



TRENDS AND ISSUES REPORT

Executive Compensation: Strong Governance in Uncertain Times

A “Quick Poll” in collaboration with *Directorship* magazine



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Executive Summary

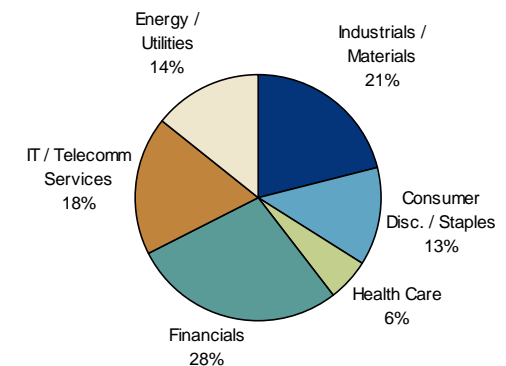
Conducted in collaboration with *Directorship* magazine, the Pearl Meyer & Partners Quick Poll, **Executive Compensation: Strong Governance in Uncertain Times**, examined the processes and protocols that Boards currently rely on when setting executive pay. This issue is increasingly critical given continued economic turmoil and the growing scrutiny of executive compensation, making it more imperative than ever that organizations demonstrate strong and effective governance.

The December 2008, survey of board members, executives and human resources professionals received 71 responses: 43 from “outside directors” and 28 from “employees of the firm” (primarily C-staff executives). The topics addressed include:

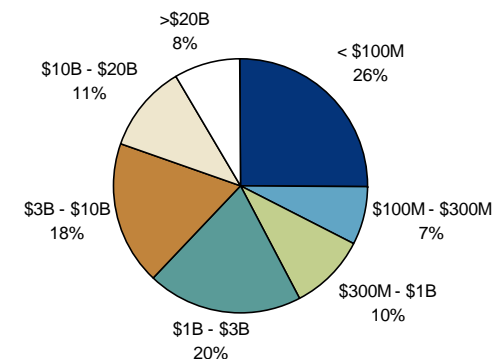
- Allocation of roles and responsibilities among key players involved in governance
Structure.
- Understanding of pay components and mechanics necessary for governance
Knowledge.
- Meeting procedures and objective pay decision inputs that indicate solid governance
Processes.
- Protocols for information flow among key constituencies to ensure clear
Communication.

For a copy of the full survey findings or more information, please contact Jim Heim at jim.heim@pearlmeyer.com or (508) 630-1502.

Respondents by Industry



Respondents by Revenue



Executive Compensation Governance Defined

What is Executive Compensation Governance?

- Governance is the protocols within which executive compensation decisions are made and implemented by Directors and others.
- Participants in the framework include:
 - Board members.
 - Compensation Committee members.
 - Company management.
 - Advisors such as accountants, lawyers, administrators and consultants.

Governance Building Blocks

<p>STRUCTURE</p> <ul style="list-style-type: none"> • Checks and Balances • Roles and Responsibilities of Key Players • Documentation 	<p>KNOWLEDGE</p> <ul style="list-style-type: none"> • Understanding of plan components, metrics and potential pay outcomes • Training and Education • Quality Advisor Support
<p>PROCESS</p> <ul style="list-style-type: none"> • Meeting Procedures • Objective pay decision inputs • Selection and management of advisors 	<p>COMMUNICATION</p> <ul style="list-style-type: none"> • Internal communication protocols among key governance constituencies • External communication protocols (media, institutional shareholders)

Effective governance requires the right structure, knowledge, processes and communication.

Key Findings

Respondents Who Self-Reported “Excellent” Governance vs. Others

The 39% of respondents who self-reported their overall Executive Compensation Governance practices as “Excellent” expressed different views than other respondents on a number of key questions.

