"5th Annual Executive Compensation Conference"

Course Materials

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"Moral Hazard and Executive Compensation"

Moral hazard is an awkward phrase that means, when a party is insulated from risk, it may behave differently than if it were fully exposed to that risk[1]. The concept has definite applicability to executive compensation. If an executive team is rewarded for the positive outcomes of good investments, but insulated from the negative consequences of investments that turn sour, then we may encourage excessive risk-taking.

It is thought that **moral hazard** has been a major contributing factor to the current financial crisis gripping Wall Street. It is directly addressed by the recent legislation enacted by Congress that grants the Treasury Department power to purchase distressed assets from banks and other financial firms. Specifically, the Act prohibits participating companies from providing compensation incentives to senior executive officers "to take unnecessary and excessive risks that threaten the value of the financial institution.[2]"

What does this phrase mean? And more importantly, how can all private sector boards, not just financial firms availing themselves of the new Federal program, consider moral hazard in designing their executive annual cash and long-term equity incentive plans?

ADDRESSING MORAL HAZARD

One way to address moral hazard in executive incentives is to avoid asymmetrical incentive structures that have a highly leveraged upside payoff with limited or no downside. The other way is to better align the financial interests of executives with the interests of long-term shareholders, not short-term speculators. This can be done by either:

(1) Having the performance period for incentives match the period required to determine whether the decision was successful (i.e., long vesting periods for incentive awards), or

(2) Providing that a portion of earned incentives or equity is held back and subject to future risk if the strong performance that justified the reward is not sustained in future years (i.e., long tail).

[1] To paraphrase Wikipedia, the term **moral hazard** does not imply immoral behavior or fraud. Rather, the term is used by economists "to describe inefficiencies that can occur when risks are displaced, rather than on the ethics or morals of the involved parties."
[2] "Emergency Economic Stabilization Act of 2008," Section 111 (b)(2)(A)

This opinion piece will focus on the second way -- holding back a portion of earned equity or incentive awards to remain subject to future performance.

We will start by identifying common and widespread devices that already address moral hazard in executive incentives, and then move to more complex and unusual types of devices.

COMMON AND WIDESPREAD DEVICES THAT MITIGATE MORAL HAZARD

First, stock ownership policies requiring executives to build and hold substantial ownership positions in company stock provide market penalties for management decisions and investments that look good initially, but ultimately prove unsuccessful.

- Unfortunately, most ownership policies do not transcend employment. Thus, executives who see trouble coming can quit and protect their capital by diversifying away from company stock

Second, long-term incentives themselves, typically based on cumulative corporate performance over rolling multi-year periods, provide a reasonable timeframe for either rewarding or penalizing the future results of current decisions.

- Unfortunately, such plans are rare in financial firms
- And, it is debatable whether the absence of a reward is, in fact, a penalty
- Further, long-term incentives are typically independent of annual incentives, meaning a bonus previously earned is not given back if future performance is poor

Third, recoupment or "claw back" policies are increasingly common among large companies. Born of Sarbanes-Oxley, however, they are typically only applicable to cases involving accounting fraud or misconduct resulting in restatement of prior period earnings, and rarely apply to instances of poor financial performance or poor management.

LESS COMMON DEVICES TO FURTHER MITIGATE MORAL HAZARD

The following are a series of ideas or "thought-starters" for how boards and management could act to further mitigate moral hazard in incentive design and governance practices. They are not meant to be prescriptive, but rather to stimulate thinking, and ultimately action, by the leaders of American business and their advisors.

1. **Hold stock past retirement.** Require top executives to continue to hold their ownership policy shares for a period of time after they voluntarily leave the company, for example, 12 months. The same should be required of outside directors.

2. **Prohibit "flipping" of option gains.** Require executives who exercise valuable options to hold a portion of the after-tax profit shares. For example, requiring executives to hold 25-50% of the net after-tax profit shares remaining after covering the option exercise price and taxes *for one year after exercise* is not onerous. It would function as a form of "claw back" if the executives exercised at a high point and the stock subsequently declined because of poor performance.

3. **Pay modest or no severance for failed performance.** Senior executives could be subject to two tiers of severance benefit – one, a higher tier, for "no-fault" terminations; the other, a lower tier, for "good reason" terminations relating to failed performance that fall short of "for cause" definitions. The public simply cannot understand why boards allow executives to receive multi-million dollar settlements when they are fired for leading the company to failure. It undercuts public support for good executive compensation practices and contributes to public perceptions that the game is rigged in executives' favor.

4. **Do not accelerate vesting** of unvested equity when terminating an executive for poor performance. It is better to allow vesting to continue, subject to restrictive covenants and claw back, rather than accelerate vesting at termination of employment, because the former executive then shares in subsequent stock price or performance declines that may have been caused by his or her performance.

   Merrill Lynch's board did this when terminating its CEO, with the result that Mr. Stanley O'Neal will ultimately receive far less than the $160 million reported retirement settlement.

5. **Pay part of bonus in restricted stock.** If a company has a highly leveraged annual bonus plan for its senior executives, it would be reasonable to pay a portion of bonus in short-term restricted stock. For example, 50% of bonus above target could be paid as restricted stock with a one- or two-year tail. That way, strong but unsustainable performance in the bonus year would entail a penalty in the form of a decline in restricted stock value if performance subsequently falters.

6. **"Bank" a portion of bonus.** A portion of executives' annual cash bonuses could be put into a pool that would be paid out, maybe with interest, five years after it was put in. During that five-year period, the pool would be subject to reductions and forfeiture for investments made or profits booked during the period the bonus was earned that are subsequently written off. A simple example would be asset impairment charges for acquisitions previously made for which the company overpaid.

7. **Make executives earn their bonus twice.** For companies with a highly leveraged annual bonus plan, a portion of the bonus would be mandatorily deferred in the form a three-year long-term incentive, with ultimate payment ranging from 0-150% of the deferred amount based on cumulative three-year performance vs. solid financial and market goals. While the idea sounds negative, and likely will be resisted strenuously by management, the underlying concept is sound. Its justification is that strong performance in the bonus year is not worth as much to shareholders if that strong performance is not sustained in future years.

EXECUTIVE COMPENSATION AND THE AGENCY PROBLEM

Moral hazard is one manifestation of the owner-agency problem where professional managers manage the business on behalf of absentee owners. Most large companies' executive compensation practices have as their roots addressing the owner-agency problem. Specifically, since managers are not owners, they will behave in ways to maximize their own long-term interests, rather than the owners' interests, unless the interests of managers are aligned with the long-term owners. Maximizing *short-term* shareholder value is not the goal per se, but rather building sustainable shareholder value over the long-term.

Owners want managers to take risks with their capital, but they do not want to over-stimulate the management because excessive risk-taking may ensue. It is thought that, without incentives, managers would not be willing to take the risks owners require as a condition of putting their capital to work in private enterprise. But, if we over-react to the current reactionary environment and insist that rewards and penalties be *equally balanced*, then we will be back where we started before we induced management to take risks on behalf of shareholders. That is why, in addressing the problem of moral hazard, these ideas emphasize putting a portion, but not all, of earned incentives at risk for sustainability of performance.

* * * * *

These concepts are worth considering by all boards and managements concerned with sustainable value creation and with restoring the reputation of public ownership of private enterprise as a vehicle for serving the public good rather than simply a vehicle for executive wealth creation.

Frederic W. Cook

THE CORPORATE COUNSEL

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Responsible Corporate Leadership—This Year's Necessary Compensation Fixes

In light of the just-adopted SEC disclosure requirements, the following are three key fixes that CEOs and their compensation committees should be initiating now. These fixes will also have the benefit of restoring trust and integrity to the system. What makes the timing so important is that, as many respected compensation consultants have recently shared with us, the fallout from this next year's proxy disclosures will cause a hailstorm. Those companies that will be able to get ahead of the storm by stating in their proxy statements that they have actually implemented *meaningful* changes will be hailed as leaders, notwithstanding errors that may have been made in the past.

Changes for CEOs to Implement

Although many critics will argue that it is the compensation committee that must take the initiative, the reality is that all it really takes is for a stand-up CEO to say "let's do it." I am, in fact, optimistic that if a few leading CEOs make the following changes at their companies and then publicly ask their fellow CEOs to do the same, we will have come a long way toward fixing the compensation mess we have gotten into. Moreover, we will head off misdirected legislative and regulatory "corrective" efforts that would further weaken the system.

A Little Background: The Two Areas Where Compensation Has Gotten Out of Line—Option (and Restricted Stock) Awards and Post-Employment Provisions

There are two big areas where most would agree that compensation has gotten out of line:

Stock Options (and Restricted Stock)

Today, the typical annual equity grant is two times what was an eye-popping "mega grant" in 1988—and back then, it was not an *annual* mega grant, it was an *occasional* mega grant. We've gotten so far out of line here that some people assume that the norm is the huge annual grant.

Many of our readers recall Fred Cook's candid talk at Stanford Directors College last June and Pearl Meyer's comments at our 2nd Annual Executive Compensation Conference last October. For CEOs and compensation committee members, it is worth taking the few minutes to reread Fred's assessment of how equity grants have gotten off track—and what to do now. Here are leading consultants with many years in this field who are now feeling the need to speak up and call for corrective actions.

Post-Employment Provisions

The second area that needs to be fixed (and will be incurring even greater scrutiny and public outcry once next year's proxy statements reveal additional embarrassing amounts) is post-employment provisions. Whether it is SERPs and retirement provisions, severance, change-in-control, etc., they've gotten way out of line.

As Pearl Meyer said so candidly last October, post-retirement compensation is not an area that many consultants have been on top of—because it was considered either the lawyer's responsibility to draft provisions or an actuarial function—and was not fully appreciated and not factored in when considering a CEO's total compensation. Many companies are sitting on retirement plans and provisions that have included in the calculations inappropriate forms of compensation (*e.g.,* stock option gains) or inappropriate formulas (*e.g.,* incorporating highest years' compensation, outsized bonuses or additional years of service, etc.). It is disingenuous for us lawyers and for CEOs and directors to say "These are legal obligations of the company and we can't do anything about it" and leave it at that.

Everyone else can see now that mistakes were made in the past and that these provisions never should have been inserted in the plans. To say: We have now fixed it on a "going-forward basis" is not enough. [Query:

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Might this even raise a "fiduciary obligation" or a "certification" issue if a CEO and directors now understand that the past formula was wrong—and if the CEO, in particular, simply stands by and does nothing about his already accrued amounts after it has been brought to his attention that a past error was made that resulted in his own "unjust enrichment."]

If a handful of CEOs who are "legally entitled to it" would speak up and say, "Yes, but it was unfair and a mistake in the first place," and actually reversed those (in hindsight) improper amounts and provisions, this would go a long way to restoring the public trust.

The Three Fixes to Implement This Year

1. Stock Options and Other Equity Awards: Implement a Hold-Til-Retirement Provision

As has been widely recognized, stock options and other equity awards (such as restricted stock and performance share plans) have gotten way out of line and should not have become part of annual compensation. Their purpose is to build long-term wealth and long-term incentive so that non-founders can, over time, realize a meaningful stake in the business so that they think like owners and represent the long term interests of the shareholders. As Fred Cook said in his landmark speech at Stanford last year "It is my belief that currently high stock option grant values for executives have gone beyond any rational motivational value and are sustained only by compensation surveys… What can be the possible purpose served in granting a CEO who already has an equity carried interest of 150-200 times salary, another option whose 'face value' is 20 times salary? The CEO is likely to be already so motivated by stock price performance that new grants add no incremental motivational value. They only add cost. It is only done because the surveys say that, without the new grant, the CEO's total compensation will not be competitive. No survey, to my knowledge, considers what executives have already received in options."

So, what do companies do that have already granted too many options and other forms of equity? Here it is unlikely that a CEO will volunteer to give up any of his past grants. But, one realistic, basic fix that a number of the top financial institutions and other savvy companies have now implemented is to require that their top executives hold their company-awarded equity until retirement. At these companies, the CEO has set the example and made it clear to the top executives affected that this is fundamental to the company's values and culture. At all these companies there was no problem in getting the key executives on board.

We have posted on the CompensationStandards website a list of several of the companies, with links to their proxy statement descriptions as models for others to implement. [Note, the typical retention amount has been 75% of the after-tax amount and it applies to all outstanding equity from past as well as future grants.]

We view this as a simple fix that will enable a company to shine in the eyes of its shareholders, sending a message that their top executives are in it—with significant "skin in the game"—for the long haul. (This will be an especially important and meaningful gesture for those companies that may be viewed as having given too much equity at the top.)

2. Stock and Other Equity Awards: Turn Off the Hose

Our second fix is to return to the purpose of equity grants. This means that the CEO and board will need to put on the table that the CEO (and perhaps other top executives) has received so much equity already that there is no reason for more. For this to happen, some responsible CEOs are going to need to speak out—as some leading CEOs already have—by, *e.g.,* asking their compensation committees to cease awarding them more equity and to put their grants back in the pool for other employees. We have listed several such examples in the "CEOs That Have Set an Example" section on CompensationStandards.com. We are expecting to see other key CEOs step forward here to set an example for other CEOs to follow.

This will go a long way to counter the cynical attitude of the public that "CEOs only care about getting as much as they can—and at least as much as the other guy". It will also return equity grants to their intended purpose.

3. Retirement Provisions and SERPs: Return to Fundamentals

Boards and CEOs must recognize that the purpose of pension plans has always been to provide security for retirement. In those companies that in the past did not have the prospect of significant equity appreciation, the pension was key. In growth companies, on the other hand, there were no pensions; instead, the purpose of their option grants was to provide (a) incentive for the long term and (b) a healthy nest egg should all things work out.

Unfortunately, the emphasis over the past several years on equity grants at many companies has not been coordinated with other aspects of long-term compensation and the ultimate nest egg to be provided. At those companies where the amounts from accumulated equity grants and other long-term programs have now exceeded what was originally intended and where several lifetimes worth of wealth has now been accumulated, boards and CEOs must focus on what is now already out there for the executive's retirement years and cut back on (and, in some cases, eliminate) the retirement and severance provisions that were intended to provide for the future. Now that some executives have amassed several lifetimes worth of wealth as a result of past grants, it is time for responsible boards and CEOs to act here to restore (both internally and externally) the credibility of (and the public's trust in) the company's leadership.

Specifically, at many companies, this will mean:

(a) Eliminating all the provisions that have crept into SERPs for top executives that provide for benefits beyond what is provided to all employees.

(b) An even more important and more fundamental fix is for those CEOs who have amassed sufficient accumulated wealth from previous equity and long term awards—so that there is no "need" for a pension—to now stand up and renounce their pension (as well as superfluous severance and change-in-control arrangements).

Note that here is where the CEO as a leader must step up and say to the board and to fellow executives that he is giving up his SERP and his pension benefits and he would hope that those in similar circumstances will do the same. We note that Jamie Dimon, when he joined Bank One, gave up a SERP amounting to several million dollars.

Why Would a CEO Give Up a Pension—or Ongoing Annual Equity Grants?

Assume a CEO who upon retirement will receive a pension with a lump sum payment of $10–$20 million. Also assume that our CEO has accumulated from previous equity granted to him another $20–$40 million.

Let's also assume that we have a standup CEO who is a straight shooter with good moral values who also takes pride in the corporate culture and the values that his company stands for. And that he has been a leader in instituting strong corporate governance practices.

The Make Up of a CEO

There are a number of CEOs that fit this bill. To reach the top takes more than just being a strong competitor. Contrary to what some cynics may believe, most CEOs are not motivated by greed. They care very much about what their company stands for and what others think of them as a person. They care about their legacy. They care about how the public and those in their community view them and how their children and their grandchildren view them—and how they will be viewed in history. They don't want to be remembered as someone who in the end cared more about having the most company-paid-for perks or an outsized—and unnecessary—pension. They want the public to view them as having fairly earned what they have received.

Right now at a number of companies we have well meaning CEOs who fit the above description, but are now finding themselves in a situation where their consultants may still be telling them that their compensation is "in line" and "competitive." Yet, the public (and the other executives and employees within their companies) see something different. The reason for the disconnect, as respected consultants are now voicing, is that some forms of compensation (primarily the accumulated equity and the post employment provisions) have gotten way out of whack.

The Reason Why CEOs Will Need to Step Up and Give Their Advisers and Their Boards The Signal

What makes it difficult to reverse things is that there are still a number of consultants and lawyers who may have, in good faith, crafted some of those provisions and encouraged those practices who now are finding it difficult to say: "We didn't fully understand the ultimate size of the payouts and we did not add up all the components and did not take into consideration total compensation when we implemented a past plan or agreement. In short, we made a mistake and, in hindsight, should not have done what we did."

Unfortunately, many of our consultant colleagues who feel this way are hesitant to say to a CEO or a board: "We need to fix these errors and that means adjusting and reversing what we have already mistakenly delivered or contracted to deliver." As one leading consultant said to me not long ago (when we were having a very open discussion about the situation at many of his and other firms' client companies), "I still have children that I am putting through college…" In short, many consultants have a legitimate fear and do not want to risk losing a client because either (a) the client (the CEO and/or the board) feels the CEO is entitled to it and would be outraged by the notion that it was not appropriate, or (b) the board reacts to the consultant's well-meaning assessment and rollback recommendations and then terminates the consultant for having gotten them into this mess in the first place.

CEOs also need to realize that directors are going to be very reluctant to raise these issues for fear of sending a wrong message to the CEO that he is not appreciated.

So, here we have a situation where it truly will have to be up to a standup CEO to say "let's fix this".

And this brings us back to the question: Why would a CEO step up *NOW*?

I do believe that respected CEOs, when shown what Fred Cook and others have now laid out explaining how we got here and what needs to be fixed, will take the lead because they will see that the system has, in fact (although unintentionally) been "gamed."

As covered above, the first reason why a CEO would do it is because his critical thinking will lead him to the conclusion that, in hindsight, mistakes were made that need to be fixed. And his leadership instincts will tell him that he must take the initiative here in this sensitive area. But we realize that in many cases, this will put a CEO to the test of whether he is really willing to give up significant amounts that he could say he is "legally entitled to." There is one immediate reason for action now, however.

A Powerful New Motivator—The Looming CD&A Analysis

Perhaps the most immediate and pressing reason why many CEOs may well make these fixes *now* will be to head off what otherwise could be very embarrassing and damaging new proxy statement CD&A *analysis*. We expect that during the coming weeks many CEOs will be in for rude surprises as their lawyers and consultants bring to their attention what now will need to be addressed for the first time in the new CD&A section in this year's proxy statement.

CD&A stands for Compensation Discussion and Analysis. And, it is the "analysis" that will now need to squarely address the issues that we highlighted above for each of the three items where fixes need to be made. With institutional investors and others aiming their sites on the upcoming CD&As—and with lawyers and consultants on notice that boilerplate and hollow analysis won't pass muster, CEOs will be on the line (as a result of their certifications).

For example, a CEO's certification of the analysis of a pension or equity component that does not squarely address what, in hindsight, were (a) inappropriate provisions or amounts, or (b) redundant incentives or (c) unanticipated and unintended payouts that were uncovered (*e.g.,* as a result of wealth accumulation analysis) could expose the CEO (and the CFO) to embarrassing and costly attacks from the plaintiffs' bar, as well as institutional shareholders. CEOs can also anticipate that the press will have a field day with those CEOs who attempt to hide behind a Grasso-like "well, the board authorized it" statement, when the CEO will now be on the line. (As a number of respected counsel are now suggesting, we expect to see many of the new compensation committee report sections ending with a conclusion that the compensation committee found all the components of the CEO's compensation to be fair, reasonable and appropriate. Even without such language, a CEO who knows differently and didn't act to fix a problem will not be able to hide behind the board's boilerplate.)

A Wake-Up Call to Action

It is now becoming clear to those of us who are in the trenches that many CEOs and compensation committees are about to encounter some very damaging disclosures and fallout. Unfortunately, many CEOs and directors have not yet been fully informed or do not yet understand the full extent of the disclosures and the required analysis and explanations that will now have to be set forth in their upcoming proxy statements. Most importantly, not enough attention has been given to the second aspect of the disclosures—the fallout—how those disclosures will be reacted to by regulators, institutional shareholders and critics, including the media.

A very poignant example that might help bring it home comes to mind. Last year our friends at Pfizer, which has historically been a model corporate citizen and corporate governance and disclosure leader, did a commendable job in their proxy statement, getting a jump on trying to comply with the SEC's then new compensation disclosure proposals. Unfortunately, apparently not enough attention was given to the potential fallout: what the public focused on was the outsized pension that Hank McKinnell would receive (in large part due to a SERP, created before Hank's watch, that included stock plan gains in the calculation). The result was that Hank McKinnell became one of last year's poster boys for excessive compensation—and a lifetime's worth of good work and good deeds was ignored.

[Hank McKinnell was a dedicated employee who spent his entire 30+ year career at Pfizer, holding onto his company stock all the way. And, when he reached the top he took significant steps to expand Pfizer's role as a good corporate citizen, personally committing himself to the plight of the underserved around the world. What Pfizer and Hank have accomplished, especially in providing free medication and medical services and support combating the ravages of HIV and AIDS in underserved nations deserves real praise as a model that so many other CEOs and companies should be following. Another stand-up thing that Hank did was to take the time to write a book taking a bold stand that the health system in the United states is backwards and that we each must take greater responsibility for our own health and not rely on a system that is focused on treating illness and disease after the fact. The title of Hank's book is "A Call to Action." Hopefully, now Hank will be remembered in a positive light for being the unwitting leader in another call to action to restore trust to our system, something I know Hank cares about.]

The Lessons and Necessary Actions

There are important lessons here. First, companies should not fall into the trap of being so focused on complying with the new disclosure requirements, that no one is anticipating and addressing the public reaction to the disclosures—and what can be done in advance to head off the hailstorm. As Pfizer learned (and as many others will learn this proxy season), no matter how you paint it, the critics and the media are too knowledgeable now. In particular, the focus will be on the two areas where there is no denying that compensation at the top has gotten out of line. People will be looking very closely not just at the numbers, but at what the compensation committee and the CEO now say in the CD&A about those out of whack components of many CEOs' compensation. They will not accept the rationales of the past.

The second lesson is that the CD&A, unlike the compensation committee report of the past, must truly provide candid *"analysis"* ("Compensation Discussion and Analysis"). The critics will not buy into the argument that "everyone else is doing it" (that is where benchmarking and pointing to survey numbers and the "being competitive" mantra will fall apart). Now the regulators and the critics (and the plaintiffs' lawyers) will be looking to see what tools the compensation committee has employed and to what extent true analysis was actually undertaken (*e.g.,* was a "wealth accumulation analysis" and an "internal pay equity study" undertaken as part of the compensation committee's analysis and assessment of the CEO's and other top executives' total compensation). As we said in the first part of this issue, in many instances that analysis will lead to the inescapable conclusion at a number of companies that additional equity is not warranted and that pension and severance and change in control arrangements cannot be justified for those who have already accumulated several lifetimes of wealth so that there is no longer any "need."

The third lesson is the importance of getting ahead of the storm. Consider the difference it could have made at Pfizer if the directors or the CEO had actually reversed the misdirected inclusion of stock gains in the pension calculations and addressed whether there was no longer a "need" for any pension or ongoing equity grants at the top. With this year's CD&As looming, those companies that address and make the hard decisions will be hailed by all for restoring trust in the system.

This is Not a "Performance" Issue

One last point needs to be made. This is not a performance issue. The problem only gets muddied when critics and defenders start pointing to a company's stock price or earnings. There are many CEOs who have done a great job in all respects. Fixing the excesses should not in any way be a reflection on their performance. As Ed Woolard and John Reed and Charlie Munger and other respected leaders have stepped forth to point out, this is about CEOs as leaders now standing up to fix things and restore trust in the system.

A Few More Fixes

In addition to the above, and especially since the new proxy statement CD&A section will require candid analysis of the need for—and purpose of—each component of the CEO's compensation, there are a few other provisions that will need fixing at some companies that could cause major embarrassment as a result of this year's upcoming proxy disclosures. So, here are a few more basic fixes that CEOs and boards may want to address at the same time the above Three Fixes are being addressed. (Again, ideally, the following fixes should be implemented before drafting the upcoming proxy statements.)

Severance and Change-in-Control Provisions. In addition to the "technical fixes" (addressing, *e.g.,* single triggers and gross up provisions that have found their way into some severance and change-in-control provisions and that can be extremely costly), many CEOs and boards will need to apply the same "need" analysis as covered above with pensions, focusing on the fundamental purpose of severance and change-in-control provisions and eliminating or curtailing them for those top executives where accumulated wealth from past equity grants has obviated the "need."

Perks. We expect to see many more CEOs and boards now following the lead of companies such as Intel and Potlatch and many others that have announced in their proxy statements "No Perks" or "Limited Perks" policies. Others that are not willing to go that far should be much more forthcoming to themselves and to shareholders about what the true value of those perks is to the CEO (*e.g.,* what it would cost the CEO to charter a comparable private jet). It sends a terrible message to the public and to other employees when they see a CEO "taking from the cookie jar" when he can afford to pay for these things out of his own pocket.

