

What do Board Members Need to Be Aware of in Executive Compensation?



**Corporate Directors Group / Directors Seminar at
Pepperdine University**

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Recent Influences on Executive Compensation and Governance

<p>Economic and Financial Crisis Fallout Continues Fall 08 – current</p>	<ul style="list-style-type: none"> ■ Financial industry in headlights ■ Compensation practices to blame ■ Increased number of bank failures ■ Public perception and media scrutiny ■ Restraint occurring in executive pay: no/low bonuses; lower LTI; no/limited salary increases
<p>Treasury/CPP/TARP Fall 08 - current</p>	<ul style="list-style-type: none"> ■ Executive Compensation Restrictions and Compliance ■ Governance/Compensation Committee Requirements (independence, risk review)
<p>Obama Administration June 09</p>	<ul style="list-style-type: none"> ■ Broad principles (risk, pay for performance, SERPS/golden parachutes) ■ Say on Pay (non binding shareholder vote) ■ Compensation Committee independence/consultant independence
<p>SEC New Disclosure Rules New leadership and requirements, 2009</p>	<ul style="list-style-type: none"> ■ Disclosure Rules (including: risk discussion, director/nominee experience and qualifications, CEO/Chair role, shareholder voting results, proxy solicitation process, proxy tables, compensation consultant relationship)
<p>Shareholder Activism Ongoing</p>	<ul style="list-style-type: none"> ■ Increased proposals related to executive compensation and board governance ■ Advisory votes on pay ■ Withhold votes on directors ■ Independent board chairs
<p>Shareholder Advisory Firms (e.g. ISS, Glass Lewis); Ongoing</p>	<ul style="list-style-type: none"> ■ Increased influence and power to drive shareholder votes (stock plans, say on pay, say on frequency) ■ RMG new 2011 guidelines
<p>Bank Regulators – Agency Guidance Final agency guidance released June 25, 2010</p>	<ul style="list-style-type: none"> ■ Guidance for Risk Management of Incentive Compensation ■ Design, Controls, Roles, Process, Accountability of Board

Recent Influences on Executive Compensation and Governance

Dodd-Frank Wall Street Reform Act

Signed into law July 21, 2010

**SEC adopts final rules re: SOP/SOF/SGP
January 25, 2011**

- Say on Pay/Frequency/Golden Parachutes
- Disclosure (pay for performance, pay ratio CEO/employee, Chairman/CEO standards, hedging policies)
- Independence Standards (Compensation Committee/Consultant)
- Claw backs
- Special requirements for Financial Institutions – Compensation
- Proxy Access

- The Dodd-Frank Act represents a “sea change”, not only for executive compensation but for corporate governance generally
 - “Law of the land”—no going back
 - SEC to promulgate rules for compliance and implementation
- Fundamentally alters the relationships between stakeholder constituencies, providing more direct power and influence to shareholders (and their representatives)
 - Provides shareholders with unprecedented ability to influence compensation policies
 - Expands on already increased transparency
- Proxy access in particular represents a fundamental change in corporate governance
 - Allows for potentially different director candidates, with differing agendas
 - Provides expanded power to shareholders (and advisors) to influence policies, and voice displeasure with compensation

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

- Dodd-Frank Act signed into law July 21, 2010; includes executive compensation provisions that significantly modify governance and disclosure for all US public companies
- **January 25th, 2011 – SEC adopted final rules on Say on Pay (SOP) Advisory Votes***
- Key pay-related provisions of Dodd-Frank (in order of anticipated timing):
 1. Say on Pay (2011)
 2. Say on Frequency of the Say on Pay vote (2011)
 3. Say on Golden Parachutes (2011)
 4. Enhanced disclosure regarding Chairman and CEO roles (2011)
 5. Elimination of broker discretionary votes (2011)
 6. Proxy access (2012)
 7. Executive compensation at financial institutions (2012)
 8. Compensation Committee member independence and Committee's oversight authority (2012)
 9. Independence of the Compensation Committee's advisor (2012)
 10. Pay-for-performance disclosure (2012)
 11. Internal equity ratio disclosure (2012)
 12. Mandatory clawback policies (2012)
 13. Hedging policy disclosure (2012)

 Actions needed
  Actions pending SEC rules
  Likely to have low impact

* Collectively, the SOP Advisory Votes refer to shareholder advisory votes on Say on Pay (SOP) [#1 in the list above], Say on Frequency (SOF) [#2], and Say on Golden Parachutes (SGP) [#3] in the table above

■ Dodd-Frank Act – Say on Pay; Say on Frequency

- On January 25, 2011, the SEC adopted Final Rules with respect to Say on Pay, Say on Frequency and Say on Golden Parachutes provisions
- Say on Pay and Say on Frequency apply for shareholder meetings on/after January 21, 2011

