

## Top 10 Compensation Committee Agenda Items for 2010

For most people looking at the well-known illusion below, the orange circle on the right appears to be larger than the one on the left. In fact they are exactly the same size.



We begin this year's "Top 10" report with this simple illusion to emphasize that when it comes to executive compensation, *context is everything and perception is relative*. The popular view of executive compensation for most of the past two decades is represented by the circles on the left side, with strong economic growth, company performance and shareholder value creation making the executive pay circle at the center appear relatively small. But on the right side, the current economic reality makes the same center circle look huge, especially in terms of

the desired alignment between performance and shareholder value.

Responding effectively to this seismic change in the surrounding "grey circles" demands that Compensation Committees carefully reconsider their own perspective on many pay practices. Accordingly, we recommend the following **Top 10 Compensation Committee Agenda Items for 2010**:

- 1) Revisit Your Executive Compensation Strategy and Philosophy
- 2) Address Possible "Red Flag" Compensation Practices
- 3) Validate and, Where Needed, Strengthen Pay-for-Performance Relationships
- 4) Expand Assessment of Compensation-Related Risk
- 5) Review Long-Term Incentive Program Design
- 6) Adopt an Enforceable Clawback Policy
- 7) Reconsider the Need for Employment Contracts and Severance Agreements
- 8) Improve Proxy Disclosure in Preparation for "Say on Pay"
- 9) Create a More Rigorous CEO Evaluation Process
- 10) Evaluate the Adequacy and Independence of Compensation Advice

As exemplified by the opening diagram, the relative importance of each of these items, and investor perceptions of your current practices, will depend in large part on the contextual variables specific to your own organization. These include industry, size, historic and expected performance, competitive outlook, business strategy and shareholder base. By evaluating the Top 10 in the context of those considerations, you can prioritize these action items and commit appropriate time and resources to your own company's most critical needs.

## 1) Revisit Your Executive Compensation Strategy and Philosophy

Compensation Committees are often bombarded with comparator data and percentile positioning relative to a peer group or broader market data. And although the peer group and pay strategy may be lightly revisited every few years, we recommend that Committees take a step back from the minutia of data and competitive positioning and rearticulate the company's fundamental philosophical principles that serve as the foundation for executive pay decisions.

For decades, the Lake Wobegon Effect prevailed in boardrooms – all executives were above-average performers deserving of higher-than-average compensation. And, for many years, the rising tide of corporate performance and shareholder returns insulated Directors from periodic criticism that such attitudes resulted in spiraling compensation levels. Today, in a context of challenging economic conditions and an SEC newly focused on the role of “benchmarking,” any compensation strategy that continues to *target* pay above the market median, absent superior performance, is very exposed and requires either revalidation or complete overhaul.

To that end, we recommend Compensation Committees take the following actions in 2010:

### **Validate Your Peer Group**

Although the perfect peer group is rare, it should closely resemble current competitors for business, capital and talent, while being realistic in terms of size and complexity. For most companies, revenue is the most appropriate measure of size and complexity is reflected in considerations such as customer base, global footprint, technological requirements, government regulation, etc. There should be a consensus on the key selection criteria and parameters for inclusion; followed by a robust evaluation of current and alternate peer groups.

### **Consider Additional Survey Sources**

Most peer groups include 15 to 20 companies, which offer precision against direct competitors but may not fully reflect competitive positioning against a broader market definition (especially for functional roles that are not necessarily industry-specific). When assessing market positioning, peer group data should be supplemented by reputable, industry-specific survey data that can be adjusted to reflect the size of your organization.

### **Review and Validate Your Pay Positioning Strategy**

Many companies find it useful to have a specified market target for compensation (e.g. the 50<sup>th</sup> percentile). Some companies also select a “performance leveraged” pay strategy that targets short- and long-term incentive opportunities higher than base salary (e.g. the 75<sup>th</sup> percentile). Where this is the case, Compensation Committees should ensure that the relative target pay positioning is supported by the relative target performance positioning (e.g. performance goals set at a level believed to represent 75<sup>th</sup> percentile performance when targeting 75<sup>th</sup> percentile pay).