Deferred Compensation Interest. Another area where top executives at some companies are receiving more than others—and at a cost to the company—is the pre-tax interest on deferred compensation. By taking pencil to paper, it will be clear that for the interest to be a "wash" would require an interest rate below the company's cost of money. So, even paying current interest rates actually costs a company. As has been reported, these amounts can become significant. At Wyeth, the CEO's annual interest payments on his deferred compensation (thanks to above-market rates) had ballooned to over $3 million a year.

Essential Tools: Tally Sheets, Wealth Accumulation Analysis, Internal Pay Equity

Before ending this special issue of *The Corporate Counsel* on fixes that need to be implemented, we should remind our readers of three essential *tools* that CEOs and boards should be utilizing now and improving upon, in light of the upcoming new CD&A disclosures and the *analysis* that will now be expected in the CD&A discussion (that CEOs, CFOs and the directors on the compensation committee will now be held accountable for). For more on implementing Tally Sheets, Wealth Accumulation Analyses, and Internal Pay Equity audits, see our September-October 2005 issue at pages 2-6 and see the excellent guidance provided on CompensationStandards.com under the "Tools" section.

Wealth Accumulation Analysis. We should call particular attention to the heightened importance now of the wealth accumulation analysis for this year's CD&A. As we referred to above, all eyes will now be on the discussion and *analysis* in the CD&A. For example, instead of boiler plate language, it will now be expected under captions like "Wealth Accumulation" that the compensation committee will expressly state that it added up all the gains, realized and unrealized, as well as projected, from all previous (and pending) equity awards (providing a total). And, then in its "analysis," the committee will need to assess whether the CEO has already received enough equity to meet the purpose of granting equity, *i.e.,* a long term, meaningful stake, so that there is no longer a need to make further grants.

The second prong of the wealth accumulation "analysis" is to assess whether there is any longer a "need" for the CEO (and some NEOs) to receive a pension or severance or CIC payments in view of the amounts already accumulated. This harks back to our discussion above of the two areas where it is generally recognized that CEO compensation has gotten out of line, because the analysis that will now be expected from directors in the CD&A (and "certified" by the CEO and CFO) will have to face up to the results of the company's wealth accumulation analysis.

Similar analysis and candid conclusions will be expected from tally sheet and internal pay equity discussions in the new CD&A. [For example, institutional shareholders and others will now be looking to the CD&A to see if the board has undertaken an internal pay analysis going back 15 or 20 years to look at the ratios between the CEO and various levels of executives, making sure to include heads of divisions/functions. As has been pointed out, it needs to cover each of the components, not just salary and bonus (including all equity awards, retirement, severance, CIC, perks, etc.). In this way a company can see (and analyze) where a component may have gotten added that may have caused an unintended disparity. The findings can also serve to help demonstrate that compensation fairness extends down the executive chain. At some companies, however, this comparison may bring some surprises to light that will need to be addressed. But, better for a company to ferret out and address those surprises now rather than be embarrassed by the disclosures in your upcoming CD&A.]

In short, directors and CEOs will want to task their HR people to do these analyses **now** rather than be caught with surprises later this year when time may be too short to implement meaningful changes to counter negative public reaction to some of the findings and analysis in the CD&A.]

Getting Up To Speed

Lastly, particularly for CEOs and CFOs (and compensation committee members) who will now be on the line for the disclosures and the analysis in the CD&A and the rest of the compensation disclosures in the proxy statement, it is essential to get up to speed. If I were a CEO or a director I would want to read first hand the following:

1. **The Summary of the 2nd Annual Executive Compensation Conference**

   This four-page summary of the highlights of the conference identifies the essential issues and action items that directors and CEOs are expected to be on top of and addressing.

2. **Ed Woolard's Talk**

   Ed Woolard's candid assessment of the fixes that need to be made, including the importance of internal pay equity—and his inspirational challenge to fellow CEOs and directors should be a must. The video tape of this 10-minute talk should be played at every company's next board meeting. And the text of the talk should be furnished to all board members.

3. **Fred Cook's Talk**

   Directors and CEOs need to hear first hand what Fred said in candor at the Stanford Directors College about how we got to where we are today and the essential fixes that boards and CEOs must stand up to and implement.

4. **The 12-Step Program for Directors**

   Those directors and CEOs that have not already read the 12-Step Guidance for directors should access the September-October 2005 issue of *The Corporate Counsel.*

5. **Ongoing Sources**

   Lastly, we are flattered by the kind words we have received from so many directors as well as those responsible for advising boards telling us that they find the CompensationStandards website and the Annual Executive Compensation Conference to be essential in order to keep abreast of the latest developments, practices and expectations impacting CEO compensation. We pledge to maintain these resources. We view this period leading up to and following the disclosures in (and the inevitable fallout from) next year's proxy statements as being a critical time for all of us to do our part to regain the public trust in our system.

—JMB

Because of its importance, readers have our permission to furnish copies of this issue to CEOs, directors and anyone else who might benefit from it.

The Publisher of *The Corporate Counsel,* **Jesse M. Brill,** is a member of the New York and California Bars and received his J.D. from Yale Law School. Mr. Brill, formerly an attorney with the Securities and Exchange Commission, is securities counsel for one of the largest brokerage firms in the nation, and Chair of the NASPP. Mr. Brill has participated on a number of panels and seminars sponsored by the SEC, NASD, Practising Law Institute, ALI-ABA, American Society of Corporate Secretaries, NASPP and others. Editor: **Michael Gettelman,** LL.B. Harvard University, Farella Braun + Martel LLP, San Francisco (mgettelman@fbm.com).

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The Upcoming "3rd Annual Executive Compensation Conference"—Heightened Importance

We are overwhelmed by the record numbers registered for the "3rd Annual Executive Compensation Conference" on October 12. There has been a surge of sign-ups over the last few weeks for the live video webcast, in particular, as more people have come to recognize the heightened importance of this year's Conference. (And, many companies and firms that had previously signed up are now upgrading to firmwide licenses as they begin to focus on how many people will now need access to the webcast, conference materials and archives.)

Now that everyone is focused on this year's CD&A and the need to address the compensation committee's *analysis* of CEO and NEO compensation—and to explain the process and the *tools* that compensation committees are utilizing, the upcoming 3rd Annual Conference has taken on a life of its own—becoming a "must" for everyone who has any part in the preparation or review of this year's proxy statements.

Please check your registration—and test your access. We encourage our readers to ensure that all your staff—and clients—are, in fact, registered for access. We are already encountering some confusion and we are anticipating that there may be a lot of frustration (to say the least) as those who are not registered individually are unable to access the webcast. If you have any questions, about your registration, please email info@compensationstandards.com or call 925-685-5111. Please note that "firmwide" and "unlimited" access licenses are limited to persons at the same firm or company.

We are looking forward to seeing many of our colleagues at the Conference. (Don't forget that those also attending the concurrent NASPP Conference are also entitled to attend the "Huey Lewis & the News" private bash on October 10th.)

The *Compensation Standards* Newsletter—A New Aid for Directors

We have been receiving more and more inquiries from in-house counsel asking if we could address a need. Counsel, to their credit, have been anticipating and focusing on the heightened importance now of keeping directors—and CEOs and CFOs—abreast of what they need to know about compensation practices. Others have been asking us to resume our popular compliance reminders, "The Box," that could be provided to directors and other insiders on an ongoing basis to help prevent inadvertent violations.

Because there is a real need for guidance right now, we have decided to do our part and provide a quarterly newsletter for directors—*Compensation Standards*—particularly during this period that we see as being the most critical for directors and CEOs.

We have enclosed a copy of the newsletter. You have our permission to make as many copies as you like and to furnish it to directors and others that might benefit from it. To ensure that it will have the most widespread usage, we encourage all our readers to take advantage of the Special Offer below, which will enable you to receive this important aid for the next year at no risk. In the alternative, you can sign up for a no-risk trial on CompensationStandards.com.

Executive Press, Inc. • P.O. Box 21639 • Concord, CA 94521-0639 • Tel. (925) 685-5111 • FAX (925) 685-5402
info@CompensationStandards.com

The Benchmarking and Internal Pay Workshop

I. Ten Rules for Competitive Benchmarking

1. Calculate the Total Cost of Management:
   - Compare total pay for the top 5, 10, 20 executives.
   - What does it cost us to manage this organization?
   - How has this changed over time, and with performance?

2. *Always* provide pay *and* performance data and rankings:
   - Compare pay percentile to performance percentile.
   - Peer group makes it easy.

3. Assume that all surveys are biased:
   - It's your job to know exactly how they each are biased and adjust accordingly.

4. Seek the truth – survey data is only a clue.

5. All Revenue is not created equal:
   - Do not blindly rely on revenue as your only guide.
   - Complexity must be a significant factor.
   - Retail and distribution revenue is not the same as manufacturing or production revenue.

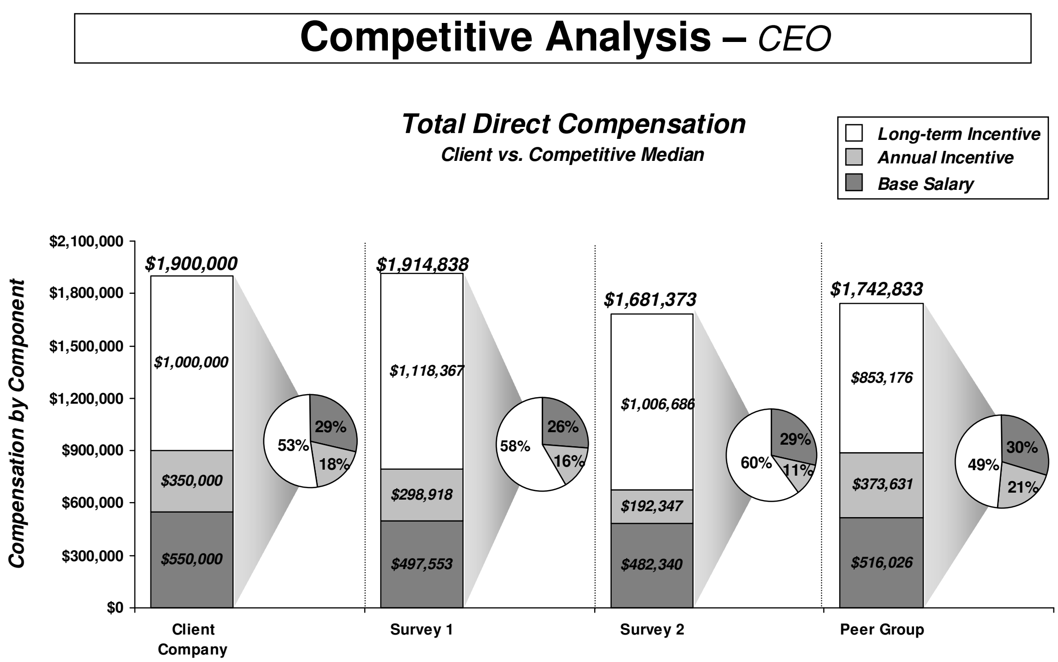
6. Use target and actual annual incentive data, separately:
   - Each tells a different story.
   - Three-year average actual data is also useful.

7. Use consistent LTE valuation methodology:
   - Black-Scholes, OR
   - Lattice Model, OR
   - FAS 123R
   - But not a mixture.

8. Show data from each data source and acknowledge that there is a range:
   - Ok to the average data, but do not imply a level of precision that does not exist.

9. Show survey matches:
   - Show the reader exactly how the positions were matched to the surveys.

10. Use stacked bar charts to summarize the analysis:



II. Ten Provocative Questions to Ask Your Compensation Consultant

1. How will you maintain your independence from management?

2. What are the worst/best things about our pay program?

3. What are the cutting edge, best practices that have actually been implemented?

4. What are the compensation best practices that have stood the test of time?

5. What do you think the right performance measures are for our company? Why?

6. What is your philosophy of performance measurement and value creation?

7. Give me an example of where you personally have taken a stand against excessive executive pay.

8. Give me an example of where you gave in to excessive demands for too much or inappropriate pay.

9. What is the best compensation program you have ever designed?

10. What is the worst compensation program you have ever designed?

III. Internal Pay Equity Real Life Examples

Buffalo Wild Wings Excerpt from 2008 Proxy Statement:

	Base Salaries		
	2006	2007	2008
Sally Smith (CEO)	$450,000	$500,000	$535,000
Mary Twinem (Exec. VP & CFO)	$280,000	$315,000	$335,000
James Schmidt (Exec. VP, General Counsel & Secretary)	$215,000	$235,000	$270,000
Judy Shoulak (Sr. VP, Operations)	$230,000	$255,000	$270,000
Kathy Benning (Sr. VP, Marketing & Brand Development)	$210,000	$224,000	$243,000

2007 Earned Cash Incentive Compensation

Each of the named executive officers set forth below earned the following amounts of annual cash incentive compensation based on 2007 performance:

Named Executive Officer	Cash Incentive Earned for 2007	Percentage of Base Salary for 2007
Sally Smith	$334,200	66.8%
Mary Twinem	$210,546	66.8%
James Schmidt	$157,074	66.8%
Judy Shoulak	$123,930	48.6%
Kathy Benning	$108,864	48.6%

Our Chief Executive Officer, Executive Vice Presidents, and Senior Vice Presidents receive annual grants subject to certain vesting restrictions. For the past three years, the annual grants were based on a percentage of the executive officer's base salary, with the Chief Executive Officer and Executive Vice Presidents receiving grants equal to 100% of their base salary, and the Senior Vice Presidents receiving grants equal to 80% of their base salary. The Compensation Committee used its discretion when determining the weight of equity incentive compensation in 2007, but in doing so considered past practice, competitive information, our principles and goals, and accumulated value of executives' equity. The number of shares awarded to each executive officer is based on the closing sale price of our stock at year-end. For example, Sally Smith's base salary for 2007 was $500,000, and the closing sale price of our stock at the end of 2006 was $26.60 per share, which resulted in the grant of 18,796 restricted stock units at the beginning of fiscal 2007.

2008 NASPP Conference

Company Performance and Internal Pay Equity

Michael Kesner
Principal, Deloitte Consulting LLP

October 2008

Background

- Deloitte Consulting, LLP ("Deloitte") reviewed Total Direct Compensation ("TDC") (base salary + annual incentives + long-term incentive opportunity) for the Chief Executive Officer and the 2nd highest paid Named Executive Officer at the 30 companies in the Dow Jones Industrial Average ("Dow 30") (please refer to the **Appendix** for a list of companies) for the prior three years to gauge whether there is a correlation between CEO pay multiples and company performance.

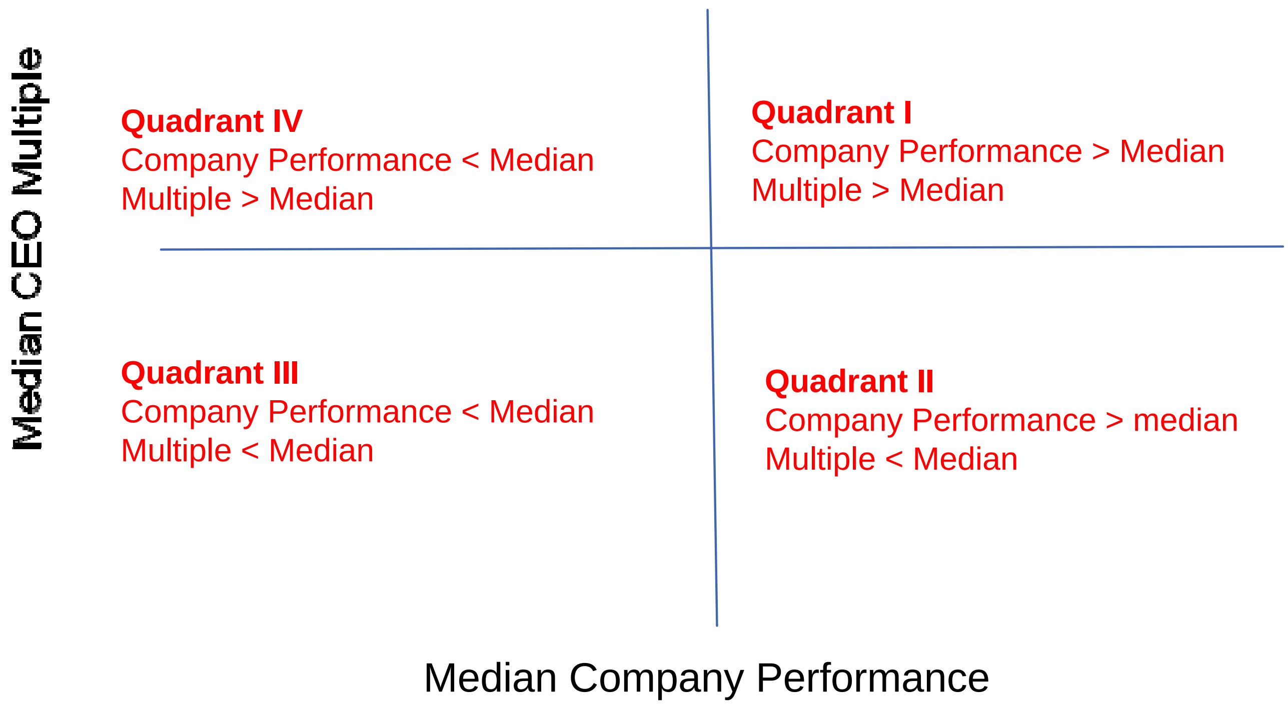
- Company performance was based on three year annualized total shareholder return ("TSR") and earnings per share ("EPS") growth.

- We also reviewed the pay relationship between the CEO and middle management and its relationship, if any, to performance.
  - The three-year average TDC multiple for middle management was based on estimated compensation levels provided by MVC Associates International; $118,000 in fiscal year 1, $113,680 in fiscal year 2, and $109,413 in fiscal year 3 for an average of $113,700, during the three-year measurement period.

Total Direct Compensation data for the DOW 30 was provided by Equilar, Inc.

Methodology

- We plotted company performance (TSR and EPS growth) and CEO pay multiples (vs. 2nd highest paid and middle management) on the following pages.
- We assigned the companies to one of four quadrants, as indicated below:



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Findings

- The median CEO multiple vs. 2nd highest paid executive was 2.29 (i.e., the CEO's TDC is 229% higher than the 2nd highest paid executive).
- The median CEO multiple vs. middle management was 165.8 (i.e., the CEO's TDC is 1658% higher than the average middle management employee).
- Median TSR and EPS growth was 7.0% and 9.4%, respectively.
- The companies were almost evenly distributed among the four quadrants. Thus, there does not appear to be a direct correlation between company performance and CEO pay multiples.
- There were seven to nine companies (depending on the performance measure, and whether the CEO was compared to the 2nd highest paid executive or middle management) in Quadrant I (High CEO pay multiple and high performance). Companies falling in this quadrant are likely to reflect the fact that CEO pay is generally more leveraged than other employees, thus, their pay multiple would expand with above market performance.
- There were six to nine companies in Quadrant III (low CEO multiple, low performance). Similar to the Quadrant I findings, this result is also logical due to the steeper reductions in pay the CEO would be subject to for below market returns.

Findings

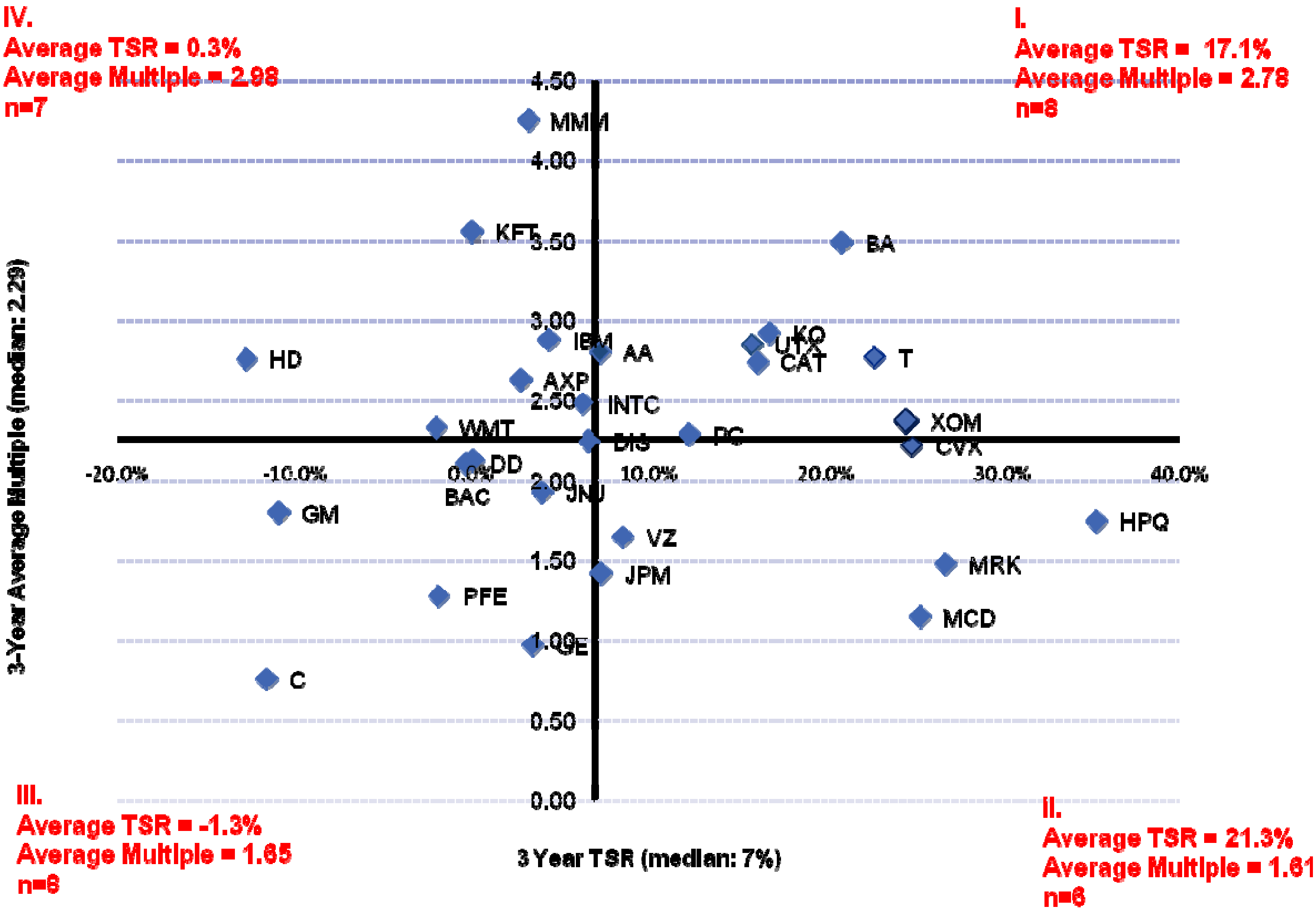
- There were five to six companies in Quadrant II (low CEO multiple, high performance), which would indicate it is possible to pay the CEO less of a premium compared to other employees and still achieve superior performance.

- There were six to nine companies in Quadrant IV (high CEO multiple, low performance) where the CEO appears to be paid a significant premium compared to other employees but the Company does not appear to have the performance to support it.

- There are likely several additional explanations for the disconnect between the CEO pay multiple and performance, including:
  - The Dow 30 is very diverse, thus the peer groups used to set pay may have created significant differences in multiples.
  - Multiples are not embedded in the compensation decision process currently.
  - The performance metrics and three year time horizon used in our analysis may not be used by the Dow 30 to determine pay levels for the CEO.