Key Provision	Description	Implications/Considerations
<p>#1 Say on Pay ("SoP") 2011</p> <p><i>Applies for shareholder meetings on or after Jan. 21, 2011</i></p>	<ul style="list-style-type: none"> • Must provide non-binding advisory vote on compensation of named executive officers, CD&A and all related disclosure (SEC did not specify format/wording of the vote, though did provide an example resolution) • New required CD&A disclosure item will discuss impact of most recent SoP vote results on compensation policies and decisions • SoP vote does not cover director pay or risk management disclosures • Most investment managers will be required to annually file how they voted on executive compensation-related matters 	<ul style="list-style-type: none"> • Draft proxy language for SoP vote • Redraft CD&A to support favorable SoP vote: <ul style="list-style-type: none"> • Executive summary • Highlight performance linkages • Possible shareholder outreach
<p>#2 Say on Frequency ("SoF") 2011</p> <p><i>Applies for shareholder meetings on or after Jan. 21, 2011</i></p>	<ul style="list-style-type: none"> • Must provide separate non-binding advisory vote on frequency of the SoP vote. Initial vote in 2011 with subsequent votes at least every six years thereafter • SEC rules require four choices on ballot (every 1, 2 or 3 years, or abstain) • Companies can determine whether to follow shareholder SOF vote. Decision must be disclosed in 8-K no later than 150 calendar days following meeting. • Following a majority vote outcome allows exclusion of new shareholder proposals regarding SoP or SoF votes until next SoF vote 	<ul style="list-style-type: none"> • Review bylaws to confirm/allow "multiple choice" SoF vote • Determine frequency preference (if any) and disclose management's choice <ul style="list-style-type: none"> • Triennial – most companies proposing • Annual – favored by ISS • Possible shareholder outreach

Note: Smaller reporting companies (public float <\$75M) are exempt from SOP and SOF until Jan 21, 2013; however, no delay for SGP in the event of a transaction

■ Dodd-Frank Act – Say on Golden Parachutes

- Say on Golden Parachutes will apply to initial transaction filings made on or after April 25, 2011

Key Provision	Description	Implications/Considerations
<p>#3 Say on Golden Parachutes (“SGP”) 2011</p> <p><i>Applies to initial filings made on or after Apr. 25, 2011</i></p>	<ul style="list-style-type: none"> • Must provide non-binding advisory votes on all executive change-in-control arrangements in the context of a transaction-related meeting (unless previously subject to SoP vote) • New disclosure table will be required in merger-related proxies, but may <i>voluntarily</i> be included as part of regular annual proxy – if SGP included in annual proxy, only new or modified arrangements will be voted upon at time of merger • Unlike existing termination disclosures, new table requires values by element, including all perquisites/benefits, and a total column 	<ul style="list-style-type: none"> • Consider whether adding new table to annual proxy statement as part of SoP vote to receive exemption in future years is desirable (no early filers have done yet)

- See Appendix for additional information regarding Dodd-Frank Act provisions and their likely effective dates

Note: Smaller reporting companies (public float <\$75M) are exempt from SOP and SOF until Jan 21, 2013; however, no delay for SGP in the event of a transaction

■ Say on Pay; Say on Frequency – Additional Details

- Say on Pay
 - Vote must be on NEO compensation as disclosed in the CD&A, compensation tables and related narrative disclosure; example language provided:
 - » “RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”
 - New CD&A disclosure required as to whether and to what extent the company took the SoP vote into account when determining compensation
 - For both Say on Pay and Say on Frequency:
 - » Required only for annual meeting/special proxies where director elections; newly public (IPO) companies not exempted
 - » Two-year delay for smaller reporting companies (generally less than \$75 million float)
- Say on Frequency
 - Four choices required on ballot: every 1, 2 or 3 years, or abstain
 - » Companies adopting the SoF approved by majority of shareholders may exclude subsequent SoP and SoF proposals until next required SoF vote
 - Company decisions re: SoF vote must be reported in 8-K no later than 150 calendar days following meeting date
 - Uninstructed shares (broker votes) counted in favor of management’s recommended SoF only in limited circumstances
 - ISS strongly favors annual SoP vote
 - » Views annual SoP vote as an alternative to recommending “withhold” votes for directors; compensation committee members
 - » Absent annual SoP vote, directors up for election in “off” years could be (more) exposed to withhold vote recommendations

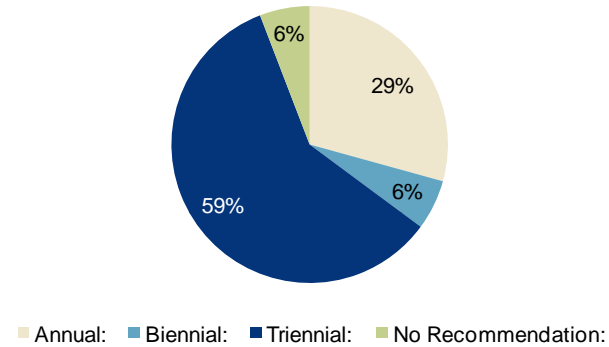
Early Filer Recommendations and Vote Results

2011 Proxy Filers: Board "Say on Frequency" Recommendations

Proxy Dates: 12/2/2010 to 2/17/2011

TOTAL SAMPLE:

