and time vested restricted stock?)
4. Performance measures; incentive plan design	• Rationale for the measures selected. • Analysis that tests the sensitivity of payouts under various performance scenarios. • Evaluation of budgeted performance for degree of difficulty built into the target(s). Such an evaluation should include the Company and peer group's projected earnings growth as estimated by analysts. Thus, if bonus targets for upcoming year reflect 10% increase, how does this increase compare to the consensus earnings estimate for the Company and its peer group. • Historical trends should also be reviewed to evaluate how current your targets compare to past performance. • Comparison of actual to budgeted results the last 3-5 years should also be used (does the Company typically achieve its financial targets, or has actual performance been far short or far in excess of bonus targets? • If individual goals are part of the performance measures, an understanding of the specific goals used for the corporate officers, and how such goals are to be evaluated. • Document discussion of need for clawbacks and what happens if financial results are restated after bonuses have been paid. • Review of pay and performance compared to peers.

Topic	Required Documentation
5. Pay increases	• Peer group and survey comparisons. • Performance considerations used (corporate and/or individual) in determining the increase in pay. How do/should these increases compare to financial or stock price performance? • Market positioning of individual before the adjustment (is individual already at or above median?) • Other factors used to increase (or decrease) pay (e.g., matched a competitive offer).
6. Timing of equity awards (and stock price/number of units)	• Documentation of discussions regarding the timing of equity grants. • If committee has delegated authority to CEO, grant guidelines or limitations on such authority. • Recommend an internal audit review and report that tests to see if the guidelines were followed. • Minutes supporting grants to individual officers and employees, including the stock price to be used and the basis for the price selected.
7. Impact of past compensation on current awards or compensation decisions	• Document discussion of how past or realized compensation should impact current pay decisions (if at all). • Wealth accumulation modeling to determine projected value of existing equity and retirement programs at varying performance levels (without additional awards). It would be important to document how, if at all, such projections impact future pay decisions.

Topic	Required Documentation
8. Termination payments, employment agreements and severance policies	• Documentation of competitive practice. • Discussion of the purpose of such policies and the benefits to the Company and its shareholders (e.g., retention during periods of uncertainty, implementation of restrictive covenants, replacement of existing benefit for a newly recruited executive). • Analysis of cost prior to approval of arrangement(s) and periodic updates. • Evidence that the agreements were thoroughly reviewed by the Committee and its advisors for appropriateness and consistency with intended objectives.[1]
9. Stock Ownership	• Documentation of competitive practice. • Company policy spelling out ownership guidelines, shares included in the analysis, timeframe to achieve compliance and how the shares are valued. • Analysis of compliance with policy and for those executives who do not comply, or are unlikely to attain guideline ownership within specified period, documentation of a "get well" plan agreed to by the executive and approved by committee (or management). • Summary of objectives the policy is intended to satisfy.
10. Accounting and Tax Treatment	• Document estimated impact on P&L of proposed annual incentive and long-term incentive awards (e.g., EPS impact of $.04 per share). • Document due diligence on accounting for long-term awards (for example, was the plan reviewed to make sure it received grant date accounting? Were the retirement provisions discussed?) • Document discussion of Section 162(m) considerations. Did Committee discuss the difficulty of designing an arrangement that met the Company's needs and complied with Section 162(m)? Did the Committee understand the magnitude of the lost tax deduction? Did the Company consider other alternatives to preserve the deduction (like deferral of payouts) and why were those alternatives rejected? • Annual calculation of lost tax benefit due to the application of Section 162(m).

[1] For each example, an overly broad good reason provision could completely undermine the intent of the plan. Thus, the Committee must exercise proper care to ensure the agreements are properly drafted.