Findings

Three Year TSR: CEO vs. 2nd Highest Paid



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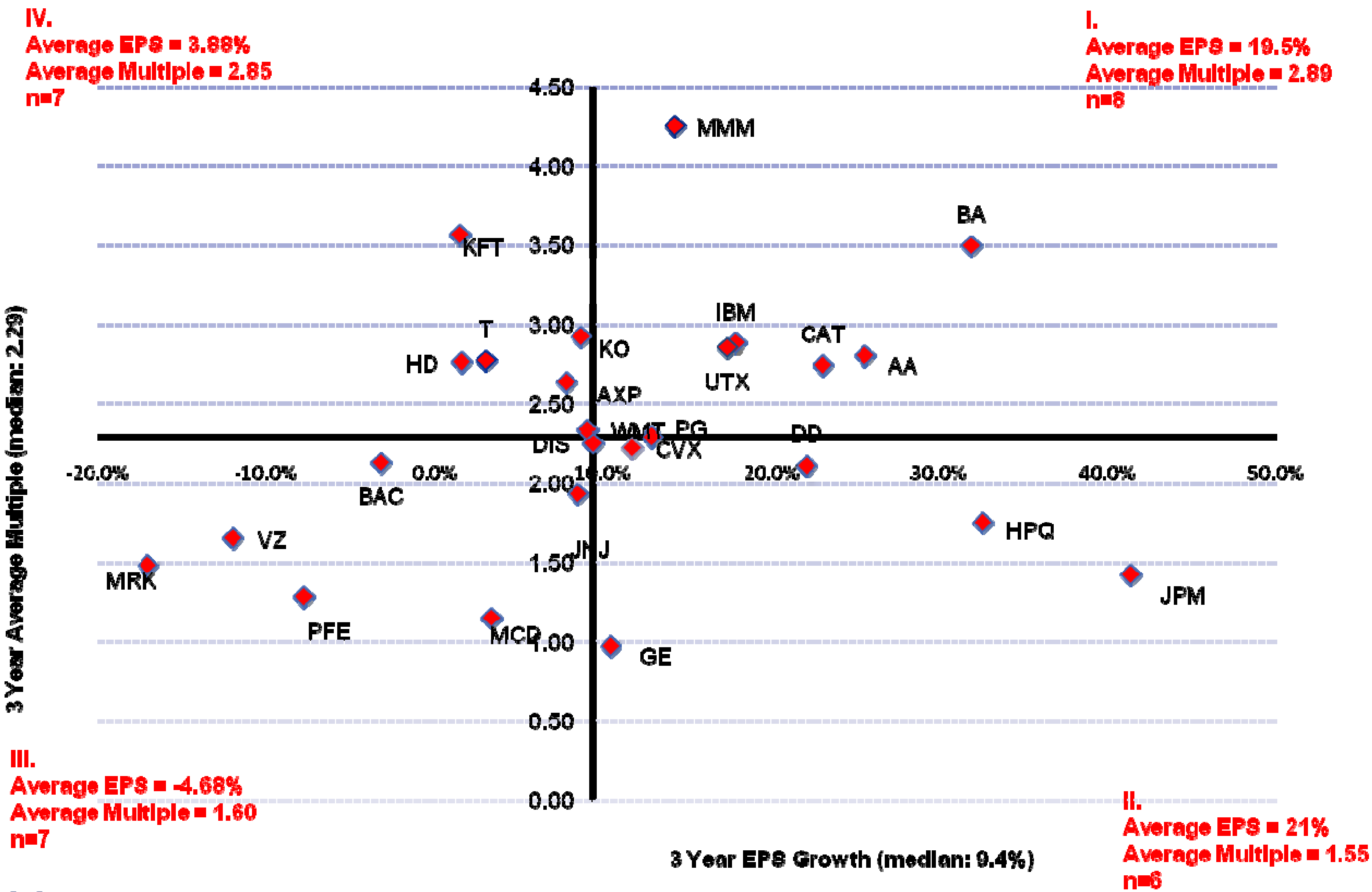
Findings

Three Year EPS: CEO vs. 2nd Highest Paid



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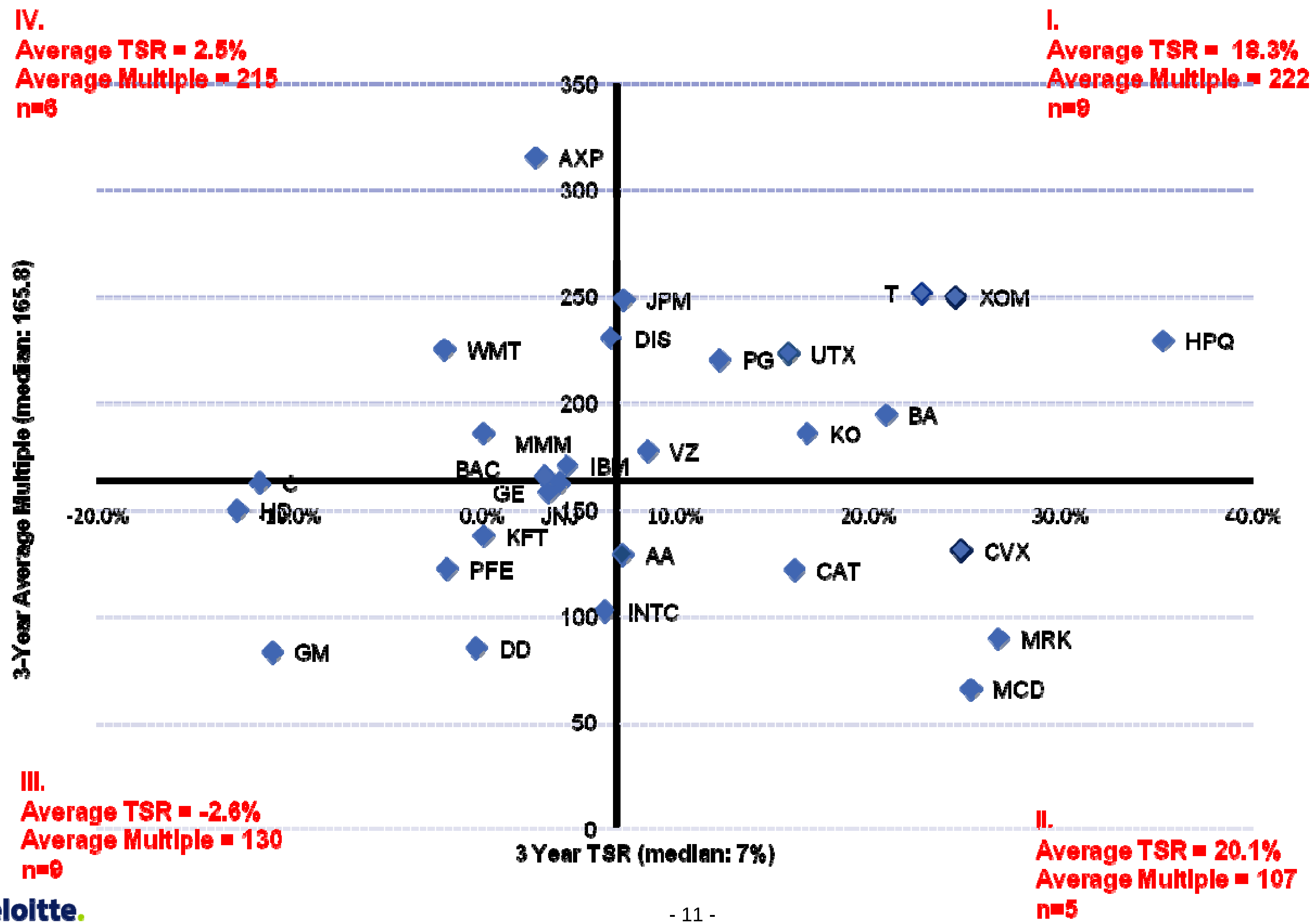
Findings

Three Year TSR: CEO vs. Middle Management



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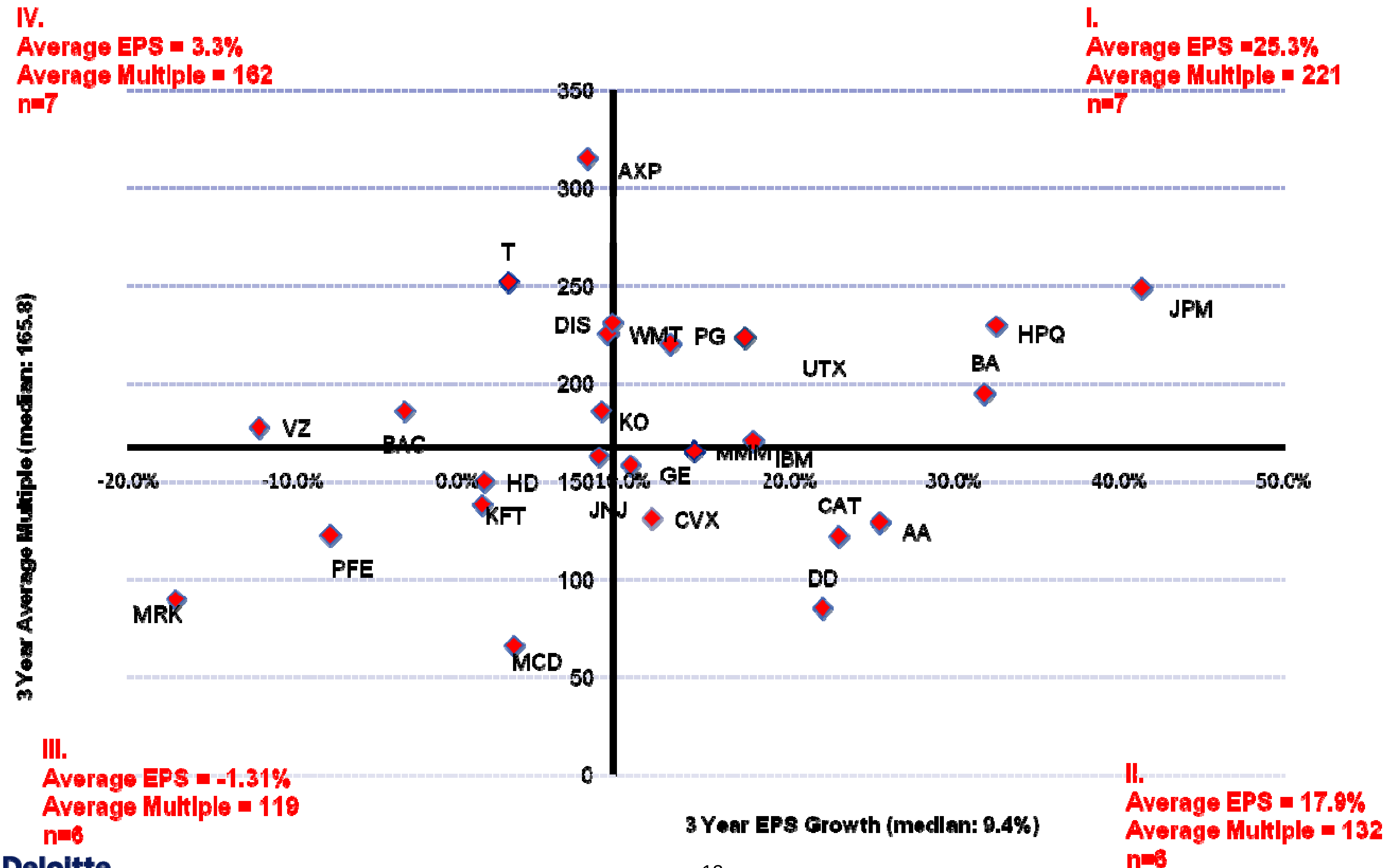
Findings

Three Year EPS: CEO vs. Middle Management



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Appendix – DOW 30

Company Name	Ticker	CEO/2nd Highest Paid			CEO/Middle Management		
		3 Yr TSR	3 Yr EPS Growth	Multiple	3 Yr TSR	3 Yr EPS Growth	Multiple
HOME DEPOT INC	HD	-12.7%	1.6%	2.76	-12.7%	1.6%	149.9
CITIGROUP INC (1)	C	-11.6%	-	-	-11.6%	-	-
GENERAL MOTORS CORP	GM	-10.9%	-	1.80	-10.9%	-	83.3
WAL-MART STORES INC	WMT	-2.0%	9.1%	2.33	-2.0%	9.1%	225.3
PFIZER INC	PFE	-1.8%	-7.7%	1.28	-1.8%	-7.7%	122.5
DU PONT (E.I.) DE NEMOURS	DD	-0.3%	22.1%	2.11	-0.3%	22.1%	85.1
KRAFT FOODS INC-CLASS A	KFT	0.1%	1.5%	3.56	0.1%	1.5%	138.0
BANK OF AMERICA CORP	BAC	0.1%	-3.2%	2.13	0.1%	-3.2%	185.9
AMERICAN EXPRESS CO	AXP	2.8%	7.8%	2.63	2.8%	7.8%	315.3
3M CO	MMM	3.2%	14.3%	4.25	3.2%	14.3%	165.8
GENERAL ELECTRIC CO	GE	3.4%	10.5%	0.97	3.4%	10.5%	158.2
JOHNSON & JOHNSON	JNJ	4.0%	8.5%	1.93	4.0%	8.5%	163.0
INTL BUSINESS MACHINES CORP	IBM	4.4%	17.9%	2.88	4.4%	17.9%	170.7
INTEL CORP	INTC	6.3%	0.6%	2.48	6.3%	0.6%	102.6
WALT DISNEY CO/THE	DIS	6.6%	9.4%	2.25	6.6%	9.4%	230.7
ALCOA INC	AA	7.3%	25.6%	2.80	7.3%	25.6%	129.0
JPMORGAN CHASE & CO	JPM	7.3%	41.4%	1.42	7.3%	41.4%	248.8
VERIZON COMMUNICATIONS INC	VZ	8.6%	-12.0%	1.65	8.6%	-12.0%	177.3
MICROSOFT CORP	MSFT	11.5%	18.6%	0.12	11.5%	18.6%	9.5
PROCTER & GAMBLE CO	PG	12.3%	12.9%	2.29	12.3%	12.9%	220.5
UNITED TECHNOLOGIES CORP	UTX	15.9%	17.4%	2.85	15.9%	17.4%	223.3
CATERPILLAR INC	CAT	16.2%	23.1%	2.74	16.2%	23.1%	122.0
COCA-COLA CO/THE	KO	16.8%	8.7%	2.92	16.8%	8.7%	185.9
BOEING CO	BA	20.9%	31.9%	3.49	20.9%	31.9%	194.6
AT&T INC	T	22.8%	3.1%	2.77	22.8%	3.1%	251.8
EXXON MOBIL CORP	XOM	24.6%	23.2%	2.37	24.6%	23.2%	250.0
CHEVRON CORP	CVX	24.9%	11.8%	2.22	24.9%	11.8%	131.0
MCDONALD'S CORP	MCD	25.4%	3.4%	1.15	25.4%	3.4%	65.7
MERCK & CO. INC.	MRK	26.8%	-17.0%	1.48	26.8%	-17.0%	89.5
HEWLETT-PACKARD CO	HPQ	35.3%	32.6%	1.75	35.3%	32.6%	229.6
25th Percentile		0.8%	2.7%	1.75	0.8%	2.7%	122.5
Median		**7.0%**	**9.9%**	**2.29**	**7.0%**	**9.9%**	**165.8**
75th Percentile		16.7%	19.5%	2.77	16.7%	19.5%	223.3

(1) Outlier: Removed from EPS Charts

CompensationStandards.com: "5th Annual Executive Compensation Conference"

Benchmarking Pitfalls & Questions Compensation Committees Should be Asking their Executive Compensation Consultant

Deloitte Consulting LLP

October 22, 2008

Deloitte.

Contents

Benchmarking Pitfalls

1. Peer group development
   - Peer group selection is all too often based on revenues; while revenue is an important factor, other measures such as market capitalization or enterprise value, number of employees, assets, and capital expenditures should also be considered in evaluating size. In addition, number of business units, internationality, average employee wages, too name a few, should also be added to the selection criteria for determining an appropriate peer group to incorporate “complexity” as well as size.

2. Too few data sources are utilized
   - Some companies are too dependent on one source of information. A far better approach is to consider multiple sources; if one data set is far higher than three or four other data sources it might indicate something is wrong with the “preferred” survey source.

3. Biased peer group/survey sample
   - Selecting peer companies that are larger, better performing, and /or higher paying.
   - A common example is the use of a “high performance” peer group.

4. Weak regression coefficients
   - For example, regression coefficients less than 40%, means 60% or more of the difference in pay is unrelated to the independent variable (typically revenue).
   - Thus, the regressed data is a lot less reliable. Consider using the un-regressed quartile data closest to the company’s size.

5. Position matches do not reflect the scope of the jobs being benchmarked and/or incorrect position matching
   - Companies may inadvertently match their positions against benchmark positions with significantly higher responsibilities. All too often, if a company's position is higher paid relative to the survey data, the interpreter may try and explain the company’s incumbent has more responsibilities, a different reporting relationship, or other factors to justify the higher pay.
   - Common mistakes include comparing a Division President to a Chief Operating Officer; a Top HR Executive to a Chief Administrative Office; and a V.P. Operations to a Division President due to some modest additional responsibilities.

Benchmarking Pitfalls *(cont.)*

6. Insufficient position matches
   - A minimum of 8-10 matches are needed for comparison.
   - Even with 8-10 position matches, corroborating data from other surveys is needed to evaluate the reasonableness of the results.
   - It is generally not appropriate to calculate median, 25^{th}, and 75^{th} percentiles with fewer than seven data points.
7. Aging data and salary effective dates
   - All compensation components are updated for inflation factors – salary, annual incentive and long-term incentives, as opposed to just base salary. While there is strong evidence to show salaries increase 3-4% per year, incentive pay fluctuates far more with performance than inflation. Thus, updating actual bonuses or long-term incentives for inflation may not be appropriate.
   - When base salaries are updated, it is important that the data be updated on a consistent basis, as surveys have different effective dates.
8. Valuing long-term incentives (“LTI”)
   - Long-term incentives are calculated by the data provider one way, and the company another way. For example, if the survey assumes the full option term, and the company uses the expected term, the over-granting of options will result because the value assigned to the company’s stock option is understated.
9. Setting target annual and long-term incentive amounts based on actual payouts at other peer companies
   - Most surveys report data based on actual bonuses. In times of strong economic expansion and company performance, it is common for actual bonuses to be above the target level. Companies that rely on high actual bonuses reported in the survey to justify raising their target bonus opportunities cause total compensation levels to escalate over time. Where possible, target rates of pay should be analyzed (although beware of companies targeting the 75^{th} percentile).
10. Actual compensation levels are compared to survey and/or proxy data without consideration for performance
    - For example, if a company is 20% below the median, but annual incentive payments were below target levels due to poor performance, is below median compensation really an issue?
11. Including special one-time new hire/promotion or buy-out awards in total compensation comparisons
    - This increases competitive compensation levels and skews the benchmarking analysis. Sometimes the interpreter knows a grant is a one-time special event and may normalize it by assuming it will be repeated every three or five years when in fact it is not. It would generally be best to exclude such amounts from the data.

Benchmarking Pitfalls *(cont.)*

12. Misuse of statistics/ statistical bias

- Focusing on pay averages rather than medians, and disregarding zeros when computing averages and medians. For example, if 5 of 10 companies grant time-based restricted stock and the average of these 5 companies is $500,000, it is not correct to conclude the peer companies grant restricted stock with a median value of $500,000. By including the zeros, the median will be well below $500,000.

13. Emphasis on cash compensation over equity compensation, or fixed compensation over variable compensation.

- Surveys often do not take into account that some companies may put greater emphasis on cash compensation over equity compensation, or fixed over variable compensation.
- Where possible, try to use survey data that details the pay mix, and the weightings of each pay element.

14. Total Compensation Focus

- All compensation decisions should be made in a total compensation context. Evaluating compensation one element at a time will inevitably lead to unintended consequences. For example, base salaries may be very low, but are *more than* offset by higher incentive opportunities. If the company was to correct the base salary shortfall without regard to the impact on total compensation, it is likely compensation levels will exceed the desired level.

15) Not applying forward-looking methodology

- Recent Form 10-Q, Form 8-K and Form 4 filings for peer companies should be reviewed to identify whether current-year data is available regarding new and amended employment agreements, updated base salaries, new equity-based grants, stock option exercises, restricted stock vesting, stock sales, etc., in addition to the data reported in the peer companies' most recently filed proxy statements. This way pay decisions are based on the most current data available.

Questions Committee Members Should be Asking their Consultant

Pay Levels & Philosophies

1. Are our pay practices consistent with our stated pay philosophy?
2. How was the peer group selected? What is the peer group(s) composition and structure? Have you considered using multiple peer groups?
3. How does our mix of at-risk versus fixed pay compare to peers?
4. Are we analyzing and comparing annual incentives at target award opportunities, as well as actual payout levels?
5. Are we valuing long-term incentives on a consistent basis with the survey data? How do you take into account the impact of performance conditions on the value of the awards?
6. How do changes in compensation decisions between base salary, annual incentives and LTI grants affect the executives' severance, deferred compensation and retirement benefit rights?
7. How should we factor internal pay equity, wealth accumulation, and company performance to the normal benchmarking process?
8. Are the severance payments under our various termination scenarios reasonable?
9. What are the advantages and disadvantages of a "hold-until-retirement" stock retention policy?

Pay For Performance

10. Are the annual and long-term performance targets established appropriately? How do we test for reasonableness?
11. Can you demonstrate how well we "pay for performance"'?
12. Are we getting a good return on our incentive expenditures? Can you measure how our return compares to other companies?
13. Is there sufficient differentiation in pay based on individual performance? How are the VP level positions and higher evaluated as a group?

Questions Committee Members Should be Asking their Consultant *(cont.)*

Governance & Controls

14. What are the total fees for executive compensation consulting services? What are the total consulting fees paid to your firm? Shouldn't we have a quarterly review process for other services to ensure there are no conflicts of interest, real or perceived?

15. What internal control process should we have in place to ensure that our executive compensation decisions are properly implemented and our SEC disclosures are accurate?

16. What risk management controls are necessary to ensure our incentive programs do not encourage excessive risk-taking?

17. What is the extra cost to the Company, if any, of Section 162(m)?
    - What can we do to ameliorate the cost?

18. When is the last time you performed a "clean slate" peer review where everything was "on the table":
    - Industry, size (based on market cap, revenues, assets, etc.,), business orientation, organizational style and other similarities and differences between company and various potential comparators.
    - Relative financial and non-financial performance of the company (and its senior executives) vs. comparators (and their senior executives) currently and over last 2-3 years.
    - Any major changes in, and developments regarding, the company's business focus and its longer-term strategic goals. Is the Committee looking at a full set of peer group data points?

Shareholders & Employee Relations

19. Why did we get poor grades (or withhold/against votes) from RiskMetrics or Glass Lewis? Are their criticisms justified?

20. If we are required to adopt "Say for Pay," how would our shareholders react? What steps could we take to ensure a "thumbs-up" vote?

21. Are there other best practices we should consider?

22. How does the workforce feel about our executive compensation practices? What issues have they raised about our total rewards strategy?

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[Ed: This excellent chart is the product of a joint effort by Watson Wyatt and Deloitte Consulting]

Wealth Accumulation/Full Walk Away Amounts - CEO

Other Potential Post-Employment Payments

Element	Voluntary Resignation	Involuntary For Cause	Involuntary Without Cause	CIC	Disability[1]	Death[2]	Retirement
Value of Previously Vested Stock Options and Pension Benefits*							
Vested & Unvested Stock Options & Restricted Stock	18,000,000	18,000,000	18,000,000	18,000,000	18,000,000	18,000,000	18,000,000
Vested Benefits & Perquisites							
Pension	14,000,000	14,000,000	14,000,000	14,000,000	14,000,000	14,000,000	14,000,000
Deferred Compensation	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Subtotal Pension Benefits	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000
Total	**$ 33,500,000**	**$ 33,500,000**	**$ 33,500,000**	**$ 33,500,000**	**$ 33,500,000**	**$ 33,500,000**	**$ 33,500,000**
Gains Realized in Last 5 Years							
Option gains realized 2004 - 2008	12,800,000	$ 12,800,000	$ 12,800,000	$ 12,800,000	$ 12,800,000	$ 12,800,000	$ 12,800,000
Full value shares vested 2004 - 2008	6,200,000	$ 6,200,000	$ 6,200,000	$ 6,200,000	$ 6,200,000	$ 6,200,000	$ 6,200,000
Total Gains Realized	$ 19,000,000	$ 19,000,000	$ 19,000,000	$ 19,000,000	$ 19,000,000	$ 19,000,000	$ 19,000,000
Gains Realized in Last 10 Years							
Option gains realized 1999 - 2008	$ 17,600,000	$ 17,600,000	$ 17,600,000	$ 17,600,000	$ 17,600,000	$ 17,600,000	$ 17,600,000
Full value shares vested 1999 - 2008	$ 8,900,000	$ 8,900,000	$ 8,900,000	$ 8,900,000	$ 8,900,000	$ 8,900,000	$ 8,900,000
Total Gains Realized	$ 26,500,000	$ 26,500,000	$ 26,500,000	$ 26,500,000	$ 26,500,000	$ 26,500,000	$ 26,500,000
Current Wealth Accumulation/Full Walk Away Amounts	**$ 60,000,000**	**$ 60,000,000**	**$ 60,000,000**	**$ 60,000,000**	**$ 60,000,000**	**$ 60,000,000**	**$ 60,000,000**
Accelerated Equity, Enhanced Severance and Benefits							
Cash Severance							
Base Salary + Bonus	$ -	$ -	$ 10,000,000	$ 11,000,000	$ -	$ -	$ -
Pro-rata Target Bonus	-	-	-	2,000,000	-	-	-
Total Cash Severance	-	-	*10,000,000*	*13,000,000*	-	-	-
Pension Benefit Enhancements							
Pension	-	(4,000,000)	3,000,000	3,000,000	-	-	-
Deferred Compensation	-	-	-	-	-	-	-
Subtotal Pension Benefits	-	(4,000,000)	3,000,000	3,000,000	-	-	-
Other Benefits & Perquisites							
Health and Welfare Benefit Continuation	-	-	25,000	25,000	-	-	-
Executive Benefits & Perquisites Continuation	-	-	100,000	100,000	-	-	-
Subtotal Benefits & Perquisites	-	*(4,000,000)*	*13,125,000*	*16,125,000*	-	-	-
280G Tax Gross-Up	-	-	-	11,600,000	-	-	-
Total Severance, Pension Enhancements, Benefits	-	*(4,000,000)*	*13,125,000*	*27,725,000*	-	-	-
Long-Term Incentives Accelerated Values							
In-the-Money Value of Accelerated Stock Options	-	-	-	10,000,000	10,000,000	10,000,000	-
Value of Accelerated Restricted Stock	-	-	-	5,000,000	5,000,000	5,000,000	-
Total Value of Accelerated Equity Grants	-	-	-	*15,000,000*	*15,000,000*	*15,000,000*	-
Total Accelerated Equity, Enhanced Severance and Benefits	**$ -**	**$ (4,000,000)**	**$ 13,125,000**	**$ 42,725,000**	**$ 15,000,000**	**$ 15,000,000**	**$ -**
Wealth Accumulation/Full Walk-Away Amounts							
Full Walk Away Amounts	**$ 33,500,000**	**$ 29,500,000**	**$ 46,625,000**	**$ 76,225,000**	**$ 48,500,000**	**$ 48,500,000**	**$ 33,500,000**
Gains Realized in Last 10 Years	**26,500,000**	**26,500,000**	**26,500,000**	**26,500,000**	**26,500,000**	**26,500,000**	**26,500,000**
Wealth Accumulation/Full Walk Away Amounts	**$ 60,000,000**	**$ 56,500,000**	**$ 73,125,000**	**$ 102,725,000**	**$ 75,000,000**	**$ 75,000,000**	**$ 60,000,000**

[1]Excludes present value of disability benefits provided by XYZ Insurance Company valued at $9.6 million.