	#	%
Proxies Filed:	252	
Say on Frequency Votes:	222	88%
Recommendations for		
Annual:	65	29%
Biennial:	13	6%
Triennial:	131	59%
No Recommendation:	13	6%

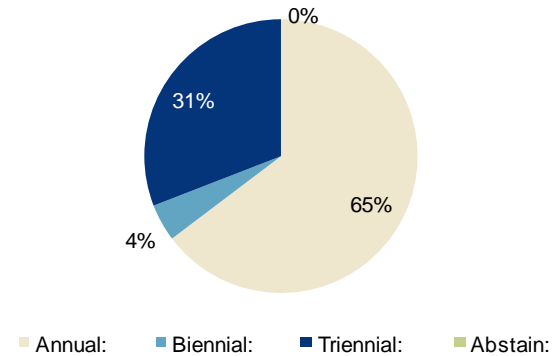


2011 Proxy Votes: Shareholder "Say on Frequency" Vote Results

Proxy Dates: 12/2/2010 to 2/17/2011

TOTAL SAMPLE:

	#	%
Say on Frequency Votes:	222	
Say on Frequency Vote Results:	68	31%
Votes for		
Annual:	44	65%
Biennial:	3	4%
Triennial:	21	31%
Abstain:	0	0%



Early Filer Recommendations and Vote Results

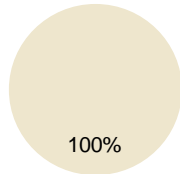
2011 Proxy Votes: Shareholder "Say on Frequency" Vote Results

Proxy Dates: 12/2/2010 to 2/17/2011

Concept: For a given Board recommendation, the number of companies whose voters supported that recommendation.

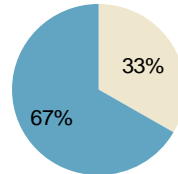
# SOF Vote Results: 68	Board Recommendation (n=62)					
	Annual		Biennial		Triennial	
	#	%	#	%	#	%
For Recommendation	17	100%	2	33%	20	51%
Against Recommendation	0	0%	4	67%	19	49%

Annual Recommendation
0%



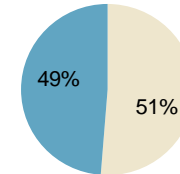
■ For Recommendation
■ Against Recommendation

Biennial Recommendation



■ For Recommendation
■ Against Recommendation

Triennial Recommendation

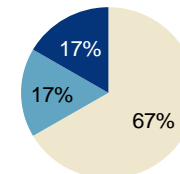


■ For Recommendation
■ Against Recommendation

Concept: For the companies that did not provide a Board recommendation, the number of companies whose voters picked each frequency.

# Vote Results: 6	No Recommendation					
	Annual		Biennial		Triennial	
	#	%	#	%	#	%
Votes For:	4	67%	1	17%	1	17%

No Recommendation



■ Annual ■ Biennial ■ Triennial

Early Filer Recommendations and Vote Results

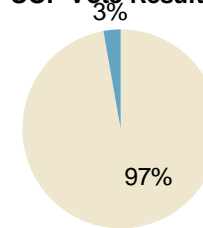
2011 Proxy Votes: Shareholder "Say on Frequency" and "Say on Pay" Vote Results

Proxy Dates: 12/2/2010 to 2/17/2011

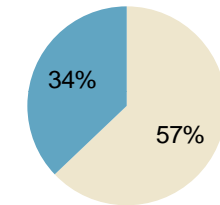
TOTAL SAMPLE:

	#	%
SOP/SOF Votes:	222	
SOP/SOF Vote Results*:	71	32%
SOP Votes		
Consistent with Recommendation	69	97%
Against Recommendation	2	3%
SOF Votes (n=68)*		
Consistent with Recommendation	39	57%
Against Recommendation	23	34%

SOP Vote Results



SOF Vote Results



■ Consistent with Recommendation
 ■ Consistent with Recommendation
■ Against Recommendation
 ■ Against Recommendation

*Note: the discrepancy in the number of SOP vs. SOF votes is due to TARP exemptions from SOF and results from companies that did not make recommendations

- Two companies—Jacobs Engineering and Beazer Homes—failed to receive majority vote for Say on Pay
 - ISS recommendation against SoP due to Pay for Performance evaluation, i.e. CEO pay increased while TSR below median relative to GICS code group
 - In Beazer's case, some additional poor pay practices
- Interestingly, majority support would have been likely in both cases if broker discretionary votes were able to be counted

ISS 2011 Policy Updates – Highlights

Problematic pay practices

- List of “egregious” pay practices reduced
 - Repricing/replacing options or SARs without prior shareholder approval
 - » Includes cash buyouts and voluntary surrender of underwater options
 - Excessive perquisites or tax gross-ups (including on secular trusts; restricted stock)
 - New or extended agreements providing for:
 - » Change-in-control (CIC) payments exceeding 3x (base + bonus)
 - » CIC severance payments without job loss (single trigger or modified single trigger payments)
 - » CIC payments with excise tax gross-ups (including “modified “gross ups)
- All agreements reviewed “holistically”
 - Precludes grandfathering, however new/extended agreements receive highest scrutiny
- Additional problematic practices
 - Egregious employment contracts
 - » Multi-year guarantees for salary increases, non-performance based bonuses and equity
 - Overly generous CEO new-hire package, i.e. excessive “make whole” provisions
 - Abnormally large bonuses without justifiable performance linkage or proper disclosure
 - » Includes metrics that are changed/canceled/replaced during period without adequate explanation
 - Egregious pension/SERP payouts—additional YOS not worked; inclusion of performance-based equity or LTI

ISS 2011 Policy Updates – Highlights

Problematic pay practices (cont'd.)

