



NACD-NE Breakfast Meeting: Executive Compensation Update

October 13, 2009



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Trends in Executive Compensation

- Each aspect of executive compensation must be examined in the context of recent economic events, keeping the following trends in mind:
 - Executive base salaries are generally flat (and in some cases reduced) as companies try to manage cash. This is most impacted by company and industry-specific factors.
 - Short-term incentive plans for 2009 have been significantly restructured in terms of metrics and plan structure based on new forecasts and degree of visibility. The majority of short-term incentive plans paid out below target in 2008 and many continue to struggle in 2009 as well.
 - Long-term incentive plans continue to be reviewed as many companies experience underwater stock options or have run rate / overhang issues. Most firms cannot provide historically competitive values because of the impact on burn rates given depressed stock prices.
 - Severance and change-in-control agreements have become more conservative in response to increased scrutiny.
 - Stock ownership guidelines and holding requirements are becoming more prevalent as shareholders push for a greater focus on long-term value creation.

Obama Administration Executive Compensation Guiding Principles

The following are the Obama Administration's proposals and guiding principles for executive compensation in US public companies.

1. **Long-Term Pay for Performance Link** – Executive compensation plans should be designed to reward long-term value creation for investors, as opposed to the short-term focus that doomed financial institutions in the market meltdown.
2. **Long-Term Risk Time Horizon** – Compensation plans for both executives and other employees should be designed to match the risk outcomes of their performance.
3. **Risk Management** – Compensation Committees should include risk-management in the pay setting process, and conduct the risk assessment in a public manner.
4. **Appropriateness of Golden Parachutes and Supplemental Retirement Packages** – Companies should reevaluate the necessity for golden parachutes and supplemental retirement packages, and should determine whether their existence will result in pay for non-performance.
5. **Transparency and Accountability in Pay Setting** – Mandate more transparency and accountability for Compensation Committees by legislating Say-on-Pay and Compensation Committee independence standards.

Transparency and Accountability in Pay Setting

The US Treasury Department proposed legislation in the Investor Protection Act of 2009 that would apply Say-on-Pay and Compensation Committee independence requirements to all US public companies.

Say-on-Pay: The Obama administration is continuing its long push for Say-on-Pay legislation to mandate an annual non-binding shareholder vote on executive compensation. The proposal has two primary goals:

1. Increase the accountability of the Board and the Compensation Committee to better align long-term shareholder value creation.
2. Mandate a non-binding Say-on-Pay vote for all US public companies.

Compensation Committee Independence: The White House is also proposing new Compensation Committee independence requirements for public companies. According to an Administration fact sheet, these requirements are broken down into three components:

1. Compensation Committee independence standards similar to Audit Committee under Sarbanes-Oxley.
2. Compensation Committees will be given the power to utilize consultants, legal counsel, and funding in order to ensure they are given the means to be truly independent.
3. Standards will be issued by the SEC to guarantee the independence of compensation consultants and outside counsel.

Pending Executive Compensation Legislation

Though the US Treasury Department's proposal on executive compensation may have garnered the most attention from the press due to its connection with the White House, many other bills are pending that have repercussions for executive compensation.

- Seven pending bills have been introduced to Congress that would have a measurable impact on executive compensation matters, including the *Shareholder Bill of Rights Act of 2009*, the *Corporate Governance Reform Act of 2009*, the *Excessive Corporate Deductions for Stock Options Act*, the *Excessive Pay Shareholder Approval Act & Excessive Pay Capped Deduction Act*, the *Shareholder Empowerment Act of 2009*, the *Corporate and Financial Institution Compensation Fairness Act of 2009*, and the *Consumer Financial Protection Agency Act of 2009*.
- Many of the bills contain legislation that overlaps, and while it is unclear which bills will gain approval, it is almost a certainty that further executive compensation regulation will be passed this year. Some of the key provisions included in the pending legislation include:
 - Say-on-Pay
 - Mandatory Risk Management Committee
 - Compensation Committee independence standards
 - Majority voting for election of Directors
 - Requirement for independent compensation consultants

SEC Changes: Compensation & Risk

- In their CD&As, companies must disclose their compensation policies and practices as they relate to risk management practices and risk-taking incentives.
- The purpose is to provide investors with material information about how the company compensates and provides incentives to its employees which may create excessive risk to the business.
- Potential issues companies may need to address include:
 - Company's risk assessment, if any, in compensation design (not restricted to executive compensation).
 - Relationship of compensation to "realization of risks" in short and long term.
 - Policies for adjusting compensation to account for risk or modifications a company has made to address changes in risk profile.
 - Extent to which company monitors compensation effect on risk management.