[2]Excludes death benefit of $6 million attributable to XYZ Insurance Company policies.

*Values previously disclosed on Outstanding Equity Table and Pension Table

Projected Wealth Accumulations/Full Walk Away Amounts

Element	Voluntary Resignation	Involuntary For Cause	Involuntary Without Cause	CIC	Disability[1]	Death[2]	Retirement
Projected Walk Away Amounts Based on Existing Equity in Five Years Assuming:							
15% TSR	$ 51,000,000	$ 47,000,000	$ 64,125,000	$ 93,725,000	$ 59,000,000	$ 59,000,000	$ 51,000,000
10% TSR	$ 44,600,000	$ 40,600,000	$ 57,725,000	$ 90,725,000	$ 54,000,000	$ 54,000,000	$ 44,600,000
5% TSR	$ 38,800,000	$ 34,800,000	$ 51,925,000	$ 87,725,000	$ 50,000,000	$ 50,000,000	$ 38,500,000
0% TSR	$ 33,500,000	$ 29,500,000	$ 46,925,000	$ 76,225,000	$ 48,500,000	$ 48,500,000	$ 33,500,000
Projected Walk Away Amounts in Five Years including Future Equity Grants Assuming[3]:							
15% TSR	$ 61,000,000	$ 57,000,000	$ 74,125,000	$ 115,000,000	$ 68,000,000	$ 68,000,000	$ 61,000,000
10% TSR	$ 51,000,000	$ 47,000,000	$ 65,725,000	$ 110,000,000	$ 60,000,000	$ 60,000,000	$ 51,000,000
5% TSR	$ 43,000,000	$ 38,000,000	$ 58,925,000	$ 95,000,000	$ 56,000,000	$ 56,000,000	$ 43,000,000
0% TSR	35,500,000	31,000,000	$ 50,925,000	$ 80,000,000	$ 50,500,000	$ 50,000,000	$ 35,500,000
Projected Walk Away Amounts Based on Existing Equity in 10 Years Assuming:							
15% TSR	$ 82,100,000	$ 75,700,000	$ 103,300,000	$ 150,900,000	$ 95,000,000	$ 95,000,000	$ 82,100,000
10% TSR	$ 64,000,000	$ 58,300,000	$ 82,900,000	$ 130,200,000	$ 77,500,000	$ 77,500,000	$ 64,000,000
5% TSR	$ 49,500,000	$ 44,400,000	$ 66,300,000	$ 112,000,000	$ 63,800,000	$ 63,800,000	$ 49,500,000
0% TSR	$ 33,500,000	$ 29,500,000	$ 46,925,000	$ 76,225,000	$ 48,500,000	$ 48,500,000	$ 33,500,000
Projected Walk Away Amounts in 10 Years including Future Equity Grants Assuming[4]:							
15% TSR	$ 104,900,000	$ 98,500,000	$ 126,100,000	$ 191,900,000	$ 116,200,000	$ 116,200,000	$ 104,900,000
10% TSR	$ 79,400,000	$ 73,700,000	$ 100,600,000	$ 164,100,000	$ 92,300,000	$ 92,300,000	$ 79,400,000
5% TSR	$ 60,700,000	$ 54,300,000	$ 81,100,000	$ 127,000,000	$ 77,300,000	$ 77,300,000	$ 60,700,000
0% TSR	$ 40,500,000	$ 36,000,000	$ 55,925,000	$ 85,000,000	$ 55,500,000	$ 55,500,000	$ 40,500,000

Total Projected Wealth Accumulation/Full Walk Away Amounts
(Add to the above amounts the $26,500 representing gains realized in the 10 year period prior to 2008)

[1]Excludes present value of disability benefits provided by XYZ Insurance Company valued at $9.6 million.
[2]Excludes death benefit of $6 million attributable to XYZ Insurance Company policies.
[3]Assumes equity awards equal to December 2007 grant values are also awarded in 2008 and 2009.
[4]Assumes equity awards equal to December 2007 grant values are also awarded in 2008 through 2014.

Compensation Standards

Summer 2008

The Executive Compensation Newsletter for Directors and Advisors

Wealth Accumulation–And Full "Walk Away" What You Need to Know–And Do

One of the essential tools that compensation committees need in order to evaluate whether they are properly setting a CEO's compensation is the wealth accumulation analysis. Its use is growing and we expect it to be as ubiquitous as the tally sheet within a few years. Indeed, a wealth accumulation/full "walk away" analysis should be part of every company's tally sheet process. Because we expect more companies to be using wealth accumulation analyses—and providing disclosure of the process and findings in this coming year's proxy statement—we are devoting the lead article in this issue to the topic.

What is a Wealth Accumulation Analysis?

A wealth accumulation analysis looks at past, present and future value generated by all compensation elements that an executive has earned (or will earn). It's a series of tables to illustrate the values of various pay elements—and total compensation—over a long time horizon and to determine their effectiveness in achieving the goals of the compensation committee. Among other components, the wealth accumulation analysis typically includes:

- gains from past and future equity grants
- future salaries and bonuses
- non-equity longer-term cash compensation
- pension/defined contribution and other payouts including severance and CIC

While the approach to wealth accumulation analyses may vary, the desired outcome is always the same—for the compensation committee to understand the total wealth potential of certain past and all future compensation elements that an executive may be entitled to under existing arrangements before making additional decisions about that executive's pay package. It helps boards focus on amounts an executive has realized—and could realize in the future—from past pay decisions.

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Wealth accumulation analyses are a necessary complement to tally sheets. Tally sheets provide a window to see what an executive is earning at a specific moment in time; wealth accumulation analyses provide a broader window into what an executive may realize—and accumulate—at future points in time (particularly at retirement or "walk away").

Why a Wealth Accumulation Analysis Is Important

The objectives of utilizing a wealth accumulation analysis and a tally sheet overlap. They allow the board to see and assess what an executive is already entitled to before making compensation decisions with respect to that executive. Use of both of these essential tools is important so that a board can prove it made an informed decision when making pay decisions, thereby fulfilling a director's fiduciary duty of care. Both of these tools provide some context for the impact of new decisions and help the board to gauge whether it is achieving the objectives of its pay program.

A wealth accumulation analysis helps the board decide whether there may be decreasing returns from providing additional compensation to an executive because that person already has sufficient incentive to perform. It assists the board to consider "how much is enough?" and even "how much is too much?" These are difficult determinations to make and a board will need this very relevant data to make such important decisions. Preparing a wealth accumulation analysis requires some effort—but without it, a board is flying in the dark and not considering its ultimate destination.

Another important benefit of conducting a wealth accumulation analysis is that it allows the company to have a better sense of what future proxy disclosures might look like under the company's existing arrangements with its Named Executive Officers. This allows the board to take any "corrective" action now to avoid unintended consequences that can lead to public embarrassment and shareholder activism that could challenge the directors personally.

Corrective action may take the form of reconsidering additional awards that the board might otherwise have granted or even negotiating with an executive to rework a pay arrangement that may no longer be appropriate (*e.g.*, post-retirement and severance arrangements where an executive has already accumulated so much wealth to make these "safety nets" inappropriate).

Another important benefit of these analyses should not be overlooked. A board can test the reasonableness of its decisions today from both an internal and a public perspective. Since wealth accumulation analyses can be used to compare what potentially will be paid out to executives to what wealth shareholders will earn over time, today's directors can more easily put themselves in the shoes of current—and future—shareholders and prevent the angry reactions that are playing over and over in the media these days. Again, corrective action can be taken now to avoid embarrassment and exposure (particularly to address walk away amounts in situations where shareholder returns turn out to be low—"pay for failure").

How to Implement a Wealth Accumulation Analysis

In the following two tables, we provide some illustrative examples. The first step to create a wealth accumulation analysis is to establish a baseline for what is in place today. The primary focus typically is on the equity and retirement benefits that an executive has accumulated to date.

Table 1

	Wealth Accumulation Today ($millions)					
Name	Total Cash Compensation[1]	Current Equity Holdings ($M)[2]	Value of Shares Sold Past 10 Years ($M)[3]	Future LTI Grants[4]	Retirement Benefits[5]	Total
Executive A	$2.6	$15.0	$0.0	N/A	$0.6	$18.2
Executive B	$1.6	$7.0	$3.0	N/A	$0.3	$11.9
Executive C	$1.3	$8.0	$1.2	N/A	$0.3	$10.8
Executive D	$1.0	$5.0	$0.5	N/A	$0.1	$6.6

Estimated future values are shown in millions

(1) Equals current base salary plus 2008 target annual incentives.
(2) Current holdings includes vested and unvested stock options and restricted shares.
(3) Represents the realized value, before taxes, of any shares sold between 12/31/98 and 12/31/08.
(4) Not applicable as shows wealth accumulation as of 12/31/08.
(5) Includes total balance of 401(k) and deferred compensation plans.

From there, projections should be made to determine what the executive's wealth accumulation will look like going forward. This will help you to understand what that executive's proxy disclosure will look like in a future year. Considerations include factoring in gains from option exercises so that executives who hold their options and stock until retirement are not perversely penalized.

Note that Table 2 only projects out five years. The actual table the board reviews should project further out (in five year installments) to the executive's estimated retirement date so that the compounding impact of growth and ongoing grants on the executive's final walk away amount is fully understood by the board.

Table 2

	Estimated Value at 12/31/13 ($millions)							
Name	Total Cash Compensation[1]	Current Equity Holdings in Total ($M)[2]	Increase in Value of Current Equity Holdings ($M)[3]	Value of Shares Sold past 10 years	Future LTI Grants[5,6]	Retirement Benefits[7]	Total Value Using Final Equity Value	Total Value Using Incremental Equity Value
Executive A	$14.2	$19.7	$4.7	$0.0	$10.5	$1.0	$45.4	$30.4
Executive B	$8.7	$9.2	$2.2	$4.8	$6.2	$0.5	$29.4	$19.4
Executive C	$7.1	$10.5	$2.5	$1.9	$4.4	$0.5	$24.4	$15.2
Executive D	$5.5	$6.6	$1.6	$0.8	$2.1	$0.2	$15.1	$9.6

Estimated future values are shown in millions

(1) Equals the sum of base salary and 2008 target bonus based on current base salary and target annual incentive % grown at 3% over 5 years (does not include any additional interest).
(2) Current holdings includes vested and unvested stock options and restricted shares.
(3) Only includes the incremental growth in equity value from 12/31/08 to 12/31/13.
(4) Represents the realized value, before taxes, of any shares sold between 12/31/98 and 12/31/08, assuming subsequent growth in equity value.
(5) Assumes annual 3% per year growth in the expected value of LTI grants.
(6) Assumes 75% of the target share award vests and 40% of the vested shares are sold to pay taxes.
(7) Only includes employer-related balances. Assumes 3% annual growth in 401(k) and Deferred Compensation balances per year with ongoing employer contributions equal to those made in 2008. Represents total, not incremental, value.
* Only future LTI grants have been adjusted for taxes. All other components are pre-tax amounts.

A Full Blown Chart

For simplicity sake, Table 2 does not include additional amounts that would be paid out in the event of severance or change in control. These are essential amounts that should be provided in the wealth accumulation/walk away chart reviewed by the board. Space does not permit inclusion here of a full blown chart. Please see the model "Wealth Accumulation/Full Walk Away Amounts" chart (an excellent chart that is the product of a joint effort by Watson Wyatt and Deloitte Consulting) that we have posted in the "Wealth Accumulation Analysis" Practice Area of CompensationStandards.com.

Compare Against Wealth Created for Shareholders

Ultimately, the incremental wealth creation for each of the NEOs should be compared to the wealth created for shareholders. Readers are directed to the tables we have posted on CompensationStandards.com prepared by Towers Perrin that compares projected wealth accumulation even in situations where shareholder returns are flat.

A Few Additional Pointers

When conducting a wealth accumulation analysis, there are a few things to bear in mind. First, it's just a tool and common sense still needs to be applied to any decisions. Second, the assumptions used are critical—they must be reasonable and be capable of being supported. Third, the timeframes used should be reasonable. Failing to project far enough can mask the potential growth over time. Note the importance of including a projection to retirement to gain a full understanding of the final walk away amounts—which may help the compensation committee assess whether severance and post-retirement "safety nets" are no longer appropriate. Finally, peer group comparisons have no place here—this is an internal look.

Readers will not want to miss important panels addressing wealth accumulation and walk away amounts at the upcoming "5th Annual Executive Compensation Conference."

Importance of Wealth Accumulation: The Consultants Speak Out

"If you don't know where you are going, you might wind up someplace else."

—*Yogi Berra*

"If you don't know where you are going, any road will do."

—*Lewis Carroll, Alice in Wonderland*

Below are two sets of commentary from respected compensation consultants on the importance of wealth accumulation in analyzing—and setting—a CEO's total pay package:

From Mike Kesner, Head of Deloitte Consulting's Executive Compensation Practice:

> "A wealth accumulation analysis is essential for determining the current and projected value that a CEO has accumulated (or may accumulate) under the company's incentive and retirement programs. Unlike the traditional annual benchmarking and pay-setting process, a wealth accumulation analysis allows the compensation committee to evaluate the reasonableness of past compensation decisions based on what was actually earned and what future values would be under multiple projected performance scenarios. Wealth accumulation analysis also considers realized compensation from stock option gains, performance share payouts, etc. It allows committees to compare actual results to the targeted level of pay, when pay decisions were initially made and to company—and executive—performance.
>
> Critics argue that any adjustments to pay (presumably downward) as a result of a wealth accumulation analysis would be unfair; a penalty for success. Some companies indicated in this year's proxy that such analyses had no impact on current pay decisions. That is unfortunate. A wealth accumulation analysis should be a key aspect of every compensation committee's analysis and decision-making.
>
> Wealth accumulation analyses allow the compensation committee to ask if there is a point at which the CEO's accumulated and/or projected wealth makes severance necessary or appropriate. It also allows the committee to question the types of long-term incentive awards being provided and the degree of risk built into such awards.
>
> Wealth accumulation analyses can be the compass that helps guide future decisions on CEO pay. Armed with this information, it can help ensure pay-for-performance, internal equity and defensible pay policies."

From Eric Marquardt, Principal in Towers Perrin's Executive Compensation Practice:

> "Information on the relative and absolute value of potential wealth accumulation from long-term incentives for top executives is a critical part of the Compensation Committee's due diligence responsibilities. Timely information on potential wealth accumulation provides input the Committee can use to make adjustments before long-term incentive pay becomes outsized. And it can help in communicating the pay opportunity to executives themselves, improving retention and even individual commitment."

A Think Piece for Directors and Consultants

The Challenges of Relative Financial Measures: What Measure(s) to Use?

By Michael Kesner, Head of Deloitte Consulting's Executive Compensation Practice

Under the SEC's new disclosure rules, we have heard about the challenges of disclosing metrics. Based on my experience, trying to establish a three year financial target to be used in a long-term incentive plan (LTIP) can be very challenging. Some companies will use—or consider—using relative financial performance, figuring "if we perform at least as well or better than our peers, we deserve to be paid our LTIP award."

What Measure(s) to Use?

While the use of relative financial performance is very appealing—as it avoids the need to (a) establish three year financial targets and (b) disclose targeted financial results in the CD&A—there are many practical challenges, including:

1. What measure(s) should be used?
2. Who is the relevant peer group?
3. Do we rely on reported results or make adjustments for unusual items?

Relative financial measures—such as EPS and revenue growth, three-year average ROIC and ROE, etc.—may all provide a useful gauge about how well the company is doing relative to peers. However, depending on a company's particular strategy, relative results may fall below the peer group median.

For example, a company may be willing to give up a little ROIC to attain higher revenue growth. Similarly, a bottom quartile ROIC performer may need to focus on profit improvement to exit the profitability cellar. As a result, revenue growth may be negative. Thus, the selection of the right relative financial measure must support the company's business objectives.

Also, relative performance—particularly EPS growth—can be significantly impacted by your starting point. For example, if a company barely broke-even last year, any improvement will yield a large percentage increase in EPS, vaulting the company to the upper quartile of its peers. Not many compensation committees are willing to pay maximum incentives for an increase in EPS of $.03 to $.06, even though it represents 100% growth and 90th percentile relative performance.

Who is the Relevant Peer Group?

Most of my clients struggle with determining the right peer group for performance comparisons. You might say: What do you mean? Don't you already have a peer group you use for compensation purposes? What's wrong with those companies? As I have learned, in some—but very limited—cases, the compensation peer group is reasonable for relative financial performance comparisons. For example, it might be reasonable for a specialty chemical company to use a relatively broad chemical group for pay comparisons—but because it only has two true competitors, relative performance comparisons to the entire peer group may be unreasonable as the demand for their products, cost of goods, etc. can be vastly different from the broader peer group.

Similarly, an oilfield services company might have a well-defined peer group, but relative financial performance comparisons should probably be limited to just the capital intensive peers, rather than the entire peer group.

And what about companies with a unique niche or conglomerate status? These companies often defy categorization, and trying to build a relevant peer group can be quite difficult. Some companies might default to a broad index, like the S&P 500, but I think such broad market comparisons are relevant only if you are using relative total shareholder return (as opposed to an earnings, return or growth measure).

Reported or Adjusted Results?

In my experience, relative financial comparisons become very complicated and lose credibility with the compensation committee and senior management team when the results are skewed by unusual items. For example, if a peer company had an asset impairment last year, this year's ROIC may be at the top of the peer group. Why? Not because of improved financial performance, but because its capital has been largely written-off. Thus, even a modest profit makes the company look like it is batting .400.

Do you adjust for this, or simply use the "as reported" figures? Same goes for companies that have unusual gains or losses, severance costs associated with a plant closing, etc. If you decide to adjust for these items, you often end up having to restate the financials for the entire 15-20 company peer group. If you decide to "play it where it lies" you may unjustly penalize or reward your executives.

My Preference

Generally, I prefer to use relative TSR based on the same peer group used for compensation purposes and three-year budgeted financial goals (like cumulative EPS or 12% ROIC). That way, management is being rewarded based on both a shareholder friendly measure (*i.e.,* TSR) and a measure that they can more directly influence (*e.g.,* a three-year internal goal). Although this approach has its own set of challenges and issues, it has served my clients and their shareholders pretty well over time.

Heads-Ups

Hold 'Til Retirement Provisions

We expect Hold 'Til Retirement policies for CEOs and top executives to be one of the biggest changes that companies will be implementing (and that institutions will be focusing on) in time to disclose in this year's proxy statements. Anyone who has not yet seen the excellent piece on HTRs in the September-October 2008 issue of *The Corporate Executive* will find it a "must" read. Be sure that your CEO sees this issue. This is one area where we can see companies taking the lead with very little downside cost.

A Roadmap to Comply with the SEC's New Regulation FD Guidance

Now that the SEC has made dramatic changes to its positions on what companies can—and should—do online, opportunities (and pitfalls) abound. The Fall issue of the *InvestorRelationships.com* newsletter provides important practical guidance that our readers who counsel public companies need right now. It includes numerous specific examples of what you should—and should not—be doing to comply with the SEC's new positions.

The newsletter is an integral part of the important new website—*InvestorRelationships.com*—that Broc Romanek has created to help all those responsible for investor relations and corporate governance keep abreast of the fast-paced changes impacting this area. Be sure that you are taking advantage of this invaluable, new resource.

To receive the Fall issue of *InvestorRelationships.com* and to access the critical upcoming Webconference "The SEC's New Corporate Website Guidance: Everything You Need to Know—And Do Now," we encourage all our readers to go to InvestorRelationships.com and take advantage of the no-risk membership offer.

The Upcoming "5th Annual Executive Compensation Conference"

Sign–ups for this year's "5th Annual Executive Compensation Conference" are running ahead of last year's record attendance. In view of the increased scrutiny of compensation arrangements and practices this coming year, this year's Conference will be even more critical than last year's.

If you have not yet made arrangements to view the Live Nationwide Video Webcast (with unlimited access to the archive of the Conference video—and the critical course materials), we urge you to do so now. We have enclosed a form for your convenience. Or, go to CompensationStandards.com to sign up online.

The "3rd Annual Proxy Disclosure Conference"

Our readers should also be sure to take in key sessions from the upcoming "3rd Annual Compensation Conference." The enclosed form will enable your company to access the Nationwide Video Webcasts of both these critical conferences.

Our Upcoming Fall Issue

We have already begun work on our upcoming Fall issue of *Compensation Standards* which will address, among other things, key compensation fixes to implement for this year's upcoming proxy season.

Renewal Time and Trial Subscriptions

As all subscriptions to CompensationStandards.com and the *Compensation Standards* newsletter are on a calendar year, it is now renewal time. We encourage you to return the enclosed No-Risk Renewal Form today (or go to CompensationStandards.com to renew online).

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Compensation Standards is tailored for the busy director, quarterly issues that do not overload directors with useless information—rather, this newsletter provides precisely the type of information that directors desire: practical and right-to-the-point. Plus, each issue includes timely compliance reminders to help directors avoid inadvertent violations (which also help advisors with their compliance tasks).

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Company Name
Comprehensive Income
Executive Name

Compensation Component	2007 Compensation	2008 Compensation	Additional Comments
Base Salary	$785,000	$785,000	
Annual Bonus			
- Bonus as a Percent of Base Salary	N/A	125%	
- Bonus in Dollars	N/A	$981,250	
Total Cash Compensation	**$785,000**	**$1,766,250**	
Long-Term Incentive Award Value			
- Time-Vested Stock Options	$1,710,000	$0	
- Performance-Vested Stock Options	$1,426,900	$0	
- Performance Shares	$3,915,000	$0	
- Time-Vested Restricted Shares	$0	$0	
Total Value of Long-Term Incentive Awards			
- Based on Amortized Value of LTI Plan Awards	**$2,350,600**	**$2,350,600**	
- Based on Unamortized Value of LTI Plan Awards	**$7,051,900**	**$0**	
Total Direct Compensation			
- Based on Amortized Value of LTI Plan Awards	**$3,135,600**	**$4,116,850**	
- Based on Unamortized Value of LTI Plan Awards	**$7,836,900**	**$1,766,250**	
Benefits and Perquisites			
- Company Match on KSOP Plan	$0	$0	
- Company Contributions to Deferred Compensation Plan Account	$0	$0	
- Club Membership Dues	$0	$52,821	
- Financial Planning	N/A	N/A	
- Health, Dental, and Vision Benefits	$706	$10,528	
- Insurance	$238	$1,269	
- Car and Driver	$0	$37,691	
- Total Estimated Value of Benefits and Perquisites	**$944**	**$102,309**	
Deferred Compensation and Retirement Plan Accounts			
Deferred Compensation Plan Account			
- Aggregate Balance of Deferred Compensation Plan Accounts	$0	$0	
- Earnings on Deferred Compensation Plan Account	$0	$0	
KSOP Plan Account			
- Aggregate Value of KSOP Plan Account	$0	$7,643	
- Earnings on KSOP Plan Account	$0	-$191	

Company Name
Equity Inventory
Executive Name

Compensation Component	Equity Value as of 12/31/07 [(1)]	Equity Value as of 12/31/08 [(2)]	Additional Comments
Outstanding Equity Awards			
Time-Vested Stock Options			
- Number of Vested But Unexercised Stock Options	0	37,500	
- Value of Vested But Unexercised Stock Options	$0	$367,500	
- Number of Unvested Stock Options	187,500	150,000	
- Value of Unvested Stock Options	$1,228,125	$1,470,000	
Performance-Vested Stock Options			
- Number of Vested But Unexercised Stock Options	0	0	
- Value of Vested But Unexercised Stock Options	$0	$0	
- Number of Unvested Stock Options	187,500	187,500	
- Value of Unvested Stock Options	$1,228,125	$1,837,500	
Performance Shares			
- Number of Unvested Performance Shares	150,000	120,000	
- Value of Unvested Performance Shares	$4,897,500	$4,308,000	
Time-Vested Restricted Stock			
- Number of Unvested Restricted Shares	0	0	
- Value of Unvested Restricted Shares	$0	$0	
Total Value of Outstanding Equity Awards	**$7,353,750**	**$7,983,000**	
Compensation Realized from Prior Equity Awards			
Time-Vested Stock Options			
- Number of Stock Options Exercised	0	0	
- Value of Stock Options Exercised	$0	$0	
Performance-Vested Stock Options			
- Number of Stock Options Exercised	0	0	
- Value of Stock Options Exercised	$0	$0	
Performance Shares			
- Number of Performance Shares That Vested	0	30,000	
- Value of Performance Shares That Vested	$0	$1,077,000	
Time-Vested Restricted Stock			
- Number of Restricted Shares That Vested	0	0	
- Value of Restricted Shares That Vested	$0	$0	
Total Value of Compensation for Prior Awards	**$0**	**$1,077,000**	

[1)] Awards are valued based on the Company's closing share price on December 31, 2007 ($32.65).
[2)] Awards are valued based on the Company's average share price for the ten consecutive trading days ending September 18, 2008 ($35.90).