- Additional problematic practices (cont'd.)
 - Excessive perquisites
 - » Perks for former execs, i.e. lifetime benefits, car allowance, use of aircraft
 - » Extraordinary relocation benefits, including home buyouts
 - » Excessive perk amounts
 - Excessive severance or CIC provisions
 - » CIC cash amounts > 3x (base + bonus)
 - » CIC severance payments without job loss (single trigger or modified single trigger payments)
 - Single-trigger equity vesting not excessive, but ISS considers double-trigger best practice
 - » New or materially amended agreements providing gross-ups/modified gross-ups
 - » Excessive payments upon termination for failure; liberal CIC definition
 - Tax reimbursements
 - Dividends/equivalents paid on unvested performance shares/units
 - Executives using company stock for hedging
 - Repricing/replacing options or SARs without prior shareholder approval
- *Considerations*
 - *Despite shortened “egregious” list, ISS standards are highly subjective*
 - *Having several additional problematic—albeit less egregious—pay practices may result in negative recommendation from ISS*

ISS 2011 Policy Updates – Highlights

Future commitments

- Historically companies with ISS-identified problematic practices could commit to eliminating the practice to avert/reverse a negative vote recommendation
- For 2011, ISS no longer will give credit for promising to eliminate/curtail certain practices (rationale: ISS feels companies have had enough time to transition to its voting policies):
 - Excise tax gross-ups, single or modified single trigger provisions in future new or materially amended employment agreements
 - Excessive perquisites, including home loss buyouts
 - Tax gross ups on perks
 - Guaranteed multi-year incentives
 - Dividends/equivalents paid on unvested performance shares/units
- ISS will continue to accept future commitments to amend/eliminate:
 - Pay-for-performance or equity burn-rate commitments
 - » Since ISS' burn-rate caps and TSR benchmarks are not disclosed until late in year
 - Modifications to plan language re: certain equity grant practices (more liberal CIC definition that benefits shareholders, etc.)

ISS 2011 Policy Updates – Highlights

Updated burn-rate policy

- ISS will vote against new/amended equity plan if a company's 3-year average burn rate exceeds the greater of:
 - Mean plus one standard deviation of the company's GICS group or
 - 2% of weighted common shares outstanding
- For 2011, ISS will limit year-over-year changes in the threshold to +/- 2%
 - Rationale: limiting the year-over-year change will limit the effects of outliers within GICS group and recent market volatility
- Policy change has effect of capping (lowering) burn rates for all but three of the GICS groups in the Non-Russell 3000, and the following groups among the Russell 3000:
 - 2020 commercial services and supplies
 - 2530 consumer services
 - 3520 pharmaceuticals and biotechnology
 - 4020 diversified financials
 - 5010 telecommunications services
- Updated burn rates for all GICS groups are shown in Appendix

Final Thoughts

- Dodd-Frank Act fundamentally changed the compensation and corporate governance landscape
- Expanding and amplifying the influence / power of shareholders and their advisors
 - Perspectives of advisory groups, institutional investors, unions increasingly influential
 - Important to know and manage
- Fundamental change in what it means to be a director (generally) and a compensation committee chair or member (specifically)
 - Near term—increased time commitments, responsibilities (and exposure)
 - Ongoing—education, subject matter experience, communication skills



Appendix: Dodd-Frank Act Overview

Dodd-Frank Act Compensation and Governance Provision Overview

Provision	Description	Implication
<p>Say on Pay Say on Frequency Say on Golden Parachutes</p> <p><i>Applies for shareholder meetings after Jan. 21, 2011</i></p> <p><i>SEC adopted final rules Jan. 25, 2011</i></p>	<ul style="list-style-type: none"> • Must provide non-binding advisory votes on: <ol style="list-style-type: none"> 1. Compensation of named executive officers 2. Frequency of Say on Pay vote: every 1, 2, or 3 years. Initial vote in 2011 with subsequent votes at least every six years thereafter 3. All executive change-in-control arrangements in the context of a transaction-related meeting (unless previously subject to Say on Pay vote) • Investment managers to report votes at least annually 	<p><i>Consider how to formulate the advisory questions in a clear and understandable manner, assessing views and concerns of key shareholders and shareholder advisory firms, and focusing on how to best explain the company's pay packages in the CD&A (e.g., executive summary, supplemental tables, link between pay and performance)</i></p>
<p>Compensation Committee Independence and Authority</p> <p><i>SEC rules by July 16, 2011</i></p>	<p>The Act directs the SEC to adopt Compensation Committee independence standards (stock exchanges may exempt certain companies based on size or other factors)</p> <ul style="list-style-type: none"> • The Committee may in its sole discretion engage outside counsel, and the Company must provide appropriate funding 	<p><i>Once the regulations are issued, companies will need to determine if the heightened independence standards disqualify any members. Likely to look like audit committee standards</i></p>
<p>Compensation Committee Advisors (Consultants and Legal Counsel)</p> <p><i>Applies for shareholder meetings after July 21, 2011</i></p>	<p>No absolute requirement that the advisors to the Compensation Committee be independent or be used. However, Compensation Committee must assess the independence of their Advisors, based on suggested factors to be articulated by the SEC</p>	<p><i>Companies will eventually need to disclose if a compensation consultant was engaged by the Compensation Committee and whether work from a compensation consultant causes a conflict of interest</i></p>