Once there is consensus on the proper market definition and a targeted pay positioning strategy, the Committee should consider the appropriate role and weight of the market data in the overall pay determination process. We believe such information is relevant and useful as a component of decision-making, but that other factors and judgment should be considered in making fully informed and effective decisions.

## 2) Address Possible “Red Flag” Compensation Practices

In a phenomenon known as the Butterfly Effect, seemingly small differences at the beginning of a process can produce disproportionately large variations in the eventual outcome. Much the same thing occurs in the executive compensation arena, where relatively small differences in practices or program designs can end up as “red flags” that provoke an outsized reaction from shareholders and advisory groups. Most successful CEOs and their Compensation Committees balk at the prospect of being strong-armed by the media, politicians, regulators, activist shareholders, or proxy advisory firms. However, the reality is that executive compensation remains a litmus test of good governance and director independence. By making relatively small reforms, Committees may mitigate or avert a seriously adverse shareholder reaction.

Accordingly, we encourage taking a long, sober look at any and all pay and benefit practices that are likely to be publicly perceived as egregious. Committee members should determine whether such practices are truly needed and worth “going to the mat” over, or could be modified or eliminated without sacrificing the compensation program’s overall competitiveness or effectiveness.

Following are a few potentially problematical areas to examine in 2010:

### **Employment Contracts/Severance**

Because they are contractual in nature, employment and severance practices evolve slowly. Nonetheless, Committees can ameliorate negative attention by eliminating certain “lightning rod” practices from arrangements with *new* executives, including: (i) multi-year guarantees; (ii) excessive “make whole” provisions; (iii) extraordinary relocation benefits; (iv) change-in-control payments exceeding 3x salary and bonus; and (v) gross-ups for excise taxes. Beyond that, committees should reassess the *business rationale* for continuing any such practices for incumbents.

### **Equity-Based Compensation**

Beyond traditional concerns with acceptable annual and aggregate dilution, there is growing attention to equity-based programs that (i) lack a specific grant timing policy; (ii) pay dividends or dividend equivalents on unearned performance shares/units; (iii) lack the ability to clawback gains if predicated on financial results that are subject to a restatement; (iv) lack policies that prohibit executives from any form of hedging activity in the company’s stock; and (v) allow for repricing, replacing, or buying out underwater options without shareholder approval. At a minimum, Committees should evaluate their current practices and ensure appropriate policies are in place to address these concerns.

### **Executive Perquisites**

Despite their often relatively small dollar value, many controversial perquisites can be enormously costly in terms of lost political capital and goodwill with shareholders. Regardless of competitive practice, it is increasingly difficult to justify company-paid perquisites for the most highly compensated employees. The apparent tone-deafness of some companies to criticism only fuels support for additional regulatory oversight and intervention in executive pay matters. At a minimum, committees should pre-empt problems by eliminating lightning rod practices from agreements with new executives and reconsider their *business rationale* for incumbents.

### 3) Validate and, Where Needed, Strengthen Pay-for-Performance Relationships

Pay-for-performance is the motherhood and apple pie of executive compensation. Every company claims to honor it, but few actually ensure that their programs satisfy what we call the essential “three Rs”:

- Right Level of Pay
- Right Performance Measures
- Right Level of Performance

Too often, companies default to (i) the current or market pay levels; (ii) using the same measures as prior years or peers; and (iii) tying to management’s budget without considering other performance perspectives. We believe a more robust process and approach is needed to substantiate claims of pay for performance. We recommend that Compensation Committees consider the following issues as they close out 2010 and begin planning for 2011:

#### **The Right Level of Pay**

Setting compensation opportunities under variable pay programs should be *influenced by* competitive practice and market benchmarks, but also consider the company’s pay mix philosophy and risk profile; the individual’s contribution to performance; and the aggregate relationship between payouts and performance. Ultimately, the *actual* level of pay will be evaluated relative to performance – not the target pay opportunity relative to market benchmarks.