The Link Between Performance and Pay

- A correlation between pay and performance does exist if you begin to look statistics other than the overall package provided in a given year.
- 100% of Top 20 NYSE CEOs and 92% of Top 20 NASDAQ CEOs earned actual bonuses at or greater than their target bonus, while 100% of Bottom 20 NYSE CEOs and 80% of Bottom 20 NASDAQ CEOs received bonuses below target.

| Target Bonus | NYSE | | | NASDAQ | | |
|------------------------------------|---------------|-----------|-----------|---------------|-----------|-----------|
| | All Companies | Top 20 | Bottom 20 | All Companies | Top 20 | Bottom 20 |
| Median \$K | \$2,025.0 | \$1,715.0 | \$3,281.0 | \$1,310.3 | \$1,270.5 | \$1,715.0 |
| Median % of <u>Base</u> | 149% | 129% | 175% | 128% | 126% | 188% |
| Actual Bonus | All Companies | Top 20 | Bottom 20 | All Companies | Top 20 | Bottom 20 |
| Median \$K | \$1,902.6 | \$3,273.4 | \$0.0 | \$1,092.0 | \$1,482.9 | \$1,146.5 |
| Median % of <u>Target</u> | 91% | 170% | 0% | 100% | 133% | 52% |
| Payout Range Prevalence | All Companies | Top 20 | Bottom 20 | All Companies | Top 20 | Bottom 20 |
| % Paying <u>At or Above</u> Target | 43% | 100% | 0% | 53% | 92% | 20% |
| % Paying <u>Below</u> Target | 57% | 0% | 100% | 47% | 8% | 80% |

Data included in this table reflects only those companies disclosing bonus targets, and may not match other summary statistics presented in this study.

10 Considerations for 2010

1. Risk mitigation and risk assessments will be a hot button issue for regulators and the media.
2. Say-on-Pay is likely to be legislated in the near future, and Compensation Committees should make decisions as if it will become a reality.
3. Compensation Committee conservatism reigns as Committee members are increasingly concerned about shareholder and public perception.
4. Interest in performance plans are gaining steam once again as companies seek to further align executive pay with performance.
5. Developing a true executive compensation strategy will yield benefits to those Compensation Committees that make the investment.

10 Considerations for 2010

6. The prevalence of companies adopting stock ownership guidelines will increase.
7. Compensation Committee governance has changed drastically over the last year – significantly longer meetings, time allocated for trends and best practices, conducting an executive compensation audit / inventory.
8. Point-in-time tally sheets are insufficient for making well-informed compensation decisions. It is critical to consider pay using multiple performance scenarios over multiple timeframes.
9. In this turbulent time of evolving regulations and executive compensation design, it is important to ensure that well-meaning compensation modifications of today do not become compensation challenges of tomorrow.
10. Executive compensation consultant independence will become an increasing visible issue that Committees will need to confront.



RiskMetrics Group
The Center for the Financial Community

'09 Proxy Season Trends and a Look Ahead

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Historical Vote Recommendations on Comp Cmte



Pay for Performance Policy

| Year | Withhold Recommendations |
|----------|-----------------------------|
| 2004 | 25 companies |
| 2005 | 70 |
| 2006 | 11 |
| 2007 | 22 |
| 2008 | 43 |
| 2009 YTD | 60 of 4500 annual mtgs ~ 1% |

Problematic Pay Practices Policy

| Year | Withhold Recommendations |
|----------|--------------------------|
| 2004 | Not applicable |
| 2005 | Not applicable |
| 2006 | 15 |
| 2007 | 16 |
| 2008 | 69 |
| 2009 YTD | 400 of 4500 mtgs ~ 9% |

As of 6/15/09

Pay for Performance



| | 2009 YTD Relative | 2008 Absolute | 2007 Absolute |
|---------------------------------------------|-------------------|---------------|---------------|
| # of companies failing the performance test | 975 | 651 | 244 |
| Recommended WITHHOLD/ AGAINST | 60 | 43 | 20 |
| Percent | 6% | 6% | 8% |

The Pay for Performance policy is a case-by-case analysis that looks at both the company's stock performance and the alignment of CEO pay.



Management Say on Pay

Management Say on Pay (MSOP)

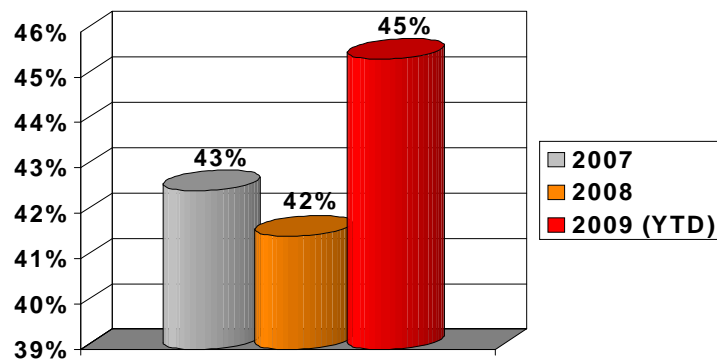
| | FOR | AGAINST | Total * | Comp Committee W/H |
|------------------|-----------|----------|---------|--------------------|
| S&P 500 | 20 (65%) | 11 (35%) | 31 | 4 |
| Russell 3000 | 73 (72%) | 28 (28%) | 101 | 3 |
| Non-Russell 3000 | 148 (87%) | 22 (13%) | 170 | 4 |
| All | 241 (80%) | 61 (20%) | 302 | 11 |