Dodd-Frank Act Compensation and Governance Provision Overview

Provision	Description	Implication
Elimination of Broker Discretionary Vote <i>Effective immediately (SEC to issue proposed rules Q2, 2011)</i>	<ul style="list-style-type: none"> Brokers may not vote without customer instruction on certain issues, including: election of Directors and “executive compensation” (e.g. Say on Pay) 	<i>Some companies historically have relied on the discretionary authority to brokers to achieve positive votes on executive compensation issues. Going forward, it may be increasingly important for companies to conduct shareholder outreach in advance of any votes on compensation issues</i>
Clawback Policies <i>No effective date (SEC to issue rules)</i>	<p>Companies must implement and disclose policies for recouping payments to current and former executive officers based on financial statements that are subsequently restated (this is an expansion of the Sarbanes-Oxley clawback provisions)</p>	<i>Companies will eventually need to adopt a clawback policy, however, an effective date has not been specified yet (the national securities exchanges and associations are to issue listing requirements and the SEC needs to issue regulations)</i>
Enhanced Disclosure in Proxy (four areas) <i>No effective date (SEC to issue rules)</i>	<ol style="list-style-type: none"> <u>Pay for performance</u>: the relationship between compensation actually paid to executives and the company’s financial performance <u>Internal equity ratio</u>: the ratio between the CEO and median employee’s pay <u>Hedging policies</u>: whether employees and Directors are permitted to purchase financial instruments to hedge or offset a decrease in the firm’s stock price <u>Role of COB/CEO</u>: why the roles of the Chairman and CEO are combined or separate 	<i>The Act is unclear with respect to instruction and details of these provisions. The SEC is required to issue rules and will address effective dates</i>

Dodd-Frank Act – Special Rules for Covered Financial Institutions

- Effective date unclear – **SEC issued proposed rules February 8, 2011**; final rules to be adopted between April and July, 2011
- Directs Federal regulators to require “covered financial institutions” to disclose structure of incentive compensation arrangements (“ICAs”) so that the regulator may determine:
 - If the structure provides excessive compensation
 - If it could lead to material financial loss
- Regulators will provide guidelines that prohibit incentive compensation that encourages inappropriate risks by providing excessive compensation or that could lead to material financial loss
- “Covered financial institutions” include depository institutions, broker-dealers, credit unions, investment advisors, FNMA, FHLMC, and any other financial institution that the regulators indicate should be covered
- Exemption for financial institutions with assets of less than \$1 billion

■ Dodd-Frank Act – SEC Proxy Access Rules

- The Dodd-Frank Act confirmed that the SEC has authority to allow proxy access, and the SEC has issued new rules (August 25, 2010)
 - Smaller Companies (<\$75 million float) are exempt for three years
 - Allows certain eligible shareholders to have their nominees included in the proxy ballot
 - On October 4, 2010, the SEC delayed implementation pending Court of Appeals review of challenges brought by U.S. Chamber of Commerce and the Business Roundtable

Provision	Description
Eligible Nominating Shareholders	Only those shareholders that hold at least 3% of voting securities for a period of three years (which may be aggregated) are permitted to have their nominees included in the proxy. <ul style="list-style-type: none"> – Shareholders cannot borrow stock to achieve this threshold amount
Timing (window period)	Nominations must be filed with the SEC and delivered to the Company 150 days after the Company's prior year proxy filing within 120 days of the one year anniversary
Number of Allowable Nominations	Shareholders allowed to nominate the greater of 1 director or 25% of the total Board (even for staggered and classified Boards)
Process Not Intended to Effect CIC	Shareholders cannot use new rules if they hold their stock with the intent of changing control of the company
Requirements for Director Nominees	There will be certain requirements specified in the rules, including independence, company qualification requirements, etc
Multiple Nominees	In cases where a company receives multiple shareholder nominations, it must include in its proxy materials the nominee of the shareholder with the highest qualifying voting power percentage
Company Response	If the company decides to include the nominee, it must notify the nominating shareholder within 30 days of its proxy filing. If the company believes it can exclude the nominee, it must notify the nominating shareholder within 14 days after the close of the window period for the submission of nominations.