#### **The Right Performance Measures**

Too often, companies take an autopilot approach to the complex and critical task of selecting performance measures, using the same metrics year after year regardless of changes in their company circumstances or overall business conditions. Moreover, across multiple incentive plans, they may focus too much, or too little, on particular areas of performance (e.g., by over-emphasizing profit at the expense of managing the balance sheet).

We recommend that Compensation Committees thoroughly assess whether all their programs’ performance measures:

- Are central to the company’s business strategy and market differentiation
- Are strongly and *demonstrably* correlated to value creation for shareholders
- Can be affected by management actions in an appropriate time-frame
- Are complementary across programs
- Can be reliably measured and monitored

#### **The Right Level of Performance**

The goal-setting process should be based on more than management’s annual budget and 3-to-5 year business plan. Threshold, target and superior performance levels should reflect a 360-degree assessment – that is, a comparison to historical performance levels, to peer performance, and to future expectations of shareholders and “the Street.” Each of these perspectives should be supported by multiple forms of analysis and the resulting market-based performance goals aligned with corresponding incentive award levels to create a pay-for-performance relationship that is appropriate at *all* points along the payout curve.

Compensation Committees should annually backtest their incentive plans to determine whether the “targeted” pay-for-performance relationship was actually achieved, recognizing that the lack of performance alignment can result in a non-sustainable compensation level (e.g. relative pay above relative performance) or create retention risks (e.g. relative pay below relative performance).

#### 4) Expand Assessment of Compensation-Related Risk

In the wake of the near-collapse of financial markets and ensuing global economic downturn, many blamed excessive risk-taking and outsized Wall Street compensation packages. Under new SEC rules, all listed companies now must formally assess whether compensation-related risks are “reasonably likely to have a material adverse affect on the company.” However, many processes now used to evaluate and address compensation risk may be insufficiently rigorous or explicit to address regulatory requirements and growing shareholder concerns.

All Compensation Committees should undertake a more rigorous compensation program risk assessment in 2010. This is a three-part process: to identify policies, practices, and features that may add to or mitigate risk-taking; to ensure that the Compensation Committee is knowledgeable about the company’s business risks; and to ensure that compensation plans are designed, administered and appropriately balanced so as not to exacerbate those risks or create new risks.

The exact process should be based on each company’s unique combination of business strategy, organizational structure, ownership, compensation philosophy and program design. The following components are relevant to most situations:

<p style="text-align: center;"><b>Compensation Program Design</b></p> <ul style="list-style-type: none"> <li>▪ Peer Group/Pay Positioning</li> <li>▪ Compensation Mix</li> <li>▪ Risk Pay Horizon vs. Pay Time Horizon</li> <li>▪ Ownership Requirements/Clawbacks</li> </ul>	<p style="text-align: center;"><b>Performance Metrics and Goals</b></p> <ul style="list-style-type: none"> <li>▪ Strategic Alignment</li> <li>▪ Selected Measures and Definitions</li> <li>▪ Goal Setting Analytics/Processes</li> <li>▪ Funding and Calibration (Slope)</li> </ul>
<p style="text-align: center;"><b>Administrative Procedures</b></p> <ul style="list-style-type: none"> <li>▪ Approval Process/Timing</li> <li>▪ Auditing/Validating Results</li> <li>▪ Discretionary Adjustments</li> </ul>	<p style="text-align: center;"><b>Communication and Disclosure</b></p> <ul style="list-style-type: none"> <li>▪ Clear Communications/Expectations</li> <li>▪ Prompt Resolution of Issues</li> <li>▪ Accurate/Adequate Proxy Disclosure</li> </ul>

Within each of the areas box above, Committees should develop a robust and standardized set of questions to help in evaluating whether a given arrangement is a red, yellow, or green light for the organization. Questions might include:

- What are the key business risks and how might they impact or be interrelated with the compensation program?
- Are there significant differences between the Company and market pay levels / practices?
- Could the mix of pay elements (fixed vs. variable and short-term vs. long-term) result in undesirable risk taking?
- Are upside and downside opportunities in incentive plans appropriate?
- Are performance metrics balanced and aligned with the Company's business strategy and time horizon for key business risks?