Question / Topic	Overall Rating			
	Excellent		All Others	
Number of hours spent by average Compensation Committee member on committee activities over the past 12 months	36% indicated “more than 50”		26% indicated “more than 50”	
Level of CEO influence on the executive pay decision-making process	An Appropriate Amount	100%	An Appropriate Amount	85%
	Too Much	0%	Too Much	13%
	Too Little	0%	Too Little	2%
Level of Advisor/Consultant influence on the executive decision-making process	An Appropriate Amount	100%	An Appropriate Amount	78%
	Too Much	0%	Too Much	5%
	Too Little	0%	Too Little	17%
Indicated that “Too Little Time” was allocated towards executive pay design, governance and administrative activities by the following constituencies...	Compensation Committee Chair	0%	Compensation Committee Chair	26%
	Compensation Committee as a Group	4%	Compensation Committee as a Group	26%
	Board as a Group	8%	Board as a Group	26%
The Compensation Committee receives a report documenting the Peer Group selection process on an annual basis	88%		50%	

Extent to which respondents agreed to various statements relating to their executive compensation governance practices...

Average score based on following scale: 5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1 = Strongly Disagree	“The Compensation Committee has processes in place to ensure that advisor opinions are provided absent the “filter” of Management”	4.8	3.8
	“The Compensation Committee’s self-assessment practices address the appropriate evaluation factors and include specific recommendations for improvement”	4.4	3.3
	“The Compensation Committee has developed mechanisms or protocols that ensure accountability for responding to issues identified in self-assessments”	4.1	3.1

Responses from “Outside Directors” vs. “Employees of the Firm”

Interestingly, there was little difference in the responses of outside directors and firm employees on topics such as:

- The influence of the Committee, outside advisors and the CEO on the executive pay decision-making process (i.e., whether various constituencies had too much, too little, or an appropriate level of influence).
- Whether the Committee was provided with sufficient context and analysis to support effective decision-making.
- The relative importance of various considerations related to executive pay programs, such as pay-for-performance orientation, retention of executives, and risk/reward relationships.

However, employees of the firm were more critical than outside directors when it came to:

- Whether appropriate time was allocated towards executive pay design, governance and administrative activities.

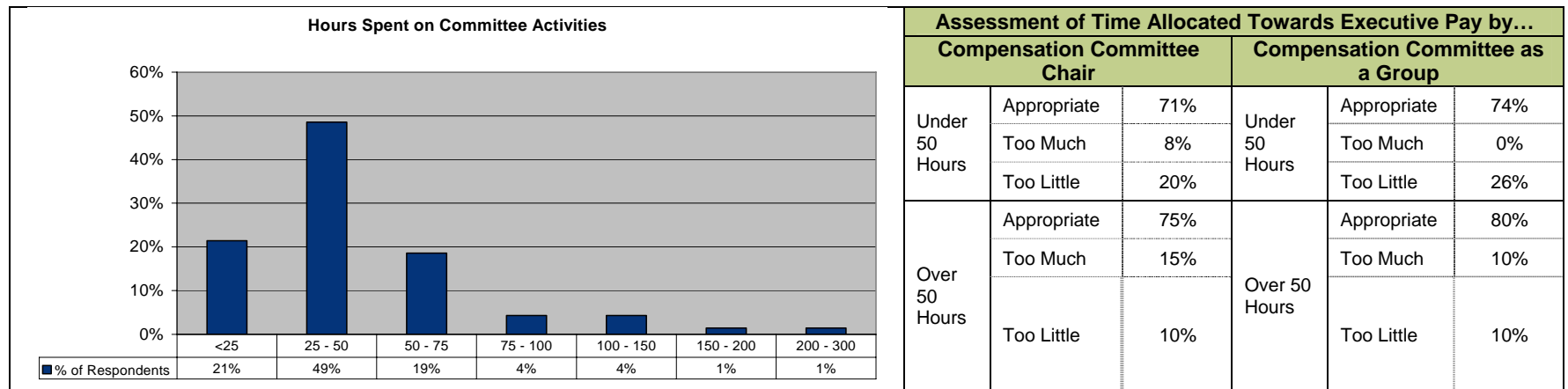
Topic	Responses from Outside Directors		Responses from Employees	
Indicated that “Too Little Time” was allocated towards executive pay design, governance and administrative activities by the following constituencies	Compensation Committee Chair	12%	Compensation Committee Chair	26%
	Compensation Committee as a Group	17%	Compensation Committee as a Group	30%
	Board as a Group	16%	Board as a Group	22%