Dodd-Frank Act / Proxy Access

Timeline of Implementation and Further Actions

Provision	Effective Dates in DFA	Status or Further Action Scheduled
Say on Pay and Say on Frequency	Proxy statements for meetings on or after 1/21/2011	SEC issued Final Rules 1/25/2011
Say on Golden Parachute	Effective on or after 4/25/2011	SEC issued Final Rules 1/25/2011
Financial Institution Excessive Compensation Rules	Rules to be issued by 4/21/2011	Proposed Rules Issued by Joint Regulators Feb.,2011 Final Rules scheduled for Apr. – July, 2011
Compensation Committee & Advisor Independence; Committee's Oversight Authority	Effective by 7/16/2011	SEC to issue Proposed Rules Jan. – Mar., 2011 SEC to issue Final Rules Apr. – July, 2011
Disclosure of Compensation Consultant Conflict of Interest	Proxy statements for meetings occurring on or after 7/21/2011	SEC to issue Proposed Rules Jan. – Mar., 2011 SEC to issue Final Rules Apr. – July, 2011
Clawback Policy	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Pay-for-Performance Disclosure	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Internal Equity Ratio Disclosure	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Disclosure of Hedging	None stated	SEC to issue Proposed Rules Aug.– Dec., 2011
Disclosure of COB/CEO Roles	None stated, but it is so similar to 2010 rule that most companies have complied in the 2011 proxy	SEC has not committed to dates for guidance
Proxy Access	SEC issued final proxy rules August 25, 2010; effective 60- days from publication in Federal Register, but delayed implementation pending Court of Appeals review	Court of Appeals review – expedited, but no firm dates set
Broker Non-Vote on Executive Compensation	Effective 7/21/10	SEC to issue clarifying Proposed Rules Apr. – July, 2011



Dodd-Frank Act Details

■ Say on Pay – Details/Final Rules

- Required non-binding advisory vote on compensation of Named Executive Officers; effective for any shareholder meeting occurring after January 21, 2011
- Non-binding vote that cannot be construed to:
 - Overrule a decision by the Board
 - Create any change in the fiduciary duty of the Board
 - Limit shareholders' right to make executive compensation proposals
- SEC's final rules provide that:
 - Vote must be on NEO compensation as disclosed in the CD&A, compensation tables and related narrative disclosure
 - » Does not cover non-employee director pay or risk assessment disclosures
 - Specific wording/format not proscribed; however example provided:
 - » *“RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”*
 - New CD&A item requires disclosure as to whether and to what extent the company took the SoP vote into account when determining compensation
 - For both Say on Pay and Say on Frequency:
 - » Required only for annual meeting/special proxies where director elections; newly public (IPO) companies not exempted
 - » Two-year delay for smaller reporting companies (generally less than \$75 million float)

▪ Say on Frequency – Details/Final Rules

- Effective for any shareholder meeting occurring on or after January 21, 2011; must include a separate resolution subject to shareholder vote on whether the Say on Pay vote should be held every one, two or three years:
 - Included in the first proxy statement including the Say on Pay vote
 - At least every six years thereafter
- SEC final rules provide that:
 - Four choices required on ballot: every 1, 2 or 3 years, or abstain; plurality vote represents outcome
 - » Companies adopting the SoF approved by *majority* of shareholders may exclude subsequent SoP and SoF proposals until next required SoF vote
 - Company decisions re: SoF vote must be reported in 8-K no later than 150 calendar days following meeting date
 - 2012 proxies must disclose SoF adopted by company and date of next SoP vote
 - Uninstructed shares (broker votes) counted in favor of management's recommended SoF only if three requirements met: (1) an SoF recommendation is included in proxy; (2) the proxy card includes "abstain" option and (3) proxy card includes statement in bold as to how company will vote uninstructed proxies
- ISS strongly favors annual SoP vote
 - Views annual SoP vote as an alternative to recommending "withhold" votes for directors; compensation committee members
 - Absent annual SoP vote, directors up for election in "off" years could be (more) exposed to withhold vote recommendations

▪ Say on Golden Parachutes – Details/Final Rules

- Effective for any shareholder meeting occurring on or after January 21, 2011
- Applies to initial transaction filings made on or after April 25, 2011
- The Act requires a non-binding advisory vote on golden parachute agreements or understandings and compensation for all listed U.S. companies
- A separate vote is required at any shareholder meeting to approve an acquisition, merger, consolidation or sale of substantially all of the company's assets (a "Transaction")
- Issuer must disclose to shareholders in clear and simple terms:
 - Any agreements or understandings with any Named Executive Officer
 - » For votes by the target company's shareholders, disclosure covers agreements between target company and its NEOs and also seems intended to cover agreements between such NEOs and the acquiring company, but read literally, requires disclosure of agreements between the target company and acquiring company's NEOs.
 - » For votes by the acquiring company's shareholders, the disclosure covers agreements between that company and its own NEOs.
 - Includes any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the Transaction, and
 - The aggregate total of such compensation that may be paid or become payable on such Transaction
- No Say on Golden Parachutes vote is required if the agreements have been previously approved as part of a prior Say on Pay vote

■ Say on Golden Parachutes (cont'd.)