The ultimate goal is not the absolute elimination of compensation-related risk, but to ensure the level of executive rewards and related risk-taking remain in shareholders’ long-term interests.

## 5) Review Long-Term Incentive Program Design

Long-term incentives are generally the largest component of executive compensation value, play the broadest role in attracting, motivating, and retaining desired talent, and – given the need for shareholder approval of new share requests – are often the most scrutinized. Although incentive designs should always be tailored to the unique needs and priorities of the company, Compensation Committees should take a step back and reconsider the following fundamental design concepts to ensure they are still appropriate and effective for where the company is today:

### **Stock Options vs. Restricted Stock**

Stock options and restricted stock are very different in terms of their risk/reward profiles, performance linkage opportunities, and shareholder alignment. The choice or mix of equity vehicle should extend beyond consideration of competitive practices or participant preferences. It should include a fact-based assessment of each vehicle's ability to create the desired pay for performance relationship, including the life-cycle stage of the company and its future growth prospects. For example, the stock price of a company with high volatility, a high beta, and limited trading volume may be driven more by external factors than underlying business performance – thereby limiting the potential effectiveness of stock options as a reward currency.

### **Service-Based vs. Performance-Based Vesting**

In response to the focus on pay-for-performance, some companies have eliminated service-based components in their long-term incentive programs. However, this can result in limited retention value from performance-based awards if the history or prospect of earning shares is low. This is especially true in the current economic cycle, where goal-setting visibility remains low and earning opportunities are therefore more variable. A key question for Compensation Committees is whether retention objectives need to be met with service-based awards or whether the opportunity for performance-based awards is sufficient.

### **Absolute vs. Relative Performance**

Most companies today use absolute performance goals in their long-term incentive programs. Stock options are tied directly to absolute changes in the company's stock price, while performance shares are often linked to absolute performance goals over a 1-3 year period. However, most companies today face increased market volatility and continued poor visibility into near-term economic conditions. In these circumstances, relative measurement may present an effective alternative for companies with a solid peer group or index to reference, when used in combination with other long-term incentive components.

### **Performance Period vs. Vesting Period**

Despite a general push to put the "long-term" back in long-term incentives, performance periods continue to be pressured by the problem of poor goal-setting visibility. This has led to the use of hybrid designs with a 1-year performance period followed by a 2-4 year vesting period. Although these designs may create the desired 3-5 years performance period, they may not necessarily result in a true long-term performance orientation.

### **Ownership Requirements vs. Holding Periods**

Most large companies maintain minimum stock ownership policies, with a smaller percentage of companies requiring equity holding periods in conjunction with or separate from the ownership policy. Generally, ownership standards are intended to align executive and shareholder interests, whereas holding periods are intended more to align rewards with the time horizon of risks. Committees should evaluate both programs in tandem to determine if they are necessary and appropriate.

## 6) Adopt an Enforceable Clawback Policy

Given the significant portion of executive compensation delivered via performance-based variable pay programs, there is growing concern about companies' ability to recoup or clawback payments based on financial results that are later restated. The principle here is simple and logical – if the compensation was not truly earned, it should be returned to the company and its shareholders. In practice, however, such policies are challenging to design and administer.