Company Name

Analysis of Benefits Paid in Connection with Termination of Employment

Executive Name (1)(2)

	Voluntary Resignation	Involuntary Without Cause	Change in Control	Disability	Death
Value of Previously Vested Equity Awards and Pension Benefits					
Vested and Outstanding Equity Awards					
Time-Vested Stock Options	$367,500	$367,500	$367,500	$367,500	$367,500
Performance-Vested Stock Options	$0	$0	$0	$0	$0
Subtotal - Vested Equity Awards	$367,500	$367,500	$367,500	$367,500	$367,500
Vested Benefits & Perquisites					
KSOP	$7,643	$7,643	$7,643	$7,643	$7,643
Deferred Compensation	$0	$0	$0	$0	$0
Subtotal - Pension Benefits	$7,643	$7,643	$7,643	$7,643	$7,643
Total Value of Vested Equity and Benefits	**$375,143**	**$375,143**	**$375,143**	**$375,143**	**$375,143**
Equity Gains Realized in Last 5 Years					
Option gains realized (2004 - 2008)	$0	$0	$0	$0	$0
Restricted shares vested (2004 - 2008)	$0	$0	$0	$0	$0
Performance shares vested (2004 - 2008) (3)	$1,077,000	$1,077,000	$1,077,000	$1,077,000	$1,077,000
Total Gains Realized	**$1,077,000**	**$1,077,000**	**$1,077,000**	**$1,077,000**	**$1,077,000**
Current Wealth Accumulation/Walk Away Amounts	**$1,452,143**	**$1,452,143**	**$1,452,143**	**$1,452,143**	**$1,452,143**
Enhanced Severance and Benefits and Equity Acceleration					
Cash Severance					
Salary and Annual Bonus	$0	$2,649,375	$5,298,750	$1,320,000	$400,000
Pro-Rata Annual Bonus	$0	$981,250	$981,250	$981,250 (4)	$981,250
Subtotal - Cash Severance	$0	$3,630,625	$6,280,000	$2,301,250	$1,381,250
Pension Benefit Enhancements					
KSOP	$0	$0	$0	$0	$0
Deferred Compensation	$0	$0	$0	$0	$0
Subtotal - Pension Benefits	$0	$0	$0	$0	$0
Other Benefits and Perquisites					
Health and Welfare Benefit Continuation	$0	$15,792	$31,584	$0	$0
Outplacement	$0	$0	$30,000 (5)	$0	$0
Additional Other Benefits or Perquisites	$0	$0	$0	$0	$0
Subtotal - Benefits and Perquisites	$0	$15,792	$61,584	$0	$0
280G Tax Gross-Up	$0	$0	$5,465,739	$0	$0
Total Severance, Pension Enhancements, Benefits, Gross-Up	**$0**	**$3,646,417**	**$11,807,323**	**$2,301,250**	**$1,381,250**
Acceleration of Unvested Equity Awards					
Time-Vested Stock Options	$0	$1,470,000	$1,470,000	$1,470,000	$1,470,000
Performance-Vested Stock Options	$0	$1,837,500	$1,837,500	$1,837,500	$1,837,500
Performance Shares	$0	$4,308,000	$4,308,000	$4,308,000	$4,308,000
Time-Vested Restricted Stock	$0	$0	$0	$0	$0
Total Value of Accelerated Equity Grants	**$0**	**$7,615,500**	**$7,615,500**	**$7,615,500**	**$7,615,500**
Total for Accelerated Equity and Severance Enhancements	**$0**	**$11,261,917**	**$19,422,823**	**$9,916,750**	**$8,996,750**
Wealth Accumulation/Full Walk-Away Amounts					
Vested and Accelerated Compensation	**$375,143**	**$11,637,060**	**$19,797,966**	**$10,291,893**	**$9,371,893**
Gains Realized in Last 5 Years	**$1,077,000**	**$1,077,000**	**$1,077,000**	**$1,077,000**	**$1,077,000**
Wealth Accumulation/Full Walk Away Amounts	**$1,452,143**	**$12,714,060**	**$20,874,966**	**$11,368,893**	**$10,448,893**

1) Assumes a termination date of December 31, 2008.
2) Awards are valued based on the Company's average share price for the ten consecutive trading days ending September 18, 2008 ($35.90).
3) Represents the performance shares that vested in 2008 due to the attainment of the 2008 stock price hurdle. Award is valued based on the ten day average ending September 18, 2008.
4) Executive was assumed to receive a pro-rated target bonus. As this analysis is as of December 31, 2008, the amount represents the full target bonus.
5) The cost of outplacement was estimated at $15,000 per year (represents two years of outplacement).

Company Name

Analysis of the Executive's Wealth Accumulation [1]

Executive Name

	Voluntary Resignation	Involuntary Without Cause	Change in Control	Disability	Death
Projected Value of Existing Equity if the Following Events Occur on December 31, 2012, Assuming:[3]					
20% Annual Stock Price Appreciation [4]	$31,058,450	$33,126,350	$33,126,350	$33,126,350	$33,126,350
10% Annual Stock Price Appreciation [5]	$10,589,200	$17,987,600	$17,987,600	$17,987,600	$17,987,600
5% Annual Stock Price Appreciation [6]	$6,563,500	$12,223,400	$12,223,400	$12,223,400	$12,223,400
0% Annual Stock Price Appreciation [7]	$3,235,850	$7,458,600	$7,458,600	$7,458,600	$7,458,600
Projected Value of Existing Equity if the Following Events Occur on December 31, 2017, Assuming:					
20% Annual Stock Price Appreciation [4]	$92,072,250	$92,072,250	$92,072,250	$92,072,250	$92,072,250
10% Annual Stock Price Appreciation [5]	$22,600,250	$22,600,250	$22,600,250	$22,600,250	$22,600,250
5% Annual Stock Price Appreciation [6]	$10,910,950	$10,910,950	$10,910,950	$10,910,950	$10,910,950
0% Annual Stock Price Appreciation [7]	$3,291,800	$3,291,800	$3,291,800	$3,291,800	$3,291,800

1) Assumes dividends are reinvested in additional shares of XXX stock once the shares are vested or stock options are exercised.

2) The analysis is based on the following assumptions: (i) the "base-line" stock price for the stock price appreciation was the Company's share price on December 31, 2007 (i.e., $32.65), all time-vested stock options are assumed to vest, (iii) all performance-vested stock options are assumed to vest except for the tranche in 2008 (and the catch-up feature does not result in the vesting of that first tranche), (iv) the first tranche of performance shares is already earned, (v) the remaining performance shares (tranches two through five) are only earned if the stock price hurdles are attained, which only occurs in the scenario of 20% stock price appreciation, and (vi) no additional equity awards are granted.

3) In the event of Involuntary Termination Without Cause, Termination due to Death, or Termination due to Disability, the executive may earn the performance-based awards in the year of termination if the performance goals are met (including the catch-up feature). We have assumed that the stock price goals required to vest in the final tranche of performance shares are achieved only if stock price appreciation is 20%, but no other awards are earned in the other performance scenarios.

4) 20% annual stock price appreciation results in a share price of $81.24 on 12/31/12 and $202.16 on 12/31/17.

5) 10% annual stock price appreciation results in a share price of $52.58 on 12/31/12 and $84.69 on 12/31/17.

6) 5% annual stock price appreciation results in a share price of $41.67 on 12/31/12 and $53.18 on 12/31/17.

7) 0% annual stock price appreciation results in a share price of $32.65 on 12/31/12 and 12/31/17.

Talking Points: Wealth Accumulation and Tally Sheets (10/08)

Speakers:

- **Doug Friske** - Towers Perrin
- **Mike Kesner** - Deloitte Consulting
- **Jesse Brill** - Chair, NASPP and CompensationStandards.com

I. What are wealth accumulation projections and tally sheets?

II. Why are these analyses so important right now?

III. What should Committee members be looking for when reviewing these analyses?

IV. How shall the Committee use the data from these analyses in making future pay decisions?

V. What (if any) are the challenges and pitfalls in creating/applying these analyses?

- What are wealth accumulation projections and tally sheets?

  — Tally sheets:

    – Snap shot of current state
    – Provides complete picture of rewards package, including perqs, benefits and compensation
    – Somewhat redundant with proxy disclosure
    – Allows mgmt and CC the opportunity to understand all the various pieces of the existing rewards arrangement and how they work together

  — Wealth accumulation projections

    – Look at what might be in the future as it relates to potential value realized through all forms of rewards
    – Include cash compensation, long-term incentives, deferred compensation, termination benefits and retirement benefits
    – Assess results under different timing (5 years, 10 years, retirement) and performance results (negative TSR, positive TSR)

- Why are these analyses so important right now?

  — Avoid unintended consequences
  — Ensure programs are aligned with business and pay strategies
  — Helps to explain and rationalize each element of the pay program in isolation and in combination with other pay elements

- Informs ongoing discussions regarding the continued reasonableness and viability of each reward component, particularly severance and pension benefits
- Requires discussion in the CD&A

- What should Committee members be looking for when reviewing these analyses?
  - Relative value of different reward components
    - For example, what are the relevant values for fixed pay, incentive pay, cash compensation, equity pay, and retirement benefits
  - How values change over time and under different performance scenarios
  - Differences in values across the executive population
    - For example, is there a big gap between the CEO and other executives? Are there certain executives with minimal award values? Have certain executives taken significant value off the table through equity sales?
  - Are there potential unanticipated, unintended events indicated by the analysis?
    - For example, CEO with significant vested value and little incremental value realized by staying, raising succession questions.
  - What might disclosure look like down the road based on the data?
  - Are figures reflective of the Committee's intended pay philosophy and company dynamics?
    - For example, numbers for an equity-biased pay program with hold-until retirement provisions for a long-tenured executive team at a great performing company will look very different than if these conditions were not present.

- How shall the Committee use the data from these analyses in making future pay decisions?
  - Ensure Committee is comfortable with current and projected values; if not, adjust program elements to address areas of concern
  - Assess whether the programs are resulting in values that reflect the intent behind various programs. If not, make adjustments
    - For example, if retirement program is providing disproportionate value understand why and potentially make changes
  - Determine whether certain programs are still relevant and necessary
    - For example, if executive has significant equity value, is pension plan (at least as constructed) still necessary?
  - If Committee is unwilling to change deal for existing employees, analysis could be used to revise program for new employees

- What (if any) are the challenges and pitfalls in creating/applying these analyses?

- Tally sheets are redundant with proxy disclosure for the most part, so incremental benefit may be unclear (tally sheet preparation has been folded into the proxy disclosure process in many cases)
- Wealth accumulation are less common, face more resistance, and could have greater impact on future decisions
- Challenges in creating wealth accumulation analyses include:
  - Picking reasonable assumptions regarding performance, timing and pay practices
  - Reaching consensus with management and the Committee on the role of these analysis, how it will be conducted and how it will be used
  - Gaining agreement to conduct and share the analysis
- Challenges in applying wealth accumulation analyses include:
  - Understanding all the contributing factors to the results (e.g., historical practice, competitive positioning, executive team composition, mix of rewards, performance)
  - Reaching agreement that the results are credible and meaningful
  - Determining what is “the answer” (e.g., is there an amount of wealth at which certain programs should cease to exist)
  - Avoiding the conclusion that bad behavior (e.g., poor performance, stock sales) is rewarded while good behavior (e.g., strong performance, holding all shares) is punished
  - Knowing the limitations of the analysis (i.e., should not be used for benchmarking)
  - Understanding how to apply judgment

A Position Piece from Consultants: Sunsetting Severance and Other “Security” Provisions

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 severance provision may no longer serve a valid economic purpose, boards should consider asking their top executives to forgo severance. We encourage companies to implement a sunset provision (generally ranging from three to five years) in agreements for new CEO hires and to ask current top executives who have accumulated sufficient amounts so that security is no longer necessary that they voluntarily phase out and sunset existing agreements.

We encourage companies to review their post employment provisions and projected total walkaway amounts annually, including accumulated gains from options and other long term incentives with a view to sunsetting any other “security” provisions or arrangements that may no longer be necessary.

I. Real Life Example: Zebra Technologies CEO New Hire Long-Term Incentive Tied to Doubling Stock Price in Five Years

Long-Term Incentive:

3 Types of Grants: "Initial Option", "TSR Option", and "TSR Stock"

"Initial Option": 75,000 time-based shares that vest in equal installment on the first four anniversaries of the grant date as long as he remains employed by the Company.

"TSR Option": 168,750 performance-based options on an incremental vesting schedule dependent upon TSR performance as detailed below.

"TSR Stock": 56,250 performance-based restricted shares on an incremental vesting schedule dependent upon TSR performance detailed below.

Vesting Period	Total Shareholder Return Achievement Level	Total Vested Percentage of Award [1]
• September 4, 2007 to September 4, 2012 • Vesting percentage dependent upon the Total Shareholder Return Achievement Level measured over any 45 consecutive trading-days. • Once a TSR achievement level is met, the Company must achieve a higher level for additional shares or options to vest.	At least 60.0%	25%
	65.0% - 69.9%	28.8%
	70.0% - 74.9%	33.4%
	75.0% - 79.9%	39.3%
	80.0% - 84.9%	46.8%
	85.0% - 89.9%	56.2%
	90.0% - 94.9%	68,4%
	95.0% - 99.9%	83.8%
	100%	100%

(1) *Any portion of the award which is unvested at the expiration of the Vesting Period will be forfeited.*

II. Real Life Example: Zebra Technologies CEO Decreasing Change-In-Control Awards

Termination by Employee for good reason or by Company without cause (under the circumstances other than death or disability):

- CEO will not receive outplacement services;
- The continuation of his base salary will be for paid for 2 years;
- Healthcare coverage will continue for 2 years;
- The unvested portion of the "Initial Option" and any annual equity awards will vest immediately; and
- If the termination under these circumstances happens within 120 days of a "Change in Control," the unvested portion of the "Initial Option" and any annual equity award will vest immediately. The unvested portion of the "TSR Option" and "TSR Stock" will immediately vest as follows:

Date of "Change in Control"	Percentage of Unvested "TSR Option" and "TSR Stock" That Will Vest
Prior to September 4, 2008	100%
On or after September 4, 2008, but prior to September 4, 2009	80%
On or after September 4, 2009, but prior to September 4, 2010	60%
On or after September 4, 2010, but prior to September 4, 2011	40%
On or after September 4, 2011, but prior to September 4, 2012	20%

All information on Zebra Technologies was taken directly from the Company's 2008 Proxy Statement.

III. Real Life Example: 3-year RSV Plan with Interim Vesting and Make-up Feature

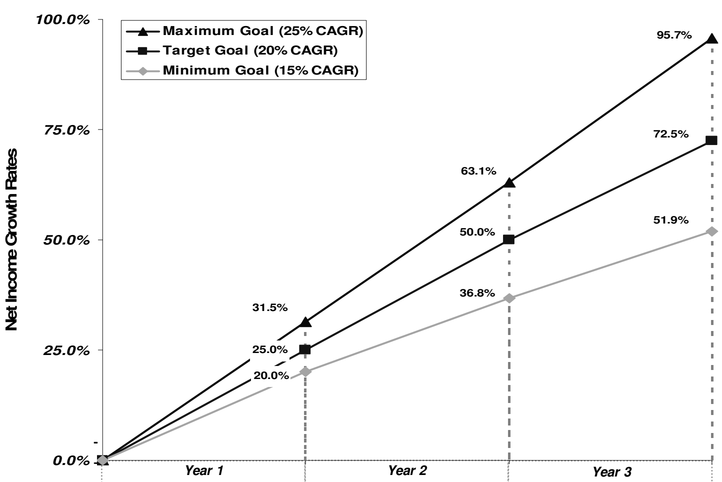
Performance-Based Vesting – *Cumulative Net Income*

Example:
During Year 1, the Company earns $120M; a 20% increase over $100M for the prior year (not shown here). For Year 2, net income increases 29.2% to $155M and cumulative net income is $275M. For Year 3, net income increases 38.7% to $215M and cumulative income becomes $490M.

Based on this performance, 7.5% of the RSUs would vest at the end of Year 1.

At the end of Year 2, 25% of the RSUs would vest because the Company's cumulative net income met the target goal.

A significant increase in the growth rate in Year 3 generates cumulative net income that exceeds the maximum goal, causing 100% of the RSUs to vest at the end of the year.



		Year 1		Year 2		Year 3	
Actual Annual Net Income & % Increase Over Prior Year:		*$120,000,000*	*20%*	*$155,000,000*	*29.2%*	*$215,500,000*	*39.0%*
Cumulative Net Income and Vesting Percentages: Actual vs. Plan	*Actual:*	*$120,000,000*	*7.5%*	*$275,000,000*	*25%*	*$490,500,000*	*100%*
	Maximum Goal:	$131,500,000	20%	$294,600,000	50%	$490,300,000	100%
	Target Goal:	$125,000,000	10%	$275,000,000	25%	$447,500,000	50%
	Minimum Goal:	$120,000,000	7.5%	$256,800,000	18.75%	$408,700,000	37.5%

IV. Real Life Example: "Rules of the Road"

The definitions of the components of annual incentive calculation are as follows:

Capital	▪ Capital = Operating Investment (OpInv) ▪ Average Operating Investment over prior 13 months will be used ▪ Does not include Corporate LBO Goodwill
Earnings	▪ Earnings = After-Tax Operating Income (ATOI) ▪ Earnings before deducting interest and goodwill amortization, but after deducting income taxes ▪ US federal income taxes calculated at constant rate of 35% (state income tax already deducted in calculating ATOI) ▪ Separate tax rates for all other countries ▪ Same tax rate will be applied for 3 years ▪ For corporate, actual federal and state income tax liability will be deducted in calculating ATOI
Cost of capital	▪ Cost of Capital = 15% ▪ Same Cost of Capital for all BWA operations
Capital charge	▪ Capital Charge = Operating Investment X Cost of Capital
Economic value	▪ EV = ATOI – Capital Charge

The following is the policy for major financial events and treatments:

Goodwill	▪ Goodwill (plus accumulated amortization) will be included in Operating Investment ▪ Goodwill (plus accumulated amortization) will be included in the EV goal setting calculation ▪ Corporate LBO Goodwill will not be included
R&D	▪ Annual R&D investment will represent an expense on the income statement and a deduction from ATOI ▪ Special R&D projects may be capitalized and amortized over three years, subject to corporate level approval
Major acquisitions (Greater than 10% of Corporate/Group/ Plant Operating Investment)	▪ Projections used to authorize the acquisition will be build into the EV goal lines so that management is held accountable for achieving those projections ▪ Adjustments subject to June 30 cut off date; major acquisitions after June 30 will only generate adjustments in following year ▪ All authorization requests for acquisitions will include EV projections
Plant expansions (Greater than 10% of Corporate/Group/ Plant Operating Investment)	▪ Same treatment as acquisitions from date expansion becomes operational. Projections used to authorize or justify plant expansions will be built into future goal lines, so that management is accountable for achieving those projections ▪ Adjustments subject to June 30 cut off date; plant expansions after June 30 will only generate adjustments in following year ▪ All authorization requests for capital will include EV projections
Plant closures **(Greater than 10% of Corporate/Group/ Plant Operating Investment)**	▪ Assuming that a plant closure is reviewed and authorized, the projections used to authorize that transaction will be incorporated into the business unit goal lines ▪ Adjustments subject to June 30 cut off date; plant closures after June 30 will only generate adjustments in following year ▪ Matching events: if there are closing costs associated with shutting down a plant, the business unit will not be charged with those costs until the sale/shut down is actually completed and the assets are off the books and out of the capital calculation
Windfall gains (or losses)	▪ Large gains (or losses) not caused by major acquisitions, plant expansions, or plant closures will be included in ATOI with no adjustment

Deloitte.

October 22, 2008

CompensationStandards.com

Designing innovative and responsible pay arrangements

I. The Basics

- Incentive plans should be designed to support the company's business objectives, both short-term and long-term.
  - Benchmarking what leading companies and peers use may result in the selection of arrangements that do not fit the company's situation.
  - Incentive plan design teams should include representatives from finance, operations, human resources and legal.

Incentive Plan Performance Metrics (Illustrative)

Company Characteristics	Potential Measures	Comments
Rapidly expanding	• Revenue growth • New product revenue and/or margin • ROIC	• The company may be willing to sacrifice some margin/return in exchange for accelerated revenue growth/market share.
Distressed	• Cash flow or EBITDA • Strategic measures focusing on operational excellence	• The company may want to focus on improving cash flow by reducing costs, managing working capital, reviewing capital expenditures, etc. • In addition, there may be a need to hold managers accountable for quality, safety and talent management to ensure cost savings objectives do not override sound business practices.
Capital intensive	• ROIC, ROCE, Economic Profit • EPS • Revenue growth	• The company should focus on attaining returns equal to or in excess of its cost of capital for significant capital projects/investments. • However, it is often necessary to include a growth measure for EPS or revenue to ensure the managers continue to seek opportunities to expand the business.
Recently merged	• Synergy savings • EPS/ROIC	• It is often a business imperative for a recently merged enterprise to realize promised synergy savings by aggressively reducing inefficient capacity, merging sales forces, leveraging customers, etc. Thus, the use of synergy goals can be extremely useful in focusing managers on achieving or exceeding the expected synergy goals.
Multi-divisional	• Operating income • ROIC or ROA	• Use of division level goals such as operating income to support corporate EPS or ROIC to support corporate-wide ROE or ROIC is important to provide a proper "line of sight" at the business unit level and faster alignment with corporate objectives.
		Note: If a company meets more than one set of characteristics, a combination of measures would be appropriate.

- Incentive plan alternatives should be pressure-tested prior to implementation.
  - A common method for testing the plan is to estimate payouts under the proposed plan design based on the prior one to three years' results
  - Ideally, median performance will result in median payouts; below or above median performance will correspondingly earn below or above median cash compensation.
  - Target levels of performance are often established based on the company's budgeting process, which shall include input regarding competitors' expected results for the performance period and Wall Street analyst expectations, in addition to internal factors.
  - Performance targets (and actual results) should be "net" of the accrued bonus to ensure the plans are "self-funding."
  - Threshold and maximum levels of performance are almost as important as the target performance level, as these levels determine what percentage of the incremental results is shared with plan participants.

Sample Performance Curve and Sharing Ratio

	Pre-Tax Income	Bonus Pool	Sharing Ratio
Maximum	$30 million	$12 million	55%
Target	$25 million	$ 6 million	37.5%
Threshold	$20 million	$ 3 million	-

- In the above illustration, the difference between the threshold and target pre-tax income goals is $5 million. Since the plan is "self-funded", the target level of pre-tax income is net of the bonus pool. Thus, in order to calculate the sharing ratio, the bonus pool must be added back to the pre-tax income amounts.

	Pre-Tax Income	Bonus Pool	Pre-Tax/Pre-Bonus
Target:	$25 million +	$ 6 million =	$31 million
Threshold:	$20 million +	$ 3 million =	$23 million
% Change:		$ 3 million ÷	$ 8 million = 37.5%
Maximum:	$30 million +	$12 million =	$42 million
Target:	$25 million +	$ 6 million =	$31 million
% Change		$ 6 million ÷	$11 million = 55%

- Sharing ratios of 25% or more should be carefully scrutinized, since the company, in essence, is carving-out 25% or more of its future profits for employees.
  - This level of sharing could be the result of a number of factors. For example, the performance targets may be too tightly clustered together. Thus, small increases in profits (or decreases) can significantly increase (or decrease) the bonus pool. Another factor could be the plan is too rich for the company's current level of profitability. A third factor could be there are too many participants. Another possibility is the targeted level of compensation (e.g., 75th percentile) is too high. Talent intensive businesses (professional services, investment banking) tend to have higher sharing ratios than less talent intensive businesses.
  - It is also worth considering increasing the sharing ratio as performance levels increase. Thus, above target sharing ratios might be higher than the sharing ratios for performance between threshold and target, as the above target results are harder to achieve. The above illustration

reflects an increase in the sharing ratio from 27.5% to 55% as performance moves from threshold to target to maximum.

- Another useful check on the performance metrics and targets is to test how incentive plan payouts correlate with stock price performance over a long period of time. If bonuses are consistently paid at target or higher, but stock price performance lags competitors, the market, or both, it is possible the wrong performance measures are being used or the performance targets are not sufficiently aggressive to warrant the level of payouts.

II. Specific Plan Provisions

The following is a list of key provisions to consider including in the annual incentive plan:

– Relative Total Shareholder Return (TSR) or financial performance modifications. Due to the difficulty and inherent uncertainty in establishing incentive plan financial targets, consider modifying payouts based on relative TSR or relative financial performance by plus or minus 35% to 50% of the target award value.

- For example, If the company exceeds the performance goals, but fails to meet the peer group's median results, a reduction in payouts will occur. Conversely, if the company fails to achieve its financial targets, there is still an opportunity to earn up to 35% - 50% of the target bonus pool based on relative results.