- A new disclosure table (Item 402(t)) will be required in the following format:

Golden Parachute Compensation

Name	Cash(\$)	Equity(\$)	Pension/NQDC(\$)	Perks/Benefits(\$)	Tax Reimbursement(\$)	Other(\$)	Total (\$)
PEO							
PFO							
A							
B							
C							

- Differs from current termination disclosure (Item 402(j)) in significant ways
 - Includes value of all perks, even if under \$10,000 threshold
 - Includes value of all benefits, even if provided to all salaried employees
 - Must be displayed in tabular format, including a “total” column
- Does not replace Item 402(j) in annual proxy statement
- If Item 402(t) included in annual proxy statement, Say on Golden Parachute vote in merger proxy will not be required if arrangements are not modified

■ Compensation Committee Independence

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- New standards must be implemented for Committee independence under the Act, which are in addition to the independence standards already applicable to compensation committee members pursuant to:
 - Existing exchange listing standards
 - Section 16 of the Exchange Act
 - Section 162(m) of the Internal Revenue Code
 - State law
- The Act requires the SEC to direct national securities exchanges and national securities associations, by July 16, 2011, to adopt a condition for the listing of any security that issuers have an independent compensation committee
- Factors for exchanges to take into account in defining independence:
 - The source of compensation of the board member, including any consulting, advisory or other compensatory fee paid by the issuer to that member
 - Whether a member of the board is affiliated with the issuer, its subsidiary or affiliate of a subsidiary
- These standards are similar to the standards applicable to determine the independence of audit committee members required by SOX

■ Compensation Committee Authority

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- As part of the listing requirements to be implemented under the Act, a compensation committee must:
 - Have the authority to retain a compensation consultant or legal adviser that reports directly to the compensation committee
 - » This is already a NYSE (but not NASDAQ) listing requirement
 - Be provided with the funding to retain a compensation consultant or legal adviser
 - » Other securities laws currently mandate a similar listing requirement with respect to audit committee counsel and advisers

Compensation Committee Consultants and Disclosures

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- Committees may only select compensation consultants, legal counsel, or other advisors after taking into consideration factors that could affect their independence, including:
 - Other services provided by the consultant to the company
 - Ratio of fees received by a company to total revenues of consultancy
 - The policies and procedures of the consultant that are designed to prevent conflicts of interest
 - Any business or personal relationship of consultant
 - Any company stock owned by the consultant
- Regulations defining independence to be issued by July 16, 2011
- Factors are intended to be competitively neutral among categories of consultants
- The SEC will issue rules requiring proxy disclosure regarding whether:
 - A company chose to retain a compensation consultant
 - The compensation consultant's work raised any conflict of interest and, if so, the nature of the conflict and how the conflict was addressed
- The new disclosure requirement is effective for meetings occurring on or after July 21, 2011
- These new disclosure rules are in addition to existing disclosure requirements relating to the role and, in certain cases, the fees, of compensation consultants

■ Uninstructed Broker Votes on Executive Pay

- Effective with enactment, but SEC to issue transition rules
 - SEC has tentatively committed to issuing proposed rules between April and July, 2011 that further explores other matters that may constitute “executive compensation”
- The Act requires all national securities exchanges to prohibit brokers from voting proxies for shares without receiving specific voting instructions from the beneficial owner of the shares (resulting in so-called broker non-votes) with respect to votes on:
 - Election of directors (already not permitted for NYSE member firms)
 - “Executive compensation”
 - Other significant matters as determined by the SEC
- Votes on “executive compensation” include Say on Pay, Say on Frequency and Say on Golden Parachutes votes and will presumably include votes on compensation plans in which executives participate

■ Clawback Policies

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- Companies must implement and disclose a policy for recoupment of incentive pay in the event of a material restatement that would not have been paid had the financials not been restated
- Clawback Parameters (and observations on some outstanding issues):
 - The company must recover from any current or former executive officer who received, based on erroneous data, incentive-based compensation (including stock options awarded as compensation)
 - » What does “received” mean?
 - » Is a stock option “received” on grant? Vesting? Exercise? Sale of shares received upon exercise?
 - During the three-year period preceding the date on which the issuer is required to prepare an accounting restatement,
 - In excess of what would have been paid to the executive officer under the accounting restatement
 - » Is the clawback based on the award or the payment of the compensation?
 - » If the exercise price of an option is higher than it would have been, is that an offset against the clawback?
 - » If a bonus was discretionary, does the Committee consider how it would have exercised its discretion taking into account the restatement? Or does the clawback only cover objectively-determined incentive-based compensation based on quantifiable financial information?