Rather than simply adopting a generic clawback policy or one modeled after a competitor, Compensation Committees should specifically address the following key issues:

### **Covered Employees**

While any employee receiving incentive compensation can be covered under a clawback policy, in practice most policies today focus on a limited group of executives who are in positions to identify, mitigate, or avoid the kind of circumstances that might be involved in a subsequent financial restatement. Compensation Committees should decide whether their priority in having a clawback policy would be to protect the company and its shareholders in aggregate, or to provide a deterrent or penalty for problematical behavior.

### **Covered Compensation**

Any performance-based compensation can be subject to clawback policy. However, most policies today are limited to short- and long-term incentive compensation that is predicated on the financial results subject to restatement. Some policies have a broader reach that includes any equity-based compensation gains, under the logic that share prices were positively affected by the financial results that were subsequently restated. Compensation Committees should determine what is fair and consistent with the objectives of the policy.

### **Covered Restatement**

Any restatement could be covered by the clawback policy, but most policies today are limited to (i) a “material” restatement that (ii) was determined by the Board to be caused by specific actions or inactions on the part of the covered employees and (iii) where the impact of the restatement resulted in a “material” reduction to the amount of incentive compensation that would have been paid to the covered employees. Again, Committees should decide if the priority is to cover any restatement, or to isolate material restatements in which the covered employees played an active or passive role. Most shareholders support the former, but executives may point to other intended controls in place from internal and external auditors that they relied on for interpretive guidance and approval.

### **Board Discretion**

Regardless of the choices made above, the Compensation Committee and the Board also must decide whether the clawback process should be triggered by any qualifying restatement, or whether discretion can be applied. Most current clawback policies allow for Board discretion so that (i) all the relevant facts and circumstances can be considered and (ii) a cost/benefit assessment can be performed before initiating the process to recoup prior payments.

### **Effective Date**

Clawback policies can be retroactive or, as is the case with most policies in place today, prospective in nature. Compensation Committees need to decide whether to include prior awards and grants, and whether to include a “statute of limitations” on policy enforcement.

Given these complexities, care should be taken to avoid unintended consequences by considering all possible scenarios.

## 7) Reconsider the Need for Employment Contracts and Severance Agreements

Many of the top shareholder concerns and “egregious practices” involve employment contracts and/or severance agreements. This is due in part to their nature:

- Contracts are often used to induce executives to join the company and may contain relatively generous provisions.
- Contracts and severance agreements are intended to protect executives in the event of job loss, *not* as a means to align pay and performance.
- Contracts and severance agreements are enduring legal contracts and often not easily changed to address emerging practices and trends.
- Most payments for severance and other clauses are made years after arrangements were approved, creating a disconnect between the facts and circumstances at the time of adoption and the actual, later payout.

These arrangements continue to attract a high degree of scrutiny from shareholders and the SEC. Accordingly, Compensation Committees should again take a step back and evaluate their role in the overall compensation strategy. Below are a few of the contextual considerations that should be explored and vetted:

### **New Hires**

New hires offer the best opportunity to eliminate and/or substantially modify contracts. Ironically, however, contracts address some of the biggest concerns of incoming employees: role clarity, compensation commitments and severance protection. Moreover, their limited and low W-2 history with the company expose new hires more to “Golden Parachute” excise taxes until they have accumulated multiple years of bonuses, option exercises, and stock vesting. For those reasons, Committees should carefully consider how to phase in or phase out employment contracts and severance protection for new hires.

### **Significant Owners**

Contract, severance, and change-in-control benefits are less obviously needed for executives who are founders or significant owners. In such cases, ownership provides a degree of protection in the event of job loss, but also reduces the likelihood of job loss or a change-in-control that would not directly benefit the individual. Compensation Committees should not automatically offer such arrangements based on job title, but consider the need and business purpose of arrangements of the particular incumbent.

### **Late-Career Executives**

Employment contracts for late-career executives who are also longtime employees may be unnecessary. Similarly, severance protection may be less appropriate if the individual has significant accumulated retirement benefits or equity-derived wealth. Furthermore, potential contractual protections such as non-compete and non-solicitation features may no longer provide material benefits to the company. Again, Compensation Committees should evaluate the need for such arrangements based on the incumbent, rather than the position.