– Use relative performance, rather than absolute performance to establish goals. Rather than using targeted financial performance, consider calculating incentives based on relative performance (financial performance or TSR or both) compared to peers.

- Of course, such comparisons are not perfect. The company needs to have an appropriate peer group of at least 10-15 companies. In addition relative financial measures, if used, often require adjustments to reported results to obtain a fair performance comparison.

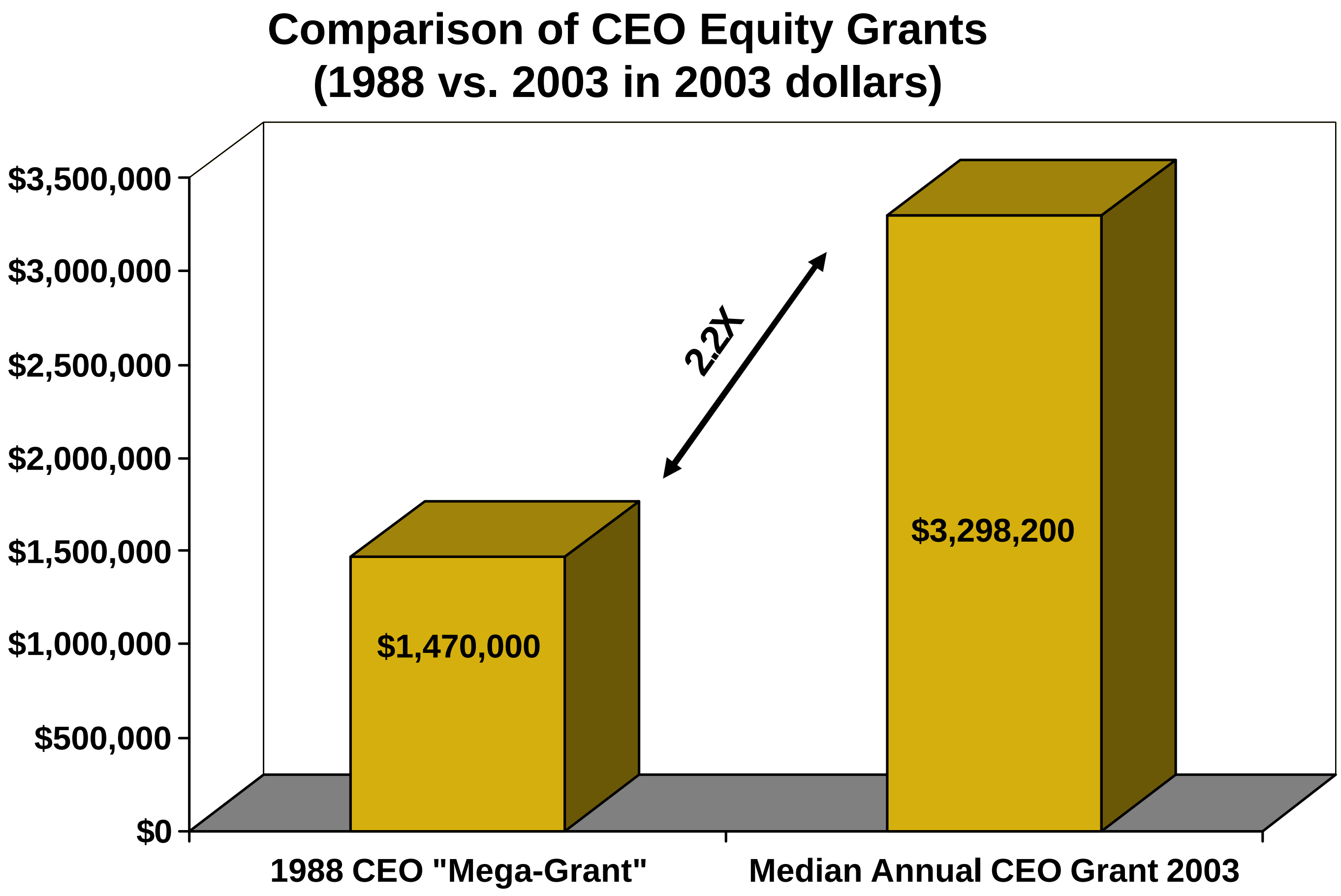
– Pay a portion of the annual bonus in stock. In the event performance exceeds target or a specific dollar amount, pay a portion of the earned incentive in stock that vests three years after the "performance year". If the performance of the company is sustained or improved, the stock will likely be more valuable, thus adding a longer term focus to a short-term incentive plan. Conversely, if the results are not sustainable, or artificially inflated, the shares awarded will likely be less valuable.

(Illustrative)

Bonus Over	**% Payable in Shares**
$500,000 +	33%
$250,000 - $500,000	25%
$150,00 - $250,000	20%
$75,000 - $150,000	15%
<$75,000	0%

- Include a banking feature. Similar to paying a portion of the annual bonus in stock, require that a portion of the earned incentive award be held back and "banked." The banked award would be subject to forfeiture to the extent future performance falls below pre-determined performance levels.
- Termination provisions in incentive plans for death, disability or position elimination should provide for a pro-rated payout based on actual performance, determined at the end of the performance period. Termination for poor performance should result in no payout.
- Change-in-control provisions. To the extent possible, the company should try to operate the annual incentive plan through the end of the fiscal year as though a CIC did not occur. In the event it becomes impractical to do so, consider providing for payouts at the end of the year based on actual results through the CIC date and target performance for the balance of the year. A number of companies will guarantee target or higher bonuses for the CIC year. Regardless of how well-intentioned, employees may lose some focus on financial results due to the bonus guarantee, and thus the adoption of a guaranteed payout requires careful consideration.
- Adjustments for unusual items should be spelled out in advance to ensure management and the Compensation Committee agree upfront on the types of adjustments the Committee will consider in determining the financial results used for incentive plan purposes (see below for Section 162(m) provisions). The identified adjustments should include both positive and negative effects on earnings (for example, increases in EPS due to share buy-backs and decreases due to plant closings). The actual adjustments made at yearend should be in the discretion of the Committee.
- Section 162(m) flexibility. Although controversial, a negative discretion provision provides the Compensation Committee with the maximum amount of flexibility. Here is how it works. The Committee first establishes a threshold level of performance, that if attained, funds the maximum bonus for the CEO and three highest paid named executive officers (the CFO is no longer subject to 162(m) thanks to a recent IRS rule change). The second step is to use downward discretion to reduce the bonus to the desired payout level. This approach allows the Committee to use its judgment in calculating allowable adjustments to reported financial results and to factor in individual performance in the incentive calculation.
- Clawback provisions. Incentive plan should provide for Board discretion to clawback previously paid incentives if a subsequent restatement of earnings would have yielded a lower payout. Current clawbacks typically limit the repayment to those individuals involved in misconduct that led to the restatement, as opposed to those who inadvertently benefited from the error.
- Hold until retirement. In addition to traditional stock ownership requirements, companies should incorporate stock retention provisions in equity incentive plans for top management. Retention rates of 25% to 50% of the after tax (and after exercise price) gains will create a long-term focus on share price. Since retention only occurs on future gains, executives are not required to buy shares or take cash bonuses in stock. Hold until retirement provisions, therefore, do not place a financial burden on the executives, since in good times, the accumulated stock is only a portion of future gains and if the stock performs poorly, the executives will retain a very modest level of stock.

Executive Compensation Trends



1. 1988 salary data based on "Are CEO's Really Paid Like Bureaucrats" (Hall, Lieberman: Quarterly Journal of Economics, August 1998).1988 mega grant calculated at face value of 3x salary, and converted to expected value based on assumed Black-Scholes multiple of 0.5.
2. 2003 median grant value from 2003 Towers Perrin Executive Compensation Database. Data based on expected value of CEO long-term incentives for companies with $3-$6 billion in revenue (to most closely match data sample from Hall / Lieberman [1998]).

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THE NEWSLETTER FOR THOSE THAT ADVISE PUBLIC COMPANIES

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"Hold 'Til Retirement" Requirements for Equity Awards: How to Pick and Implement What's Right for Your Company

A Word from the Publisher

We are devoting much of this issue to a very timely piece on implementing hold 'til retirement policies for top executives.

In the current environment, we see a real opportunity for companies to make a statement that will resonate with shareholders and employees. Because most CEOs already adhere to a philosophy that the CEO should hold his/her shares for the long term, adopting a policy covering the CEO and NEOs can be quick and simple—yet meaningful. As a result, we expect that many companies and compensation committees will want to do so in time for this year's upcoming proxy statements. (We can see institutional investors pushing for HTR policies this proxy season; here is an opportunity for many companies to get ahead of this one at very little cost.)

[Another feature which dovetails nicely with hold 'til retirement—because it eliminates the need for executives to sell shares into the open market to pay for the exercise of stock options—is the *net exercise*. Anyone who missed the March-April 2008 issue of *The Corporate Executive* which was devoted to "Everything You Need to Know About Implementing Net Exercises" will want to read that excellent issue. Don't overlook the workshop on net exercises at the upcoming NASPP Conference.]

Lastly, we round out this issue with some ESPP developments and with a few important heads-ups on pages 11–12.

—JMB

A number of leading companies require their executives to keep a substantial part of the stock awards they earn for the duration of their career. These companies boast a variety of benefits, including aligning executives and shareholders, encouraging long-term focus, fostering a company-wide ownership culture and providing a continuing and growing personal incentive to work towards superior stock performance. Institutional investors note that these requirements help to alleviate concerns raised by recent scandals relating to the timing of option exercises and stock sales by senior executives, as well as by the general increase in the size of equity compensation awards over the past 20 years.

Notwithstanding the benefits, only a minority of companies have true "hold 'til retirement" (HTR) requirements. By our count, there are now close to 40 companies that have hold 'til retirement requirements. On the other hand, at least two-thirds of S&P companies have some form of traditional stock ownership guideline, whereby executives are required to acquire and retain a certain value of company stock (usually a multiple of salary).

Given the continuing focus on stock ownership and some of the weaknesses of more traditional stock ownership guidelines, we think that the time is right for more boards to consider HTR requirements. [For more on the need for companies to reassess their stock ownership guidelines, see the Winter 2008 issue of *Compensation Standards* at pg 4.]

We will first outline some of the different forms HTR requirements take, describe their

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benefits and explore steps that can be taken to address criticisms. We conclude with a step-by-step guide on how to pick the HTR requirement that is right for your company and how to implement it.

Forms of HTR Requirements

Boards can choose from multiple designs to implement HTR requirements. We have divided them into three categories: (1) retention ratios, (2) long-term vesting and (3) temporary requirements in conjunction with traditional stock ownership guidelines.

Retention Ratios

The typical HTR requirement is the "retention ratio," which establishes a percentage of earned equity awards that must be retained until the executive leaves the company. Whenever the executive receives a share from a company stock plan, such as when a stock option is exercised or when shares are vested under a restricted stock grant, a portion of the net shares received must be retained for the duration of the executive's career with the company.

These requirements apply to awards that have already been earned, so the executive is not in danger of losing the awards on leaving the company. Rather, the executive simply is required to continue to hold the shares after he has already satisfied the relevant service vesting and/or performance vesting requirements. In addition, in this typical design the retention ratio applies only to so-called "profit" or "gain" shares that remain after payment of taxes and, in the case of stock options, the exercise price.

For example, JPMorgan Chase generally requires its CEO and each member of its management committee to retain 75% of the net shares of stock received from equity awards after deductions for taxes and exercise prices. In the case of an award of 100 restricted shares, on vesting about 50 shares would go to taxes and a little more than 35 (or 75% of 50 after-tax shares) would be required to be held by the executive until retirement. Fifteen shares would be available to the executive to satisfy current needs or to diversify.

In contrast, typical stock ownership guidelines generally require an executive to acquire a certain fixed value of company stock, usually expressed as a multiple of salary, within a fixed period of time. For example, a CEO with a $1 million salary and an ownership guideline of five times salary would be expected to maintain ownership of shares with a value of $5 million.

Long-Term Vesting

Under the long-term vesting design (which is particularly well suited for restricted stock and RSUs), some percentage of an executive's equity award does not vest (that is, the executive does not become entitled to receive it) until normal retirement. Therefore, not only can the executive not sell or exercise these awards until retirement, but they will be forfeited if the executive leaves before retirement age.

ExxonMobil is one major company that employs this design. It divides stock grants to its executives into two parts: One half vests after five years, and one half vests only on the *later* of normal retirement and 10 years after grant. Thus, an executive must hold this second half for at least 10 years after grant, even if the executive retires before that time.

Temporary (With Traditional Guidelines)

Some companies implement holding requirements only until traditional stock ownership guidelines have been met. Bristol-Myers Squibb, for example, requires its most senior executives to retain all of their profit shares until the executive satisfies the stock ownership guideline. At that time, the executive is required to retain 75% of any excess profit shares for one year following vesting or exercise.

These temporary designs provide a means for executives to achieve designated stock ownership levels. Their benefits, however, are really tied to the benefits of traditional stock guidelines themselves. We believe, however, that true hold until retirement retention ratios, which are compatible with traditional stock ownership guidelines, can provide substantial additional benefits.

Real-Life Examples

Once a board has selected any of the basic designs, there are still a number of variables. The following table provides some examples of the variety of designs currently employed.

Company	Design	Formula	Equity Awards Subject	Executives Subject
Bristol -Myers Squibb	Temporary	100% until stock ownership guideline met	All equity awarded, net of taxes and exercise price	Executive officers
Citigroup	Retention Ratio	75%, 50% or 25% of shares, depending on seniority	All equity awarded, net of taxes and exercise price	75% for Executive Committee (16 people), 50% for Senior Leadership Committee (39 people) and 25% for other "senior management"
ExxonMobil	Long-term Vesting	50% of stock awards restricted for 10 years or until retirement, whichever is later	All restricted stock awards (ExxonMobil has not issued options since 2000)	"Most senior executives," including all named executive officers
FPL Group	Retention Ratio	66% of shares Also has traditional stock ownership guideline	All equity awarded, net of taxes and exercise price, after becoming subject to the policy	Executive officers
Goldman Sachs	Retention Ratio	75% or 25% of shares, depending on seniority	All equity awarded (other than IPO awards made in 1999), net of taxes and exercise price	75% for CEO, CFO, COO and Vice Chairmen, and 25% for Participating Managing Directors (about 300 people)
JPMorgan Chase	Retention Ratio	75% of shares	All equity awarded (other than 2007 awards, to the extent exceeding 50% of incentive compensation), net of taxes and exercise price	Management committee (48 people)
Merrill Lynch	Retention Ratio	75% of value Also has traditional stock ownership guideline	All equity awards, net of taxes and exercise price	Executive officers and other designated members of senior management
Morgan Stanley	Retention Ratio	75% of shares	All equity held at time executive becomes subject (whether or not received from awards) and all equity awards thereafter, net of taxes and exercise price	Management Committee (about 15 people)
Synovus	Retention Ratio	50% of shares Also has traditional stock ownership guideline	All equity awards, net of taxes and exercise price	Executive officers
Wachovia	Retention Ratio	75% of shares Also has traditional stock ownership guideline	All equity awards, net of taxes and exercise price	Executive officers
Wells Fargo	Retention Ratio	50% of options	Options exercised, net of taxes and exercise price	Executive officers

Reasons to Adopt

HTR requirements strongly support executive stock ownership, emphasize long-term performance of the company's stock, balance increases in equity award size by ensuring increasing executive ownership and can help restore investor confidence. HTRs also possess significant advantages over traditional stock ownership guidelines. Each of the above is a significant reason for boards to consider HTR requirements now.

Strongly supports executive stock ownership

Executive stock ownership has long been called the cornerstone of good corporate governance. HTR requirements provide an effective, manageable and visible way for the continuous stock accumulation by executives over the course of their entire careers.

Emphasize long-term performance

With a typical HTR design and annual equity grants, the number of shares of company stock that an executive is required to retain increases each year. As a result, it is assured that an executive will continue to build exposure to long-term company performance notwithstanding any short-term changes in the value of shares. This type of guaranteed, increasing exposure strongly aligns the long-term interests of executives with those of other shareholders.

We believe that the emphasis on long-term performance is one reason that many investment banking firms have adopted HTR requirements. These firms emphasize annual compensation and generally do not make extensive use of multi-year performance plans. HTR requirements provide an appropriate balance to this type of compensation design.

Balance increased size of equity awards

As the size of equity awards and the resulting accumulated wealth of executives has increased over the past 20 years, many institutional investors and respected advisors have noted that there often has not been a corresponding increase in executive stock ownership levels. An HTR requirement ensures that any dilution resulting from equity compensation is counterbalanced by increasing executive ownership and alignment.

For this reason, a number of institutional investors, such as the American Federation of State, County and Municipal Employees, have introduced shareholder proposals supporting HTR requirements. In addition, Riskmetrics's Corporate Governance Quotient (CGQ) positively rewards companies that have holding periods relating to a meaningful portion of shares acquired on the exercise of stock options or vesting of restricted stock (although specific percentages or periods are not disclosed). Compensation practices account for 30% of a company's CGQ.

Restore investor confidence

Executives profiting through the exercise of options and/or sale of stock at the expense of outside investors has been a repeating feature of the corporate frauds over the past decade. HTR requirements strongly counterbalance any perception that executives can inappropriately time market sales. A number of business groups, such as the Conference Board Commission on Public Trust and Private Enterprise, the Business Roundtable and the National Association of Corporate Directors have introduced best practice initiatives endorsing additional executive stock ownership and holding requirements.

Investors and the public at large have become exercised over the huge amounts of wealth that even "caretaker" CEOs have received through equity grants with no "strings" attached. A company's adoption of an HTR sends a great message to investors—and helps restore the public's trust in the integrity of the system—that the CEO and top executives are tied to the company's performance (through ups and downs) for the long term.

Advantages Over Traditional Stock Ownership Guidelines

Traditional stock ownership guidelines also provide a path to executive stock ownership. However, guidelines are relatively fixed as to the value of stock required to be owned, which has a number of important consequences. First, for executives who may receive annual equity awards valued at a multiple of their base salaries, or who otherwise work at the company for many years, guidelines may lose effectiveness as a means of promoting increased ownership and/or ensuring that a substantial portion of the executive's net worth is represented by company stock. This is especially true during periods of rising stock prices. (As a company's share price increases, the number of shares an executive is required to retain actually falls.)

Second, as a consequence of the fixed nature of traditional stock ownership guidelines, guidelines also face pressure during periods of declining stock prices. When share prices fall, executives must either purchase additional shares, which may be difficult if market declines are associated with an otherwise difficult economic environment, or the company must relax enforcement, which can lead to criticism at exactly the time investors would want to see executive commitment to the company. Traditional guidelines can also impose unequal burdens on executives, particularly between long-tenured employees (who may have satisfied the guidelines long ago) and new hires (who may have to, or may feel obligated to, devote a large portion of current income toward satisfying the guidelines).

HTR provisions are dynamic and can address each of these potential issues. Moreover, operating a continuing HTR requirement in tandem with a traditional ownership guideline can provide for an executive ownership and retention program that is both robust and fair. As one possibility, top executives could be required to retain 100% of any profit shares until the ownership guidelines were satisfied, and then could be required to retain a smaller percentage, such as 75% of any profit shares acquired after that time. A program such as this one sends a message that executives are expected to exceed stock ownership guidelines as they become more senior and provides a mechanism for achieving stock ownership that is both fair to new hires and operates "automatically" during times of decreasing stock prices.

Addressing Potential Criticisms

HTR designs, if not designed with care, can have potential drawbacks and unintended consequences. The primary criticisms of HTR requirements are that such requirements could encourage executives to leave and that they may not be "competitive."

Do the requirements encourage executives to leave?

HTR requirements (and strict stock ownership guidelines) are sometimes said to encourage executives to leave their companies. Because most shares can be sold only after employment ceases, an executive arguably has an incentive to leave to realize prior earnings.

There are a number of approaches that can address this concern. First, the company can set the holding period at the *later* of retirement or age 65 (or 10 years from grant).

A company may also want to use the tandem approach described above, which involves traditional stock ownership guidelines plus a reduced retention ratio after satisfying that guideline. For executives at levels beneath the top executive level, a reduced retention ratio (say, 50 or 60%) could operate to limit the perceived burden of the HTR requirement after an executive has achieved a meaningful stake in the company. We believe that this can be an effective approach that has seen only limited use so far. Companies may consider scaling back the retention ratio on an executive's becoming eligible for early retirement. FPL Group uses a similar approach, eliminating the holding requirement when an executive reaches age 60.

The ExxonMobil long-term vesting approach (the *later* of retirement or 10 years from grant) combines the concepts of stock retention and employee retention and strongly addresses the concern of employee turnover. It also helps address and justify a compensation committee's decision to continue making grants in the years leading to a CEO's retirement.

Are HTR requirements "competitive"?

We strongly believe that typical HTR requirements can be competitive if targeted at the appropriate executive population and successfully presented as providing strong corporate governance and shareholder alignment. In particular, an HTR requirement may not represent a marked departure from the status quo for many executives. For example, in our experience CEOs only rarely sell during their tenure. Establishing a retention ratio for many CEOs would represent a public affirmation of an existing moral commitment at little additional cost. This CEO retention ratio could be paired with reduced retention ratios for the next management tier. We believe that such a combined approach would achieve most of the benefits we have described with limited competitive cost.

Adopting such designs—at least for CEOs and NEOs—in the current environment can send a powerful message not only to the public, but internally throughout the company.

Not appropriate for some?

Companies must consider their *complete* compensation program when evaluating HTR requirements. For a company that has a significant long-term compensation program, with multi-year performance- and/or service-based vesting periods, and a rigorous stock ownership guideline, adding HTR requirements may seem at first blush to be overkill. When viewed, however, from the perspective of shareholders and corporate governance—and in view of the substantial amounts that are now being delivered to top executives through equity awards—HTR requirements are an important ingredient. (Of course, for a company that has limited equity compensation or provides below-median compensation, HTR requirements may not be appropriate.)

It should be kept in mind, however, that HTR requirements are most appropriate only for executive officers rather than lower tiers of management. [We very much like the idea of graduated retention ratio tiers as an executive makes his/her way up the higher executive ranks. In this way, the executive can take pride in achieving the next level, with the greater responsibility to shareholders it also entails.]

We expect that many companies would benefit from incorporating HTR requirements into their compensation programs. With retention ratios, these programs appropriately balance the goals of shareholders and executives.

Ten Steps to Designing the Program That Is Right for You:

1. Decide on the type of design. We believe the retention ratio offers the most benefits with the least cost. [But also see our discussion below on ExxonMobil's retention design, which we especially commend to those companies that award restricted stock.] In addition, if a company is considering requirements for specific new-hire or retention awards, long-term vesting may also be an appropriate choice.

2. Pick who will be subject. The most common choice is to include a company's top executives. Alternatives include covering a management committee or, perhaps (at lower retention levels) additional management tiers.

   This is the area where there is probably the most flexibility, depending on what a company wants to achieve. A company can make a substantial statement by covering only its CEO, particularly in light of the disparity between the compensation of the CEO and the remainder of the executive team at many companies. On the other hand, layered retention requirements that go deeper into an organization could be used to foster a company-wide ownership culture (particularly for companies that make extensive use of equity grants).

3. Set retention ratios. The most common retention ratio is 75% of profit shares. Companies should also consider combining this type of retention requirement with a traditional stock ownership guideline. (A hybrid requirement for executives to retain a higher percentage until the ownership guidelines are satisfied may be appropriate.)

   Most companies base HTR requirements on the number of profit shares, but there are examples that base HTR requirements on share value (giving credit for in-the-money, but unexercised, options). In our view, a share-number approach would be consistent with more compensation programs.

4. Decide which shares will be covered. For CEOs and the top level of executives, all outstanding award shares should be included. We are big fans of the approach that many of the savvy companies with HTRs have taken: the CEO commits all his outstanding award shares—including previously vested restricted stock and currently held shares from previous option exercises. He then asks the top tier of executives to make the same commitment. We understand that this approach has worked well in practice. It sends the right message (internally and externally).

   If lower tiers are included, we believe that the most straightforward approach is to cover all equity awards, beginning with any awards that are currently outstanding but unvested at the time an executive becomes subject to the HTR requirement (or even only new grants going forward). This type of requirement is less likely to require change as grant programs mature and is fair to employees who may have had expectations of realizing the value of previously earned and vested shares before becoming subject to the requirement.

Some companies use HTR requirements that cover only one type of grant, such as options. Others cover all shares owned by an executive at the relevant time, including shares previously earned and vested and shares purchased in the open market. A company may also want to consider whether an HTR requirement should apply to any special or nonstandard grants that may be made outside the company's normal incentive compensation program.

5. Consider exceptions. Common exceptions from an HTR requirement include shares pledged to charity, certain estate planning transfers (possibly depending on the continuity of beneficial ownership) and economic hardship. Companies should decide what exceptions apply and who will have to approve them; the latter may be different for executives under the purview of the compensation committee and other employees.

   As we have mentioned, companies may also want to consider relaxing the retention ratio when an executive reaches regular or early retirement age. This type of feature may go a long way toward addressing potential downsides of HTR requirements.

6. Be sure to include anti-hedging provisions. If employees subject to a share retention policy can hedge their shares, the purpose of the policy is defeated. A company should be sure to address this issue in drafting and implementing its policy. [For more on anti-hedging policies, see the September-October 2002 issue of *The Corporate Counsel* at pg 8.]