*Number of proposals as of 6/1/09

RMG may recommend withhold/against votes from compensation committee members, in addition to the MSOP, for egregious compensation practices.

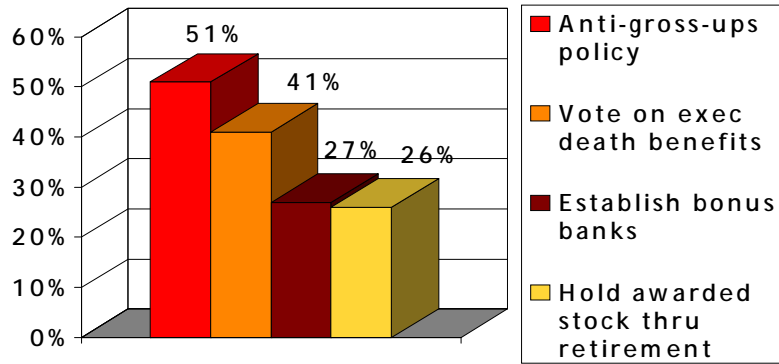


Average Support for SSoP



Source: RiskMetrics Group (% support from votes cast "for" and "against," as of 9/1/2009)

Executive Compensation New Pay Shareholder Proposals

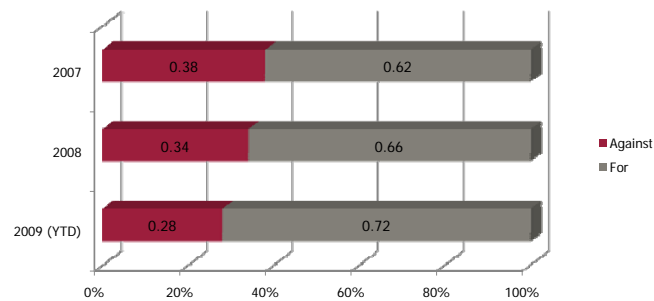


Source: RiskMetrics Group (% support from votes cast "for" and "against," as of 9/1/2009)

Equity Plan Proposals



RMG vote recommendations on equity plan proposals for all companies



Option Repricing/Exchange



S&P 500 Index

| | 2009 YTD | 2008 | 2007 |
|------------------------|-------------|------|------|
| Recommended FOR | 7 | 0 | 1 |
| Recommended AGAINST | 3 | 0 | 0 |
| Total | 10 | 0 | 1 |

Most S&P 500 option exchange proposals contain “shareholder-friendly” features.

Option Repricing/Exchange



Russell 3000 Index (excluding S&P 500)

| | 2009 YTD | 2008 | 2007 |
|------------------------|-------------|------|------|
| Recommended FOR | 15 | 5 | 1 |
| Recommended AGAINST | 33 | 11 | 1 |
| Total | 48 | 23 | 2 |

The primary reasons for recommending AGAINST option exchange programs for the Russell 3000 index are (i) participation by named executive officers and/or (ii) the lack of value-for-value (cost neutral) features.

Update on Executive Compensation

**National Association of Corporate Directors
Boston Chapter
October 13, 2009**



2009 Was A Difficult Year

▪ **Short Term Incentive Issues**

- Budgets did not anticipate depth of recession
- Many STI programs will not reach targets this year

▪ **Long Term Incentive Issues**

- Significant drop in stock prices before LTI issuance
- Using Black Scholes values alone would have dramatically increased dilution
- Equity grants flat to slight increase in shares
 - Management felt they got a pay cut
 - Compensation committees felt they were very fair



2010 Does Not Look Any Easier

- **Short Term Incentive Issues**

- Direction of economy still unclear
- New worry: will management targets be too conservative?

- **Long Term Incentive Issues**

- Focus on share usage: do not want to go to shareholders often
- Match equity instruments to needs of company
 - Restricted shares as part of package for retention
 - Performance shares: what “performance” makes sense?



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Washington vs. The Real World

- **Easy Issues**

- Reasonable severance packages
- Independent compensation committees and consultants
- Transparent disclosure

- **We Need More Clarification**

- Risk Management: complicated issue/different for every company
- Say-On-Pay: shareholders' opinions welcome/how get dialogue?
- Holding Requirements: how long?/unintended consequences?



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