Amending or terminating contracts can be challenging. At a minimum, Compensation Committees should utilize such arrangements only when necessary and with appropriate time horizons for either (a) when certain features of the arrangement (e.g. 280G gross up) will expire or (b) the entire agreement will expire (e.g. no evergreen renewal).

## 8) Improve Proxy Disclosure in Preparation for “Say on Pay”

Although “Say on Pay” has been on corporate radar screens for several years, it appears likely to be implemented for all public companies in 2011. While we believe there is little to fear, such a mandate will make the CD&A and related compensation disclosures important means of communicating with and influencing shareholder views on executive pay matters. In response, Committees should adopt a renewed and more nuanced focus on their executive compensation disclosures, with the goal of moving beyond purely technical compliance with SEC proxy requirements to effectively “tell the story” behind their decisions and the outcomes.

While most companies have made significant improvements to their executive compensation disclosures in recent years, the prospect of Say on Pay requires that proxy materials be particularly clear, concise, and persuasive. We recommend Committees review and discuss the following issues with those responsible for the company’s proxy materials:

### Executive Summary

Most CD&As are long and attention spans are short. It is therefore an effective communication strategy to begin compensation disclosures with an “Executive Summary” that covers the critical information shareholders will need to understand the Compensation Committee’s decision-making during the year, including:

- An overview of the economic and industry competitive context
- Key business results during the year
- The impact of those results on executive officer pay
- The impact of business results and other factors on decision-making for next year

### More Analysis

The SEC continues to expect more analysis of executive compensation in the CD&A. Among the results reported that are particularly ripe for expansion:

- Any competitive market assessment
- Any review of pay and performance alignment
- Any analysis used to select performance measures or set goals
- The analysis used for compensation program risk assessment

### Supplemental Tables

There is always a disconnect between target pay and actual pay, and between proxy-reported pay and actual pay. These disconnects can become even more pronounced when declining performance results in substantially lower actual pay, but the SCT and other disclosures continue to focus on target pay. Coupled with the probability of “Say on Pay,” this creates a considerable opportunity for confusion and misunderstanding that could negatively influence shareholder votes.

Accordingly, companies should seek opportunities to include supplemental tables that more accurately and clearly communicate compensation results for recent years. Examples might include:

- The percentage of total compensation opportunity that is performance-based
- The percentage of target short-term incentive opportunity achieved in each of the prior 3 years
- The percentage of equity grant value reported over the prior 3 years that was actually realized
- The percentage of total outstanding equity holdings that is underwater

## 9) Create a More Rigorous CEO Evaluation Process

The Compensation Committee or the full Board is responsible for evaluating the CEO's performance and CEO pay is based in part on that review. However, many lack a robust and structured process for performance assessment. Given the importance in the current environment of getting CEO pay right, Committees should identify key areas that may need improvement, particularly:

### **Process Leadership**

Ideally, the Board Chairman or Lead Independent Director should lead the CEO performance evaluation process. In practice, at many companies the Compensation Committee Chair is in charge. What is most important is that the process be led by a Board member in a leadership role and who has credibility with the CEO.

### **Process Participants**

Most CEO evaluation processes obtain performance feedback from all Board members. Some companies have expanded the process to include direct reports to the CEO (i.e. 360-degree feedback) and significant customers. Involving a broader group in the performance review can provide more holistic feedback, but with the drawback of increased administrative complexity and confidentiality concerns.

### **Evaluation Content**

A CEO performance evaluation should be sufficiently broad to capture all aspects of current and future job performance, including: Leadership, Culture, Communication, Job Performance, Board Relations, and Shareholder Relations. Within each of those areas, specific performance criteria, key strengths and development opportunities should be evaluated and rated.