7. Document the requirement and consider enforcement. Most companies implement HTR requirements through a policy adopted by the board. Adopting a policy tends to be simple, in that it does not require the consent of any specific executive, and is also a straightforward way of covering awards that are outstanding and/or previously acquired shares.

   Companies that take the policy approach will need to consider enforcement. Almost all policies act as a form of moral commitment. For example, Citigroup refers to its holding requirement as a "blood oath." Some policies provide that a violation will be considered in making future awards. Depending on the provisions of an applicable employment agreement or the equity awards themselves, a policy violation could result in cessation of future grants or even be "cause" for termination. If a company is thinking about enforcing an HTR requirement for some period after an executive's departure, having an enforcement mechanism may be particularly important.

   Alternatives to a policy-based approach would be to include the requirements in the award agreements themselves, which may be particularly effective if the executive is required to countersign the award, or to require separate share ownership agreements. Goldman Sachs has used separate share ownership agreements since its initial public offering. [We have posted on CompensationStandards.com Goldman Sachs', ExxonMobil's and Total System Services' agreements.]

8. Don't forget to focus on your SEC filings, etc. We asked former SEC Chief Counsel, David Lynn, what his take is on whether a company has any filing obligations when it adopts an HTR policy. Here's his response:

   "I don't think that policies of this sort get picked up by Item 601(b)(10)(iii) of Reg. S-K as a compensatory plan, contract or arrangement, so I don't really think that they must be filed as an exhibit to a periodic report. Perhaps the best approach is to announce the adoption of the policy in a Form 8-K and file the policy as an exhibit 99.1 to the 8-K. I would also say that the company should post the policy in the corporate governance portion of its website, where I think it is more likely to get noticed than as an exhibit to an SEC report." [We have posted on CompensationStandards.com the JPMorgan Chase Form 8-K with the letter to all employees that announced their HTR policy as an exhibit 99.1.]

9. A Press Release. To follow on David Lynn's suggestion about posting your HTR policy on your company website (and in addition to your proxy disclosure and an 8-K filing), we think that companies should take advantage of this opportunity to trumpet this responsible corporate governance/shareholder friendly move by issuing a press release. (Readers may wish to borrow from the best of the internal communications and proxy disclosures posted on CompensationStandards.com.)

10. Excellent Source of Documents. We have made a number of references to the HTR materials we have posted on CompensationStandards.com that should make it much easier for our readers to implement HTRs without reinventing the wheel. We ask that readers share with us all your HTR documents (including your press releases and website postings) as well as suggestions, pointers and interesting features that we will continue to post so that we may all benefit from each others' experiences.

An Additional Comment on ExxonMobil's Approach

We must confess that we had not been aware of ExxonMobil's "retirement or 10 years after grant—whichever is later" approach until we started preparing for this piece. (As an aside, here is an example—and a heads up for investor relations officers—of how a corporate press release could have generated more investor goodwill.) The more we have examined it, the more we like it.

To recap, 50% of each restricted stock grant made to a top executive vests over 5 years (*i.e.,* typical vesting) but the other 50% does not vest until the later of retirement or 10 years from grant. Note that you don't have to be employed, you just can't receive the shares or enjoy their fruits until 10 years from the date of grant. ExxonMobil feels very strongly that the purpose of its grants is to motivate actions and decisions by the recipients that are in the company's best long-term interests. [Note also that 50% of the total grant is essentially the equivalent of 75% of the profit shares after taxes.]

We like the 10-year horizon—particularly for executives who are approaching retirement. We think that the ExxonMobil approach has application beyond restricted stock to stock options and other forms of long-term incentive compensation. It puts "long-term" back into what we all call "long-term incentive compensation." It sends a great message to shareholders. We would like to hear from readers that adopt this laudable, responsible approach.

Go to It!

HTR requirements provide an easily visible symbol of executive and board commitment. We believe that the time is right for a wider range of public companies to consider these types of requirements.

A Session at the NASPP Annual Conference Devoted to HRTs. Because we expect many companies to be implementing HTRs for their CEOs and NEOs in time for this year's upcoming executive compensation proxy disclosures, we have arranged for Marc Trevino (see below) to head a panel at the upcoming NASPP Annual Conference devoted to HTRs. And, we have just received confirmation that Jim Parsons, who was instrumental in drafting and implementing ExxonMobil's approach, will join us on the panel. Marc and Jim will not only share with us their hands on guidance but will answer all your questions during (and following) the panel.

A Thank You

We would like to thank Marc Trevino of Sullivan & Cromwell and a member of the CompensationStandards.com Task Force for his significant contributions to the above piece. Marc's first hand experience with HTRs has given us invaluable insights into HTR design and implementation. We also owe a thank you to Marc and his colleague Joseph Hearn for the HTR documents that we have posted on CompensationStandards.com.

NEW DEVELOPMENTS

Proposed Regulations for Section 6039 Returns

In our November-December 2007 issue (at pg 10), we reported that, under the Tax and Health Care Relief Act of 2006, companies are now required to file Section 6039 returns with the IRS for ISO exercises and transfers of shares acquired under a Section 423 ESPP plan. Readers will recall that, up until passage of this legislation, companies have been required to provide informational statements to employees for these transactions but have not been required to file returns with the IRS (see our November-December 2005 issue at pg 11).

In late 2007, the IRS issued Notice 2008-8, temporarily suspending the requirement until regulations clarifying when and how to file the returns could be issued. [We understand that this notice was largely prompted by the NASPP's comment letter requesting clarification on the returns.]

On July 16, 2008, the IRS issued proposed regulations governing the returns. The good news is that the proposed regulations would suspend the requirement to file the returns (and comply with the new regulations as they relate to the information statements provided to employees) for all of 2007 and 2008. The deadline for compliance for transactions that occur in 2009 will be January 31, 2010, giving companies ample time to prepare.

The proposed regulations don't really provide much information as to how to file the returns, other than to specify the information that must be included in them and indicate that, later this year, the IRS will publish forms that must be used to file the returns. We look forward to providing our readers with more information on filing the returns once the forms are available.

The IRS is soliciting comments on proposed regulations through October 15, 2008.

Proposed Regulations for ESPPs

When the IRS issued the final ISO regulations back in August 2004, it indicated that it was also working on final ESPP regulations; these proposed regulations were issued on July 29, 2008. While the proposed regulations are far more manageable in length than the final ISO regulations were (a mere 50 pages for the ESPP regs vs. 100 pages for the ISO regs) they still address more aspects of ESPPs than we can cover in full here, so we highlight only a few areas of the proposed regs that we find most significant.

$25,000 Limitation

Perhaps the most significant area of the proposed regs, particularly for companies in Silicon Valley, is the "clarification" of the application of the $25,000 limit to offerings that span a calendar year end. As our readers recall (see our January-February 1998 issue at pg 4), employees in a Section 423 qualified ESPP can purchase only $25,000 worth of stock per year, based on the value of the stock on their grant/enrollment date. Where an offering spans a calendar year (*e.g.,* a 24-month offering), any unused limit from the first year carries forward to the second year of the offering, increasing the amount employees can purchase in that year. Let's say that an employee enrolled in a 24-month offering purchases only $20,000 worth of stock during the first year. The $5,000 worth of stock still remaining available to the employee under the limit at the end of the first year is carried forward to the next year of the offering, so that the employee could purchase $30,000 worth of stock in that year.

Application to Purchase Periods That Span Year-End. Under §423(b)(8)(A), the right to purchase stock under the $25,000 limitation accrues when the employee's right to purchase stock in the ESPP becomes exercisable. This language has generated some uncertainty as to how the limit (and carry forward) applies in an offering that spans a calendar year but where the employee doesn't have the ability to purchase any stock in the first year of the offering. Say an employee enrolls in a six-month offering that begins on October 1 and ends on March 31 of the following year, with the only purchase under the offering occurring on March 31. The employee won't purchase any stock in the first year of the offering, thus, theoretically, the employee will have a full $25,000 worth of stock available under the limit at the end of that year. Does this $25,000 carry forward to the second year of the offering, so that the employee can purchase $50,000 worth of stock on March 31? Or, since the employee's right to purchase stock under the offering isn't exercisable until the second year of the offering, does this mean that the employee accrued no rights to purchase stock under the limit in the first year of the offering, thereby negating any carry-forward for that year, and limiting the amount of stock the employee can purchase on March 31 to $25,000 worth?

Common practice, at least in Silicon Valley—we're not so sure about the rest of the country, has been to assume the former (more generous) approach (*i.e.,* that the employee in our example can purchase $50,000 worth of stock on March 31) but the proposed regulations indicate the latter (more conservative) approach (*i.e.,* that the employee in our example is limited to purchasing only $25,000 worth of stock on March 31) is correct. The regulations emphasize that employees have the right to purchase $25,000 worth of stock only for those years in which their option under the ESPP (the offering period, for typical ESPPs) is both outstanding *and exercisable*. Moreover, an example of a six-month offering, similar to our example, has been added to regulations to further drive home the IRS's point.

Need to Change Practices Now? The IRS also indicates that this is a "clarification" of the existing requirements, not a change or a new regulation, leading us to extrapolate that the IRS (or at least the authors of the proposed regulations) believes that the current ESPP regulations already require the conservative approach. So, while the proposed regulations have an effective date of January 1, 2010, companies that have been assuming that the current regulations allow the more aggressive approach may want to consider switching to the more conservative approach sooner rather than later.

Grant Date

As companies move towards ESPPs with a purchase price based on only the purchase date FMV (the 2007 NASPP Stock Plan Design and Administration Survey reported that 29% of respondents base the purchase price for their §423 ESPP on the purchase date FMV only, up from just 13% in the 2004 survey), the question of when the grant date occurs for tax purposes is muddier. The grant date is key to four purposes (i) establishing the minimum purchase price required under §423(b)(6); (ii) establishing the value of stock purchased under the plan for purposes of the $25,000 limitation; (iii) establishing the start of the two-year statutory holding period for qualifying dispositions; and (iv) calculating compensation income on a qualifying disposition.

<u>No Need for Fixed Price.</u> The proposed regulations would codify positions previously expressed in IRS private letter rulings, namely that it is not necessary for the purchase price to be fixed (or to be based on the FMV) at the enrollment date for that date to be considered the grant date. The grant date would be the date upon which the corporate action necessary to constitute an offer of stock under the plan is completed, provided that the maximum number of shares employees can purchase under the plan is known or can be determined via a formula at that time. Thus, even for plans where the purchase price is based on the purchase date FMV only, the grant date could still be considered the enrollment date.

<u>Share Limit is Required, However.</u> Note, however, that for the enrollment date to be the grant date, the plan must specify the maximum number of shares employees can purchase, either in the form of a flat share limit or via a formula. The regulations expressly state that simply writing the $25,000 limitation (as it is worded in the statute) into the plan is not sufficient for this purpose, nor is a limit on the maximum number of shares that can be issued under the plan. Where the plan doesn't include an individual limit, the grant date will be the purchase date unless the minimum purchase price is fixed as of the enrollment date. This would essentially preclude the plan from having a lookback (*i.e.,* where the price is a percentage of the lower of the FMV at enrollment or purchase) because the grant would be the purchase date and under §423(b)(6), the purchase price could not be lower than 85% of the FMV on this date.

For plans where the price is already a percentage of the FMV on the purchase date only, not having an individually applied purchase limit would force employees to hold the stock for two years after purchase to engage in a qualifying disposition. But, where employees sell at a price higher than the FMV on the purchase date, this wouldn't matter. Because the grant date would be the purchase date, employees' compensation income on qualifying dispositions would be equal to the discount offered under the plan as applied to the grant/purchase date FMV. This will be the spread at purchase, which is the same amount of compensation income that employees would recognize on a disqualifying disposition. Thus, assuming the stock appreciates in value after the purchase, employees would have no incentive to meet the statutory holding periods. [The result is different if the stock price declines and employees sell at less than the FMV on the purchase date. In this scenario, employees' compensation income on a qualifying disposition would be limited to their actual gain on the sale, whereas on a disqualifying disposition it would still be the spread on the purchase date (see our March-April 2002 issue at pg 8).]

Treating the purchase date as the grant would also impact the number of shares employees can purchase under the $25,000 limitation, but since we suspect that few employees ever exceed this limit, we imagine this consideration is secondary at best.

Exclusion of Certain Employees

§423(b)(4) requires that substantially all employees of the company must be allowed to participate in the plan, with exceptions only for employees that have not met a minimum service requirement, part-time employees, and highly compensated employees (as defined in §414(q)).

Highly Compensated Employees. The proposed regulations would expand the definition of highly compensated employees to also allow Section 16 insiders to be excluded either in addition to, or instead of employees that meet the definition under §414(q). The proposed regulations would also allow companies to exclude only a subset of employees that earn above a specified level of compensation, provided that the employees excluded are considered highly compensated under §414(q) and the exclusion is applied equally to all employees in all entities that are permitted to participate in the plan. Thus, the company would not have to exclude all highly compensated employees under §414(q) in order to exclude Section 16 insiders or those above a certain compensation level. For example, although, for 2008, §414(q) defines highly compensated employees as those earning above $105,000, a company could choose to exclude only those highly compensated employees that earn above a higher threshold, say, $300,000.

Non-U.S. Employees. The proposed regulations would allow companies to exclude non-U.S. employees if local law prohibits their participation in the plan or if they would have to be allowed to participate in a manner that would cause the plan to violate the requirements of §423. This is primarily a concern where non-U.S. employees are employed by the U.S. company, rather than by a foreign subsidiary. Companies can exclude employees in foreign subsidiaries simply by choosing not to designate the subsidiary as one of the corporate entities participating in the plan. While all employees of the sponsoring entity must be allowed to participate, it is not necessary to allow employees of the entity's subsidiaries to participate in the plan. Of course, if a subsidiary is allowed to participate, then all employees of the subsidiary must be permitted to participate on an equal basis with the employees in the sponsoring/parent entity.]

Likewise, the proposed regulations would allow companies to permit non-U.S. employees to participate in the plan on a less favorable basis than U.S. employees, if so required under local law. The reverse is not true, however; if local law requires additional benefits under the plan to be extended to non-U.S. employees, those benefits must also be extended to U.S. employees if the non-U.S. employees participate in the plan.

Comment Directly to the IRS at the NASPP Conference in October

The IRS is soliciting comments on the proposed regulations through October 27, 2008. We look forward to hearing more about these regs and the §6039 regs, as well as the latest updates on Section 409A and Section 162(m) during the popular session *The IRS and Treasury Speak: The Hottest Tax Issues for Stock Compensation* at the NASPP Annual Conference in October. A long-standing tradition at the Conference, this session, which includes representatives from both the IRS and Treasury as well as former Treasury staffers, has become a valuable opportunity for an exchange of ideas between practitioners, issuers, and regulators. Although not a substitute for submitting a comment letter, this session does afford attendees the opportunity to make suggestions to the IRS and Treasury; if you have an opinion on any of the recently proposed or issued regulations relating to stock compensation, you won't want to miss your chance to voice it during this session.

KEEPING UP

A Roadmap to Comply with the SEC's New Regulation FD Guidance

Now that the SEC has made dramatic changes to its positions on what companies can—and should—do online, opportunities (and pitfalls) abound. We have just reviewed the upcoming Fall issue of the *InvestorRelationships.com* newsletter, which provides important practical guidance that our readers who counsel public companies will need. The newsletter is an integral part of the important new website—*InvestorRelationships.com*—that Broc Romanek has created to help all those responsible for investor relations and corporate governance keep abreast of the fast-paced changes impacting this area. Be sure that you and clients are taking advantage of this invaluable, new resource.

"The SEC's New Corporate Website Guidance: Everything You Need to Know—And Do Now"

We owe Broc a debt of gratitude for having assembled the foremost experts—including key SEC Staff—who will address head-on many of the most important questions that practitioners are now asking during the upcoming WebConference, "The SEC's New Corporate Website Guidance: Everything You Need to Know—And Do Now" providing us all with the answers and practical guidance that so many of us will need in the days ahead. To receive the upcoming issue of *InvestorRelationships.com* and to access this critical upcoming WebConference, we encourage all our readers to go to InvestorRelationships.com and take advantage of the no-risk membership offer.

Wealth Accumulation and "Walk Away" Amounts

Those of our readers involved in executive compensation and/or proxy disclosures will want to make sure to see next week's issue of *Compensation Standards,* the newsletter that has become an important part of CompensationStandards.com memberships. This issue (which will be mailed to every director) focuses on the importance, for your CD&A disclosures (and in fulfilling directors fiduciary responsibilities), of assembling wealth accumulation/full "walk away" numbers. Readers will want to have that issue in hand to be prepared for calls from the CEO and directors.

New Advisors' Blog

We would like to call our readers' attention to the new *The Advisors' Blog,* maintained by several of the leading compensation consultants and practitioners. We are finding it to be a great way to keep abreast of the latest guidance and practices. Coupled with Mark Borges' Proxy Disclosure Blog and Mike Melbinger's Compensation Blog, these blogs alone are reason to make sure that all your key people are taking advantage of the invaluable resources which are part of your CompensationStandards.com membership.

Upcoming Conference Week

The most important conferences of the year for those of us involved in executive compensation as well as proxy disclosures are upon us. Those readers who cannot take in the October 22nd "3rd Annual Proxy Disclosure Conference" and the October 23rd "5th Annual Executive Compensation Conference" are encouraged to take advantage of the enclosed form which will enable you to view the Nationwide Video Webcasts-–and to have ongoing access to the video archives and materials. Those who can make it to New Orleans, where these critical Conferences will be held, will be joining a large number of our colleagues (we are expecting over 2,000) who will be taking in this year's NASPP Annual Conference and the 40-plus sessions, including the HTR, IRS and net exercise sessions we have referred to in this issue. See You There!

It's Renewal Time

As all subscriptions to *The Corporate Executive* are on a calendar year basis, renewal time is upon us. Please return the enclosed Renewal Form or (to save time and trees) please go to the "Renewal Center" on The CorporateCounsel.net to renew your subscription (note the reduced price when you renew your subscription to *The Corporate Counsel* at the same time).

We thank our readers for the many kind comments we have received from you during this past year. With the continuing rise in importance of executive compensation and proxy disclosure, our readership (both within companies and law firms) has been growing significantly. We thank you for your word of mouth referrals. This coming year promises to bring more changes. We will continue to give you our best to keep you abreast of the latest practices and guidance.

Trial Subscriptions

We encourage those who may not yet subscribe to *The Corporate Executive* to take advantage of the enclosed 2009 No-Risk Trial.

—JMB

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Executive Compensation Reform By the Back Door:

Pay Provisions in the Bailout Plan

By: Paul Hodgson, Senior Research Associate

September 30, 2008

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Analyst Alert

Executive compensation reform by the back door – pay provisions in the bail-out plan

The wisdom of trying to introduce executive compensation reform by the back door of a house that is soon to be repossessed is questionable at best.

Nevertheless, the proposed Emergency Economic Stabilization Act of 2008, the so-called bail-out plan, seeks to piggy-back executive compensation limitations onto legislation covering financial institutions that seek relief under the proposed act.

The act seeks to:

- limit compensation to exclude types of incentive compensation that encourage excessive risk-taking;
- introduce clawback arrangements to allow for the recovery of incentive compensation based on misstated financial accounts;
- prohibit severance payments.

Research from The Corporate Library has shown that many companies have already introduced clawback arrangements voluntarily, so this is hardly at the cutting edge of compensation reform. As for the other two provisions, there is no definition of what might comprise these “types of incentive compensation”, and any limitation on them, and any prohibition on severance applies only while the government retains an equity stake in the company.

Congress backs away from real reform

There was a moment, last week, when it seemed as if these same basic pay limitations contemplated by the act would be given some teeth by requiring companies not only to limit or prohibit certain types of payment, but also to give shareholders more of a say in pay decisions. A draft version of the act before the House also included two important governance reforms:

- proxy access to holders of three percent or more of the company’s equity for purposes of director election and nomination; and
- introduction of an annual, non-binding, shareholder vote on executive compensation – “Say on Pay”.

The act as it stands now has eschewed these reforms. The teeth have been pulled and seem to have been replaced by a set of very ill-fitting dentures in the form of limits under the tax code.

We have been here before.

In 1984, an excess tax on golden parachutes that were greater than 2.99 times salary and bonus was introduced as Section 280G of the Internal Revenue Code (IRC). What were companies’ reactions to this limitation? Instead of being considered a maximum for severance awards, 2.99 times salary and bonus quickly became the minimum, and has remained so. In 1993, another change to the tax code set a cap of $1 million for non-performance-related pay – Section 162(m) of the IRC. The two unintended consequences of this cap were that: $1 million became the base salary of choice, rather than the maximum; and, to satisfy the need for performance-related pay, the use of short-term cash bonuses and stock options ballooned, eventually leading to scandals associated with misstatement of earnings, repricing stock options, backdating stock options, and the opportunistic timing of both awarding and exercising stock options.

Now, the Emergency Economic Stabilization Act of 2008 may add paragraphs to Section 280G and Section 162(m) of the IRC to impose excise tax on any golden parachute payment and to limit tax deductions on any pay over $500,000.

These limits did not work then and they will not now.

Tax is not a deterrent

More than two-thirds of CEOs in the S&P 500 who are eligible for golden parachutes are eligible for one that is in excess of the limits imposed by Section 280G. What do companies do in such a case? They gross up the payments, effectively paying the excess tax for the executive. In addition, more than half of CEOs in the S&P 500 receive a base salary in excess of $1,000,000. The companies simply lose the tax deduction. In both cases, shareholders foot the bill.

Even the current administration understood at one time that in order to limit pay, a limit must be set, not a tax penalty. In 2003, the Bush administration disbursed some $2.3 billion in aid to 66 air carriers, nine of which were required to sign agreements to limit their executives' compensation to amounts equal to the executives' salary in the last fiscal year. This did not discourage the executives of American, American Trans Air, Continental, Delta, Northwest, Planet Airways, United, US Airways and Worlds Airways from participating in the disbursement. So much for the argument that pay caps will discourage executives from participating in the relief.

Executive pay at the root of the crisis

There should be no doubt that executive compensation lies at the root of the current financial crisis. There is a direct link between the behaviors that led to this financial collapse and the short-term compensation programs so common in financial services companies that rewarded short-term gains and short-term stock price increases with extremely generous pay levels. It is a link that The Corporate Library has been flagging for clients for almost 10 years, with concerns voiced about Lehman Brothers, about Merrill Lynch, about Fannie Mae, Freddie Mac, AIG, Washington Mutual, etc., etc. In theory, the attempt to prevent the use of the very compensation policies that precipitated the financial crisis is a step forward. But this will not be achieved through tax law.

While the government is right to want to limit compensation based on risk-taking, it should be careful not to limit performance-related compensation in general. Rather it should ensure that incentive programs are designed and introduced that are capable of providing substantial rewards, but only on the demonstration of substantial long-term and sustainable gains in shareholder value.

These new incentive programs will be different for each company seeking relief because each company is different – some of the companies will be bankrupt, some will have acquired a distressed company, some will have suffered significant share price declines, etc., etc. Compensation plans must be designed that fit each of these scenarios.

The problem is that such new incentive plans, such pay limitations, and such severance prohibitions can only be enforced while the government has a stake in the company. As soon as the stake has been sold, these limits can safely be ignored. If, on the other hand, companies had been forced to introduce an annual shareholder vote approving compensation, and if shareholders had been given the right to propose their own directors rather than simply voting on management's slate of candidates, the situation would have been very different. It is far harder to drop a shareholder vote on pay than it is to lift a pay cap. It is far harder to get rid of a director nominated and elected by shareholders than it is to begin to pay golden parachutes again. Moreover, the oversight and the influence, albeit indirect, that such governance changes bring with them would have gone some way to ensure that fundamental and much-needed changes to executive incentive policy might remain in place for longer than the act contemplates.

Paul Hodgson, Senior Research Associate
September 30, 2008

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Another Brick in the Wall: Fannie's and Freddie's Journey from Government-Sponsored Entities to Government Entities ($25)

In this report The Corporate Library's analysts explore the latest turns of events at Fannie Mae and Freddie Mac and review the companies' troubled history and current issues.

By: Paul Hodgson, Senior Research Associate; Greg Ruel and Damion Rallis, Research Associates
Published: September 12, 2008

Where Are They Now? An Update on Compensation Policy at the Original 'Pay For Failure' Companies ($125)

This report is The Corporate Library's latest assessment of the effectiveness of compensation policy at the companies identified in its first 'Pay For Failure' report, published in March 2006. The new analysis finds that although many companies have made improvements, two compaes – Merck and Safeway – have failed to make significant changes to compensation governance and policy. Additionally, the study examines changes in the companies' fortunes, looks at major acquisitions and divestments, governance changes, turnover in compensation committee membership, and shareholder proposals, all covering the years 2006 through 2008.

By: Paul Hodgson, Senior Research Associate
Published: July 30, 2008

The Corporate Library's
Preliminary CEO Pay Survey

By Paul Hodgson, Senior Research Associate

May 2008

Price: $45.00

The Corporate Library®

Executive Summary

The Corporate Library's 2008 Preliminary CEO Pay Survey is based on compensation data from 614 U.S. companies that filed proxy statements in the first quarter of 2008. Only 380 of the companies in this sample had the same CEO in place for all of fiscal 2006 and 2007, and all of these have provided at least two years of compensation disclosure under the new regulations introduced by the SEC in 2006. It is on this smaller sample that the analysis of increases is based.