■ No need to show executive wrongdoing

■ Enhanced Disclosure – Pay for Performance

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- The Act directs the SEC to issue rules (timing/effective date not specified) requiring each company to disclose in its proxy statement information that shows the relationship between executive compensation actually paid and the financial performance of the issuer
 - Companies should take into account change in value of shares, dividends and distributions
 - This requirement focuses more on the results than the awards
 - Over what period is the financial performance and paid compensation to be measured and compared?
 - » The stock performance graph previously required in connection with executive compensation disclosure in proxy statements (now found in the Annual Report) showed total shareholder return over five years
 - The information can be presented in either graphic or narrative form

■ Enhanced Disclosure – Pay for Performance (cont'd)

- What/when is compensation “actually paid”?
 - Is compensation paid when it vests?
 - When it is distributed?
 - When an option is exercised?
 - How long after an employee receives/is awarded/vests in shares must the “value of the stock” continue to be taken into account? What if the employee no longer holds the shares?
 - Would compensation earned or accumulated be a better concept than paid?
- What is “financial performance of the issuer”?
 - “Financial performance of the issuer” is to be measured taking into account any change in the value of the shares of stock and dividends of the company and any distributions.
 - Is financial performance measured as:
 - » Share price?
 - » Total shareholder return?
 - » Performance versus peer group?
- These rules will likely be equally complex as those currently in effect regarding disclosure of how and why awards are made

■ Enhanced Disclosure – Internal Equity Ratio

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- The Act directs the SEC to amend the proxy rules to require disclosure of:
 - The annual compensation of the CEO (measured under the proxy rules)
 - The median total annual compensation of all employees other than CEO (measured under the proxy rules)
 - The ratio of the median of the compensation of all employees (other than the CEO) to the CEO's compensation
- For purposes of determining the ratio, the rules instruct use of the “Total” column in the Summary Compensation Table
 - Potentially extraordinarily burdensome given the amount of time and resources already required to perform Summary Compensation Table calculations for only a handful of executive officers
- The median calculation covers “all employees of the issuer”
 - Will it be limited to actual employees of the issuer or will it require inclusion of employees of subsidiaries and affiliates?
 - Will it include foreign employees? Part-time employees?

■ Enhanced Disclosure – Hedging Policies

- **This rule will not be effective for proxies filed prior to end of second quarter, 2011**
 - SEC tentatively committed to issuing proposed regulations between November and December, 2010, and final regulations between April and July, 2011
- The Act directs the SEC to issue rules requiring companies to disclose in their proxy statement whether directors or employees are permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted as part of their compensation or held, directly or indirectly, by them
 - Disclosure rule, not a substantive requirement
 - Many non-financial companies also have already addressed hedging in their insider trading policies
- The Act only targets hedging of equity positions; it does not cover, for example, credit default swaps on an issuer's unfunded SERP liabilities

■ Enhanced Disclosure – Role of CEO/COB

- The Act directs the SEC to issue rules by January 17, 2011 requiring companies to disclose in their annual proxy the reasons why the issuer has chosen:
 - The same person to serve as chairman of the board and CEO; or
 - Different individuals to serve chairman of the board and CEO
- As of February 2010, the SEC's amended proxy rules already require issuers to briefly describe the leadership structure of the registrant's board:
 - Whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions
 - The disclosure should also indicate why the registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the registrant
- **The SEC has not announced a schedule for proposed or final guidance, leading many to believe the rule will be effective for 2011 proxies**



Appendix: ISS 2011 Burn Rate Caps

2011 ISS Burn Rate Caps

Mean + Standard Deviation
Russell 3000 Non-Russell 3000

GICS	Description	2010	2011	2010	2011
1010	Energy	2.14%	4.03%	4.30%	6.30%
1510	Materials	1.63%	3.04%	4.54%	6.54%
2010	Capital Goods	1.95%	3.34%	4.69%	6.69%
2020	Commercial Services & Supplies	2.89%	4.89%	3.53%	5.53%
2030	Transportation	2.13%	3.36%	2.31%	4.31%
2510	Automobiles & Components	2.99%	3.25%	2.99%	4.99%
2520	Consumer Durables & Apparel	2.97%	3.26%	3.37%	5.37%
2530	Consumer Services	2.80%	4.80%	3.17%	5.17%
2540	Media	2.28%	4.10%	4.03%	6.03%
2550	Retailing	3.10%	4.11%	4.01%	4.62%
3010					
3020					
3030	Consumer Stables	2.92%	3.76%	3.17%	5.17%
3510	Health Care Equipment & Services	3.65%	4.66%	7.92%	9.92%
3520	Pharmaceuticals & Biotechnology	5.16%	7.16%	8.58%	10.58%
4010	Banks	2.05%	2.78%	2.12%	4.12%
4020	Diversified Financials	5.15%	7.15%	8.30%	10.30%
4030	Insurance	2.02%	3.04%	2.31%	4.31%
4040	Real Estate	1.04%	2.02%	3.13%	3.18%
4510	Software & Services	5.47%	7.26%	7.58%	9.58%
4520	Technology Hardware & Equipment	4.79%	5.84%	7.08%	9.08%
4530	Semiconductor Equipment	4.82%	6.64%	7.31%	7.78%
5010	Telecommunication Services	2.50%	4.50%	5.08%	7.08%
5510	Utilities	0.80%	2.00%	1.64%	3.64%