### **Evaluation Focus**

Some components of the CEO performance evaluation review may be applicable in making future pay decisions. However, the content of the review, and the Committee's efforts, should be focused on the goal of providing constructive feedback and professional development that will improve the CEO's performance and effectiveness.

### **Administration**

If the Board uses a relatively simple evaluation process in which only Board members provide feedback, it can sometimes be administered by the Board Chair/Lead Director. Where the process and forms are more complex, and certainly where 360 feedback is included, a third-party administrator may be needed to relieve the company's administrative burden and to ensure participant confidentiality.

### **Feedback**

The Board Chair/Lead Director should meet with the CEO to provide summary feedback. Where rating scales are used, the aggregate average rating on each performance dimension can be used to help communicate key strengths and development opportunities. After a few years, trend lines will emerge that can be used to help communicate areas of performance that have strengthened or weakened over time.

## 10) Assess the Adequacy and Independence of Compensation Advice

The SEC now requires disclosure of consulting fees for executive compensation services and “all other” services *when the same firm provides multiple services to the company*. Many organizations are using this regulatory change as an opportunity to review and assess the adequacy and independence of their compensation advice. Given the complexity and scrutiny of executive compensation, your current or future consultant should pass muster in both areas.

With regard to the *adequacy* of executive compensation advice, we believe Compensation Committees should expect from their consultant:

### **Information and Not Just Data**

Data alone is not a sufficient deliverable. The Compensation Committee also should be given information and insights gleaned from the analysis that will help members make more informed and effective decisions. This requires that the consultant be able to assimilate and synthesize complex data into simple, actionable advice for a Director audience.

### **Performance Alignment and Not Just Market Positioning**

Pay practices are continually evolving, resulting in a chronic lag in the availability of timely benchmark data. As companies seek to tie compensation more directly to performance, outside pay advice needs to focus on creating that alignment rather than on achieving a particular market positioning. This requires additional competencies and analytical tools from your compensation consultant.

### **Proactive Recommendations and Not Just Reactive Advice**

Executive compensation is highly complex. Staying “ahead of the curve” requires that relevant issues and trends be identified early in the compensation process to avoid the need for the Committee to make rush decisions that may have unintended consequences. Furthermore, the boardroom advice from the lead consultant needs to be supported and substantiated by sound analytics. The consultant should therefore focus exclusively on executive compensation and possess the thought leadership and technical resources necessary to be at the forefront of emerging practices.

### **Perspective and Not Just a Presentation of Alternatives**

In addition to providing a range of alternative approaches to compensation issues, consultants to Compensation Committees should provide a point of view on the best path to take. This requires that the consultant have sufficient experience and confidence to make a strong recommendation, as opposed to simply presenting the various pros and cons of each option.

With regard to the *independence* of executive compensation advice, we believe Compensation Committees should:

### **Strive For a Single Consultant Model**

A single consultant model ensures that the Compensation Committee is driving and directing the work of the consultant and the design of the pay program, as opposed to reacting to proposals from management for their own compensation.

### **Consider using an Independent Firm**

An independent firm ensures that there is no real or perceived conflict of interest in the governance process and pay advice being rendered.

## In Closing

As the context around and perception of executive compensation have materially changed over the last two years, many companies have made incremental changes to their executive pay programs in *reaction* to challenging economic conditions, new regulatory needs, and increased governance expectations. We believe it is time to do more - that Directors should consider more robust, *proactive* changes that will newly ground compensation programs directly in each organization's current business strategies, talent requirements, performance expectations and shareholder needs. This requires that Compensation Committees take a step back and seek fresh perspectives before moving forward diligently and deliberately.

This year's Top 10 provides insight into the areas we believe should be key priorities for Compensation Committees in 2010. We hope to have the opportunity and privilege of joining you on this journey.

## About Pearl Meyer & Partners

For over 20 years, PM&P has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. The firm provides comprehensive solutions to complex compensation challenges through the development of programs that align rewards with business goals to create long-term value for all stakeholders: shareholders, executives and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles and San Jose.

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