Key findings of the survey include:

- CEO pay increased at a much higher rate at large companies than at smaller firms, with a median increase in total actual compensation of almost 16 percent in the S&P 500, compared to a median increase of only 2 percent at other companies;
- for the second consecutive year, the median rate of CEO pay increases is slowing;
- more than half of the CEOs in our sample received smaller cash bonuses in 2007 than in 2006;
- for S&P 500 companies, the median rate of pay increase remains above 15 percent, largely due to greater profits from stock options and vesting of stock awards;
- executive perquisites continue to grow in value for US companies generally;
- fewer than half of the CEOs in the sample as a whole exercised stock options during the year, in part because falling stock prices rendered many options underwater, but also reflecting the shift away from stock options that began several years ago;
- more than half of the CEOs vested in some other form of equity award during 2007; and
- the expensed median value of stock awards exceeded that of option awards, which indicates that boards have been turning to full value stock over stock options as a compensation device.

General findings

The second year of slowing pay growth has brought rates of CEO compensation increase into single digits; at least it has for all but the CEOs of S&P 500 companies. This annual preliminary survey is based on a total sample of 614 companies, and provides a preliminary look at pay movements and pay levels prior to our full report in the fall. Data is taken from the 614 proxy statements that have been filed since January 1, 2008. As usual, pay movement analysis has been restricted to those CEOs who were in post for the whole of fiscal 2006 and 2007, a subset of the total sample numbering 380. The summary table below compares this year's preliminary findings with both the preliminary and final figures from 2007. While the preliminary numbers may turn out to be somewhat lower than the final survey findings, the overall trend clearly shows the slowdown in growth.

The following definitions apply throughout:

- *Total annual compensation* is comprised of base salary, bonus, non-equity incentive compensation, and "all other compensation" (the SEC's term for what are commonly referred to as benefits and perquisites).
- *Total actual compensation* includes all the elements of total annual compensation, as well as value received from the vesting of restricted shares, from the exercise of stock options, and from any change in the value of deferred compensation or retirement benefits.

Table 1: Summary table of changes 2007–2008 (Source: The Corporate Library)

Median increase	2008 preliminary findings	2007 preliminary findings	2007 final survey findings
	%	%	%
Base salary	4.25	4.55	4.75
Total annual compensation	5.04	7.60	12.70
Total actual compensation	5.15	9.29	12.64

For the 380 CEOs who were in post for the whole of 2006 and 2007, the median increase in total actual compensation has fallen to 5.15 percent. The most significant element of slowdown can be seen to be annual and cash bonuses—the two amounts represented by *bonus* and *non-equity incentive compensation*. More than half of CEOs received a lower bonus in 2007 than they did in 2006, while non-equity incentive compensation (NEIC) showed no change at the median, demonstrating that as many CEOs saw an increase as saw a fall. Nevertheless, total annual compensation did increase by 4.8 percent at the median, driven largely by increases in base salary. See Table 2 for details.

It should be noted that our increase analyses are based on the number of CEOs that received the element of compensation in question in both 2006 and 2007. For example, the analysis of base salary increase excludes any companies that did not pay their CEO a base salary in one or both years.

Table 2: All companies changes 2006/2007—matched sample (Source: The Corporate Library)

	Base salary	Bonus	NEIC	Total annual compensation	Total actual compensation
Number	380	100	274	379	379
	Increase (%)	**Increase (%)**	**Increase (%)**	**Increase (%)**	**Increase (%)**
Maximum	66.67	566.67	3,959.35	1,249.63	2,322.33
Upper quartile	7.74	12.55	28.21	19.79	48.89
Average	4.34	(11.34)	20.14	15.48	53.26
Median	4.25	(6.83)	0.00	5.04	5.15
Lower quartile	0.00	(100.00)	(40.00)	(12.57)	(24.60)
Minimum	(100.00)	(100.00)	(100.00)	(100.00)	(92.97)

General increases in the S&P 500

For CEOs in the S&P 500 the situation was different. The 97 S&P 500 CEOs in our sample who had been in post for a two full years saw a median rise of almost 16 percent in total actual compensation. While this latter figure is lower than survey findings in 2007, it is still substantial. While these CEOs did see an increase in their bonus at the median, the decreases were more dramatic—as demonstrated by the average change which was negative 15.33 percent. NEIC rose by a slightly higher median of 5.67 percent. While increases in total annual compensation were similar in the S&P 500 to those in the larger group, the higher profits from stock options and higher value gained from vested stock awards has pushed the median total actual compensation for S&P 500 CEOs well above that of their counterparts.

Table 3: S&P 500 compensation changes 2006/2007—matched sample (Source: The Corporate Library)

	Base salary	Bonus	NEIC	Total annual compensation	Total actual compensation
Number	97	17	88	97	96
	Increase (%)	**Increase (%)**	**Increase (%)**	**Increase (%)**	**Increase (%)**
Maximum	66.67	185.06	251.52	136.11	1,431.68
Upper quartile	7.00	15.01	27.92	18.77	66.91
Average	4.94	(15.33)	8.45	5.78	56.91
Median	4.00	3.61	5.67	5.64	15.87
Lower quartile	0.10	(84.21)	(21.52)	(12.97)	(21.35)
Minimum	(67.49)	(100.00)	(100.00)	(100.00)	(84.46)

Changes in all other compensation

Unexpectedly, the amounts disclosed for all other compensation (the cost of perquisites) also increased. There was a general impression that companies would move away from providing so many executive-level benefits and that these amounts would decrease, but both the wider group and the CEOs in the S&P 500 saw median increases in all other compensation of 4.21 percent and 6.68 percent, respectively. Only 144 (just over a third) saw perk-related costs fall. Perhaps the high cost of jet fuel is driving expenses up. This is the first year that we have had available two years of data on this, so no comparable historical analysis is available.

Increases in retirement benefits

Likewise with retirement benefits, we have two years of data for the first time, and we have therefore also been able to look at changes in the value of accrued pension benefits and in the balance in non-qualified deferred compensation (NQDC) accounts. Accrued pension benefits represent the lump sum value of tax-qualified and non-qualified defined benefit pension plans while the balance in NQDC accounts represents the amount of money deferred by the CEO and/or contributed by the employer to such an account, a sort of super-sized 401(k). Despite the fact that some NQDC accounts are invested in company stock, their median growth exceeds that for pension benefits even though stock prices have been stagnant or lost a considerable amount of value in many cases. As with other compensation amounts, increases for S&P 500 CEOs exceed those for the wider group, though not by as wide a margin.

Table 4: All companies deferred compensation changes—matched sample (Source: The Corporate Library)

	Accumulated pension benefit	NQDC balance
Number	237	236
	Increase (%)	**Increase (%)**
Maximum	1,368.82	825.38
Upper quartile	28.00	40.48
Average	33.87	42.53
Median	13.58	18.93
Lower quartile	4.87	8.34
Minimum	(100.00)	(100.00)

Highest increases

The highest increase in base salary was for William Klesse, CEO of Valero Energy, whose salary went from $900,000 to $1,500,000 between 2006 and 2007. Mr. Klesse has spent slightly over two years as CEO and already has a base salary higher than former CEO William Greehey, who earned $1.4 million after nine years in the post.

The largest bonus increase went to Michael Goldberg, CEO of A.M. Castle, whose bonus went from a $15,000 joining bonus to a $100,000 discretionary bonus. The compensation discussion and analysis (CD&A) in the company's 2008 proxy statement does not provide a proper explanation for the award of the discretionary bonus.

David Weidman, the CEO of Celanese Corp, was the recipient of the largest increase in an NEIC award, though, in reality, the award does not appear to be properly classified as an NEIC award at all, and we are uncertain why it is included in that column. The CD&A in the company's 2008 proxy statement indicates that the amount "consists of annual performance bonus award payouts, payments made pursuant to the deferred compensation plan and the value of the cash balance account pursuant to the revised deferred compensation plan." The amount rose from just over $1 million to over $44 million, but the deferred compensation awards that make up the majority of the award appear to be largely unrelated to performance (and therefore should not be classed as NEIC but rather as all other compensation). The majority of the $44 million is related to service requirements and the occurrence of certain events such as the company's IPO. What minor part of it that is related to performance is either dependent on undisclosed performance targets or is part of a plan that pays 2/3 of the award if the company achieves lower quartile TSR within its undisclosed peer group and up to 80 percent of the award for below median performance. This is a level of achievement that surely needs no reward. The increase in NEIC for Celanese's CEO David Weidman also led to the highest total annual compensation increase of almost 1,250 percent.

Table 6: All companies aggregate annual compensation—full sample (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive compensation	All other compensation	Total annual compensation
Number	614	158	421	598	613
Maximum	$3,300,000	$29,985,474	$44,133,244	$12,932,805	$45,095,895
Upper quartile	$950,000	$1,250,000	$1,785,673	$212,615	$2,669,270
Average	$726,706	$1,204,418	$1,490,717	$241,198	$2,297,428
Median	$695,044	$350,000	$821,560	$74,823	$1,306,571
Lower quartile	$461,730	$113,750	$332,095	$27,779	$753,701
Minimum	$0	$0	$0	$0	$0

Within the S&P 500, the largest increase in NEIC went to Alan Boeckmann, CEO of Fluor Corp, whose award had payouts from three separate plans, a Value Driver Incentive, a Relative Performance Program (both long-term cash incentive plans) and an annual cash bonus and rose by just over 250 percent. These three awards were registered as a single cash amount under the new SEC disclosure regulations. In the prior year only an annual cash incentive paid out. Such changes in compensation demonstrate how truly unhelpful elements of the new SEC disclosure regulations are. Under prior regulations, while payouts from long-term incentives were grouped together, whether cash or equity, they did not serve to confuse shareholders by also including cash payments based on a single year of achievement. The SEC would do well to consider amending the regulations to require discrete disclosure of short- and long-term cash incentives as well as short- and long-term equity incentives so that shareholders know what they are paying for without reference to lengthy footnotes.

Table 7: S&P 500 aggregate annual compensation (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive compensation	All other compensation	Total annual compensation
Number	158	35	128	156	157
Maximum	$3,300,000	$29,985,474	$17,999,970	$5,334,680	$30,969,631
Upper quartile	$1,238,942	$3,900,000	$3,547,539	$405,748	$5,629,545
Average	$1,080,892	$3,563,939	$2,821,737	$389,598	$4,569,927
Median	$1,006,256	$2,500,000	$1,990,000	$207,568	$3,443,194
Lower quartile	$900,000	$447,037	$1,140,389	$90,807	$2,132,216
Minimum	$0	$650	$68,363	$297	$1

Again within the S&P 500, the most substantial increase in total annual compensation, of 136.11 percent, was for Whirlpool CEO Jeff Fettig, due to the payment of an "enhanced SEP award". This enhanced Strategic Excellence Program was based on a single year of EPS performance and three years of cash flow achievement. Only half of the award was included in the NEIC, as the remainder was paid in cash. Again, SEC disclosure regulations are unhelpful here in determining what is being paid and for what performance measures.

Table 8: All companies aggregate long-term compensation (Source: The Corporate Library)

	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual compensation
Number	272	338	335	614
Maximum	$77,711,816	$46,922,559	$9,839,709	$79,561,523
Upper quartile	$5,444,798	$3,116,499	$981,353	$7,080,524
Average	$5,743,260	$2,791,610	$819,491	$6,842,617
Median	$1,945,470	$912,545	$308,001	$2,735,028
Lower quartile	$341,900	$302,022	$65,686	$1,180,602
Minimum	$0	$0	($1,339,002)	$0

Increase analysis for total actual compensation excludes the rise in pay for Steve Jobs at Apple Computer whose total actual compensation moved from $1 to $14,644,801 (an increase of just under 1.5 billion percent) because this would have skewed the average increase for all CEOs. The second highest increase—2,322.33 percent—was earned by Gregory Lucier, CEO of Invitrogen. The rise was largely due to the exercise of stock options and the vesting of restricted stock. The proxy is unclear whether the shares that vested were performance-based, nor does it say how long the stock options, that resulted in a profit of almost $22.5 million, were held, nor what value growth was delivered to stockholders over the period—all of the above would seem to be pieces of information that would go a long way to justifying such an increase in pay to shareholders.

Table 9: S&P 500 aggregate long-term compensation (Source: The Corporate Library)

	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual compensation
Number	85	109	127	158
Maximum	$77,711,816	$46,922,559	$9,839,709	$79,561,523
Upper quartile	$15,228,191	$7,308,959	$2,031,330	$20,999,842
Average	$12,061,487	$5,426,568	$1,412,474	$15,939,498
Median	$5,266,251	$2,811,426	$829,969	$9,904,326
Lower quartile	$1,687,482	$893,443	$190,810	$4,437,055
Minimum	$4,526	$86,261	($1,339,002)	$547,624

The largest increase in total actual compensation in the S&P 500, at just over 1,430 percent, was for Nabeel Gareeb, CEO of MEMC Electronic Materials, who made over $77 million in option profits in 2007, compared to less than $4 million in 2006. The mega grants of options that led to this level of profit appear to be a thing of the past now, though there is still substantial embedded profit leftover in existing unexercised grants, in addition to that already realized.

Table 10: All companies aggregate retirement benefits (Source: The Corporate Library)

	Defined benefit plans		Non-qualified deferred compensation		
	Present value of accumulated benefits	Pension payments last fiscal year	Aggregate earnings last year	Aggregate withdrawal/ distribution	Aggregate balance
Number	342	18	361	31	367
Maximum	$52,396,747	$4,579,398	$11,504,841	$138,590,767	$70,936,367
Upper quartile	$6,547,046	$833,425	$208,036	$180,967	$4,561,398
Average	$5,569,776	$710,162	$224,870	$5,113,786	$4,513,717
Median	$2,848,588	$229,690	$45,158	$38,573	$1,190,194
Lower quartile	$653,802	$67,450	$5,561	$0	$330,071
Minimum	$0	$0	($14,277,565)	($7,285,382)	$0

The single largest increase in pension benefits went to Paul Beideman, CEO of Associated Banc-Corp, who vested in his supplemental executive retirement plan (SERP) after five years, with benefits growing from around $30,000 to around $500,000 in a single year because of this.

In the S&P 500, the CEO of Torchmark, Mark McAndrew, saw his accumulated pension benefits increase by over 326 percent. The company's 2008 CD&A gives the following explanation:

> In order to retain executives necessary to the Company's continued success, in 2006 the Compensation Committee commissioned a report on supplemental executive retirement plans prepared by its compensation consultant, Mercer which found that most of the Company's peers had some form of supplemental retirement benefits. After evaluation of that report and with input from Company management, the Compensation Committee recommended and the Board of Directors approved a new SERP, effective January 1, 2007, for executives designated from time to time as participants by the Compensation Committee. Messrs. McAndrew, Coleman, Hutchison and Herbel and Ms. Montgomery are among the 38 persons designated as participants in the new SERP. Each of these named executive officers except Mr. Herbel also participated in the old frozen SERP. As a condition of participation in the new SERP Messrs. McAndrew, Coleman and Hutchison and Ms. Montgomery agreed to forfeit their frozen SERP benefits unless their fixed frozen SERP benefit would be larger than their respective benefits under the new SERP at the time of their retirement.

The former supplemental pension plan was frozen in 1994 and the huge increase in benefits is a direct result of the recommendation by Mercer to introduce a new SERP, which increased McAndrew's pension from around $740,000 to almost $3.2 million. While it may be true that most of Torchmark's insurance peers offer SERPs for the purpose of retention, surely there is a more focused and performance-related method of achieving this end. Of course, given the company's significant underperformance compared to its peers as measured by TSR, a pension is guaranteed, while performance-related retention awards would have to be earned.

Table 11: S&P 500 aggregate retirement benefits (Source: The Corporate Library)

	Defined benefit plans		Non-qualified deferred compensation		
	Present value of accumulated benefits	Pension payments last fiscal year	Aggregate earnings last year	Aggregate withdrawal/ distribution	Aggregate balance
Number	130	6	134	13	136
Maximum	$52,396,747	$2,246,418	$11,504,841	$138,590,767	$70,936,367
Upper quartile	$13,522,059	$1,586,809	$576,894	$1,310,508	$7,700,168
Average	$9,332,960	$809,275	$618,876	$12,648,875	$7,972,613
Median	$5,503,367	$498,156	$145,483	$165,986	$3,309,964
Lower quartile	$1,729,418	$141,707	$16,605	$31,739	$1,109,221
Minimum	$19,402	$85,556	($14,277,565)	($31,527)	$15,455

The tenfold increase in deferred compensation for Richard Roth, CEO of SJW Corp, to more than $5 million appears to be due to incomplete disclosure in the prior year, although the source of the deferred compensation is still unclear in the current proxy.

While in the S&P 500, the reason for the hefty increase in NQDC at Zions Bancorporation was due to a $3.8 million deferral by CEO Harris Simmons. This was a larger amount than his disclosed earnings during the year, which amounted to just over $3.7 million. The biggest loss in deferred compensation of more than $14 million was due to CEO of Washington Mutual Kerry Killinger's, as it turns out, unwise decision to invest a large portion of his deferred compensation in phantom stock of the company.

Highest paid CEOs

That $77 million option profit already discussed at MEMC Electronic Materials also led Nabeel Gareeb to be the highest paid CEO so far this year, with total actual compensation in excess of $79.5 million. And the $44 million of NEIC led David Weidman, the CEO of Celanese Corporation, to have the highest level of total annual compensation of more than $45 million as well as the highest NEIC. The largest "discretionary" bonus went to the CEO of Goldman Sachs, Lloyd Blankfein, who received a bonus of almost $30 million. Indeed, four of the top five bonuses went to CEOs of financial institutions, including Wachovia, Bank of New York Mellon, Prudential Financial, and American Express. This group was followed by the new CEO of KB Home who received a discretionary bonus of $6,000,000 as the company's shares plummeted and targets were not met. The highest level of accumulated SERP benefits was for Kenneth Lewis, the CEO of Bank of America, whose frozen plan continues to be worth more than $50 million. Edward Hanway, CEO of CIGNA Corporation had the largest savings in an NQDC account with more than $70 million deferred. This distinction could have gone to Ray Irani, CEO of Occidental, except for the fact that he, along with two other executive colleagues, decided to take the balance of two of his accounts as a lump sum in July last year. This amounted to a distribution of more than $138 million, leaving a mere $45 million in his account.

Conclusion

In conclusion, while many CEOs have seen a pay growth slowdown, most noticeable with annual pay, compensation is still on the rise, particularly in the S&P 500. On the other hand, as can be seen from the summary table at the beginning of this report, the preliminary survey findings are often revised upward when the whole dataset is examined, so it is possible that the lower increases found here are not representative. Other findings in the survey include:

- almost three-quarters of CEOs in the survey did not receive a "bonus". In many cases this was due to receipt of NEIC, but in others, no cash incentive was paid at all, reflecting some sensitivity to poor performance;
- less than a third of CEOs received no NEIC during 2007, again reflecting the same sensitivity to poor performance;
- only seven CEOs received no base salary at all, while three received no annual compensation or total actual compensation;
- fewer than half of the CEOs in the sample exercised stock options during the year, in part because falling stock prices rendered many options underwater, but also reflecting the shift away from stock options that began several years ago;
- more than half of CEOs vested in some other form of equity award during 2007, an indication as to where boards have turned when they have moved away from stock options; and
- the expensed median value of stock awards exceeded that of option awards demonstrating the increasing dominance of full value stock over options.

Table 12: All companies aggregate SEC compensation disclosures (Source: The Corporate Library)

	Stock awards	Option awards	Total summary compensation
Number	463	475	614
Maximum	$37,175,835	$32,387,328	$77,628,745
Upper quartile	$2,598,445	$1,951,984	$7,149,388
Average	$2,081,802	$1,708,271	$5,621,350
Median	$869,228	$671,881	$2,864,755
Lower quartile	$271,950	$178,337	$1,217,298
Minimum	($6,400,156)	($160,190)	$0

Table 13: S&P 500 aggregate SEC compensation disclosures (Source: The Corporate Library)

	Stock awards	Option awards	Total summary compensation
Number	143	147	158
Maximum	$37,175,835	$32,387,328	$77,628,745
Upper quartile	$5,184,420	$4,626,316	$17,607,336
Average	$4,114,924	$3,763,320	$12,844,898
Median	$2,730,500	$2,602,223	$9,631,828
Lower quartile	$967,838	$1,310,749	$6,363,505
Minimum	($6,400,156)	$11,461	$1

Table 14: Aggregate compensation S&P MidCaps (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive comp	All other comp	Total annual comp	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual comp
Number	104	21	80	102	104	60	72	62	104
Maximum	$1,300,000	$3,060,000	$3,230,025	$5,029,448	$7,895,108	$33,276,801	$12,847,500	$4,700,118	$35,009,311
Upper quartile	$941,042	$1,512,500	$1,589,375	$241,488	$2,540,265	$5,411,645	$3,346,491	$992,046	$8,111,887
Average	$779,870	$1,035,618	$1,120,850	$297,356	$2,142,815	$4,521,708	$2,023,223	$733,970	$6,639,067
Median	$800,000	$900,000	$987,841	$117,635	$1,848,833	$2,338,223	$1,185,241	$310,298	$4,484,576
Lower quartile	$638,356	$257,250	$549,696	$51,670	$1,372,210	$940,706	$474,212	$54,170	$2,431,202
Minimum	$309,000	$9,731	$17,325	$600	$528,529	$33,584	$100,922	$2,160	$689,057

Table 15: Aggregate compensation S&P SmallCaps (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive comp	All other comp	Total annual comp	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual comp
Number	123	30	86	120	123	47	57	54	123
Maximum	$1,250,000	$1,557,134	$2,500,000	$675,998	$4,840,812	$20,400,858	$5,153,760	$2,109,320	$23,477,499
Upper quartile	$697,565	$522,866	$866,250	$79,550	$1,471,277	$2,648,538	$1,216,061	$622,461	$3,229,291
Average	$580,178	$403,296	$675,410	$82,115	$1,230,893	$2,557,260	$944,783	$384,831	$2,815,988
Median	$550,000	$372,500	$477,347	$43,758	$1,038,553	$1,236,812	$410,553	$144,630	$1,753,033
Lower quartile	$450,000	$112,750	$188,837	$21,453	$696,932	$382,455	$149,790	$26,655	$1,052,075
Minimum	$0	$0	$0	$0	$0	$0	$0	$0	$0

Table 16: Aggregate compensation Russell 1000 (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive comp	All other comp	Total annual comp	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual comp
Number	263	58	207	260	262	140	173	186	263
Maximum	$3,300,000	$29,985,474	$44,133,244	$5,089,642	$45,095,895	$77,711,816	$46,922,559	$9,839,709	$79,561,523
Upper quartile	$1,106,000	$2,790,000	$2,577,197	$369,443	$4,074,694	$9,642,207	$4,561,557	$1,446,182	$15,440,452
Average	$963,918	$2,509,050	$2,426,423	$340,397	$3,777,893	$8,889,519	$4,310,536	$1,176,206	$12,197,574
Median	$950,000	$1,487,500	$1,601,518	$170,783	$2,669,270	$4,778,112	$2,205,410	$547,325	$6,633,389
Lower quartile	$777,308	$290,750	$862,400	$72,853	$1,593,299	$1,355,820	$706,862	$143,648	$3,250,309
Minimum	$0	$650	$17,325	$297	$1	$4,526	$65,836	($1,339,002)	$404,370

Table 17: Aggregate compensation Russell 2000 (Source: The Corporate Library)

	Base salary	Bonus	Non-equity incentive comp	All other comp	Total annual comp	Option value realized	Value realized on vesting	Change in pension and NQDC	Total actual comp
Number	298	87	186	286	298	120	144	131	298
Maximum	$1,473,336	$1,500,000	$2,754,880	$12,932,805	$13,721,267	$33,276,801	$12,847,500	$3,385,305	$35,009,311
Upper quartile	$696,178	$450,000	$822,870	$97,590	$1,388,171	$2,495,884	$1,340,108	$467,649	$3,234,743
Average	$561,113	$342,339	$612,825	$154,919	$1,192,239	$2,446,107	$1,143,654	$371,048	$2,898,156
Median	$519,375	$200,000	$400,000	$43,758	$899,455	$871,288	$400,855	$148,956	$1,598,279
Lower quartile	$415,285	$79,800	$183,585	$19,983	$600,109	$225,680	$152,163	$42,863	$856,225
Minimum	$0	$0	$0	$0	$0	$0	$0	($1,114)	$0

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CEO Pay 2008 ($75)

The Corporate Library's CEO Pay Survey 2008 is based on compensation data from 3,242 US and Canadian companies. The report provides in-depth analysis and presents over 20 tables of information. Final increases for CEO compensation (see Table 1) have outstripped the results from The Corporate Library's preliminary survey published in May this year.

The report analysis takes into account CEO changes and tenure where necessary, excluding those CEOs who had not served for the full 12 months of the latest fiscal year because of promotions, appointments, or resignations reduced this number to 2,701 companies. Only 1,867 CEOs were in the job for the whole of that last two fiscal years, and it is from this smaller sample that increases in CEO compensation were calculated.

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