- How the organization’s Executive Compensation Governance practices were rated.

Topic	Responses from Outside Directors		Responses from Employees	
The quality of Executive Compensation Governance practices	Excellent	44%	Excellent	32%
	Good	46%	Good	40%
	Satisfactory	10%	Satisfactory	16%
	In Need of Improvement	0%	In Need of Improvement	12%

Differences in Responses Based on Committee Time Commitment

The bulk of respondents estimated that over the last year the average Compensation Committee member spent 25 to 50 hours on committee activities, including meeting preparation. Interestingly, respondents where Committee members spent less than 50 hours were about equally likely to describe their time commitments as “appropriate” as respondents where Committee members spent more than 50 hours.



Committees that spent more than 50 hours (on average) on executive pay matters had slightly higher ratings on **Process** questions:

Extent to which Respondents Agreed to Various Statements		Overall Rating	
		Under 50 Hours	Over 50 Hours
Average score based on following scale: 5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1 = Strongly Disagree	“The level of discourse in Compensation Committee meetings is typically of high quality”	4.2	4.5
	“The Compensation Committee has processes in place to ensure that advisor opinions are provided absent the “filter” of Management”	4.0	4.5
	“SEC disclosure implications are considered at the time that major pay decisions (approval of pay increases, program redesign, approval of new contracts) are completed”	4.2	4.3
	“The Compensation Committee’s self-assessment practices address the appropriate evaluation factors and include specific recommendations for improvement”	3.6	4.0
	“The Compensation Committee has developed mechanisms or protocols that ensure accountability for responding to issues identified in self-assessments”	3.4	3.7

Organizations where Committees spent more than 50 hours on average on executive pay also self-reported a higher overall rating for Executive Compensation Governance practices (4.3 vs. 3.9 for Committees that spent less than 50 hours).

Most Critical Factors in Setting Executive Pay

The following table summarizes average responses relating to the criticality of various factors in setting executive pay.

Factor	Average Score	
Appropriate pay-for-performance orientation	4.6	Average Score based on following scale: 5 = Critical 4 = Important 3 = Somewhat Important 2 = Not Important 1 = No Response
Retention of executives	4.2	
Appropriate balance of short-term and long-term goals	4.2	
Appropriate risk-to-reward relationships	4.0	
Shareholder optics	3.7	
SEC disclosure implications	3.6	
Media optics	3.3	

The Building Blocks of Good Governance

Overview

In this section, we further explore questions specific to each of the four building blocks of effective Executive Compensation Governance, and the implications of our findings.

<p>STRUCTURE</p> <ul style="list-style-type: none"> • Checks and Balances • Roles and Responsibilities of Key Players • Documentation 	<p>KNOWLEDGE</p> <ul style="list-style-type: none"> • Understanding of plan components, metrics and potential pay outcomes • Training and Education • Quality Advisor Support
<p>PROCESS</p> <ul style="list-style-type: none"> • Meeting Procedures • Objective pay decision inputs • Selection and management of advisors 	<p>COMMUNICATION</p> <ul style="list-style-type: none"> • Internal communication protocols among key governance constituencies • External communication protocols (media, institutional shareholders)

The Building Blocks of Good Governance – Structure and Knowledge

- Executive Compensation Governance Structure:** Respondents generally felt positively about their structure (checks and balances, allocation of roles and responsibilities, etc.). For example, the vast majority of respondents indicated the constituencies involved in executive pay decision-making each provide an appropriate level of input:

Constituent	% Indicating that Constituent has an “Appropriate Level of Input”
Board	94%
Compensation Committee	94%
Other Committees	86%
CEO	89%
Other Management	87%
Advisors / Consultants	86%

- Executive Compensation Governance Knowledge:** Investing time in developing and maintaining concise summaries of executive pay programs (both program mechanics and executive participation in each program) will increase Committee knowledge, and therefore improve decision making processes. The presence of such summaries is strongly correlated with overall self-reported governance ratings.

Extent to which Respondents Agreed to Various Statements		All Firms	Responses by Self-Reported Overall Executive Compensation Governance Rating			
			Excellent	Good	Satisfactory	Needs Improvement
Average score based on following scale: 5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1 = Strongly Disagree	“Concise summaries are readily available to Compensation Committee Members that address each EXECUTIVE’S current pay program participation, past pay history, contractual arrangements, current equity grant holdings and related information”	3.9	4.4	3.8	2.9	3.3
	“Concise summaries are readily available to Compensation Committee Members that address each significant PAY PROGRAM (e.g., base salary, bonus, equity, contractual arrangements), in terms of philosophy, plan mechanics, and other related information”	3.9	4.4	3.9	3.3	3.3

The Building Blocks of Good Governance – Processes and Communications

- Executive Compensation Governance Processes** - Organizations self-reporting “Excellent” governance practices generally were more likely to distribute meeting materials to Compensation Committee members well in advance of meeting dates. This allows for high quality discourse in Committee meetings (as demonstrated in survey findings) and underscores the importance of effective processes.

Topic	All Firms	Responses by Self-Reported Overall Executive Compensation Governance Rating			
		Excellent	Good	Satisfactory	Needs Improvement
% Responding	60%	76%	50%	50%	50%
Average score based on following scale: 5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1 = Strongly Disagree	4.3	4.7	4.2	3.6	3.3
Extent to which respondents agreed that: “The level of discourse in Compensation Committee meetings is typically of high quality (i.e., valuable perspectives are shared, viewpoints are expressed concisely, discussion tends to improve the decision-making process)”					

- Executive Compensation Governance Communications:** Respondents indicated that the communication protocols for pay administration upon a change-in-control and approval of security arrangements and contracts were least well understood internally. Both are areas that now receive considerable media and shareholder scrutiny. While these processes are complex and are likely reviewed less often than more mundane topics such as base salary adjustments, these findings suggest that Committees would be well served to invest time in developing and reviewing their communications protocols.

Extent to which respondents agree with the statement “Clear communications protocols are documented and understood for each of the following major pay decisions”		Average Score, All Firms
Average score based on following scale: 5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1 = Strongly Disagree	Base salary adjustments	4.2
	Incentive plan design and redesign	4.1
	Equity plan design and redesign	4.0
	Supplemental Executive Retirement Plan (SERP) design and redesign	3.9
	Approval of Security Arrangements/Contracts	3.7
	Pay administration upon a Change-in-Control	3.7
	Pay administration upon termination	3.8



About Pearl Meyer & Partners

For 20 years, Pearl Meyer & Partners (www.pearlmeyer.com) has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. PM&P provides comprehensive solutions to complex compensation challenges for companies ranging from the Fortune 500 to not-for-profits as well as emerging high-growth companies. These organizations rely on PM&P to develop programs that align rewards with long-term business goals to create value for all stakeholders: shareholders, executives, and employees. Pearl Meyer & Partners has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston and Los Angeles.

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About *Directorship*

Directorship's mission is to deliver the most comprehensive intelligence and research on leading-edge practices in corporate governance and boardroom decision-making. It is targeted to the boardroom community, including corporate directors, chief executives and C-suite officers, governance professionals, regulators, public officials, and institutional shareholders.

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