

# **BANK EXECUTIVE & BOARD COMPENSATION**

COMPENSATION SOLUTIONS TO REWARD TODAY'S DIRECTORS & EXECUTIVES

## **Topic Breakout: Preparing for Say-on-Pay** *November 10, 2009*

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## ■ Discussion Topics

- **Say-On-Pay Overview**
  - What is Say on Pay?
  - Why is Say on Pay Important?
  - Update on Recent/Pending Legislation
  - Understanding the Influence of Proxy Advisory Firms on Your Vote
  
- **Proactive Steps to Prepare for Say on Pay**
  - Improve Knowledge of Say on Pay
  - Evaluate Compensation Programs
  - Engage with Shareholders
  - Improve Compensation Disclosure
  
- **2009 Say on Pay Resolution Vote Results**
  - How Did TARP Participants Fare in 2009?
  
- **PM&P Say on Pay Survey Results**
  - PM&P Recent Survey on Say on Pay Perspectives – General Industry and Banking

## ■ Say on Pay - Overview

### ■ What is Say on Pay?

- A non-binding shareholder advisory vote on executive compensation programs (UK implemented Say on Pay in 2002)
  - » Annual vote on executive compensation as disclosed in the proxy statement pursuant to SEC disclosure rules
  - » Non-binding “golden parachute” vote required for companies undergoing an acquisition, merger, or asset sale **unless** executive pay has been subject to a prior Say on Pay Vote
- Most Say on Pay resolutions call for a single vote on the CD&A disclosure and related compensation tables
- Required (as of 02/17/2009) for all companies receiving government assistance under TARP (Troubled Asset Relief Program)
- Say on Pay expanded under the Corporate and Financial Institution Compensation Fairness Act of 2009 (HR 3269)
  - » Applies to all public companies
  - » Requires disclosure of institutional shareholder votes
  - » Provides potential exceptions to Say on Pay for small reporting issuers

## ■ Say on Pay - Overview

### ■ Why is Say on Pay Important?

- Say on Pay for all companies gaining momentum
  - » Obama Administration
  - » Congress
  - » Institutional Shareholders
  - » Proxy Advisory Firms
- Expected to apply to all publicly traded companies for 2011 proxy season
  - » Preparation for Say on Pay needed now since 2010 pay decisions will be the basis for the first required vote in 2011
- In 2009, over 100 Say on Pay proposals were filed by shareholders of non-TARP companies
  - » About 20 non-TARP companies have or will offer shareholders a Say on Pay vote voluntarily (e.g., AFLAC, Verizon, Intel, etc.)

## ■ Say on Pay - Overview

### ■ Recent/Pending Legislation

- Corporate and Financial Institution Compensation Fairness Act of 2009 (HR 3269)
  - » Pass by House on July 31, 2009 with a vote of 237-185
  - » Referred to Senate Banking, Housing and Urban Affairs Committee
  - » Key provisions of legislation
    - Say on Pay
    - Compensation Committee (and consultant) independence
    - Incentive-based compensation disclosure and standards for financial institutions
- Shareholder Empowerment Act of 2009 (HR 2861)
  - » Referred to House Financial Services Committee on June 12, 2009
  - » Similar provisions as above legislations
  - » Additional requirement for “clawbacks” for unearned compensation and/or severance
- Shareholder Bill of Rights Act of 2009 (S 1074)
  - » Referred to Senate Banking, Housing and Urban Affairs Committee on May 19, 2009
  - » Supported by CalPERS and AFL-CIO
  - » Key provisions of legislation
    - Say on Pay
    - Separate (Independent) Board Chairman
    - Establishment of Risk Committee
    - Majority voting
    - Proxy access for shareholders

## ■ Role of Proxy Advisory Firms

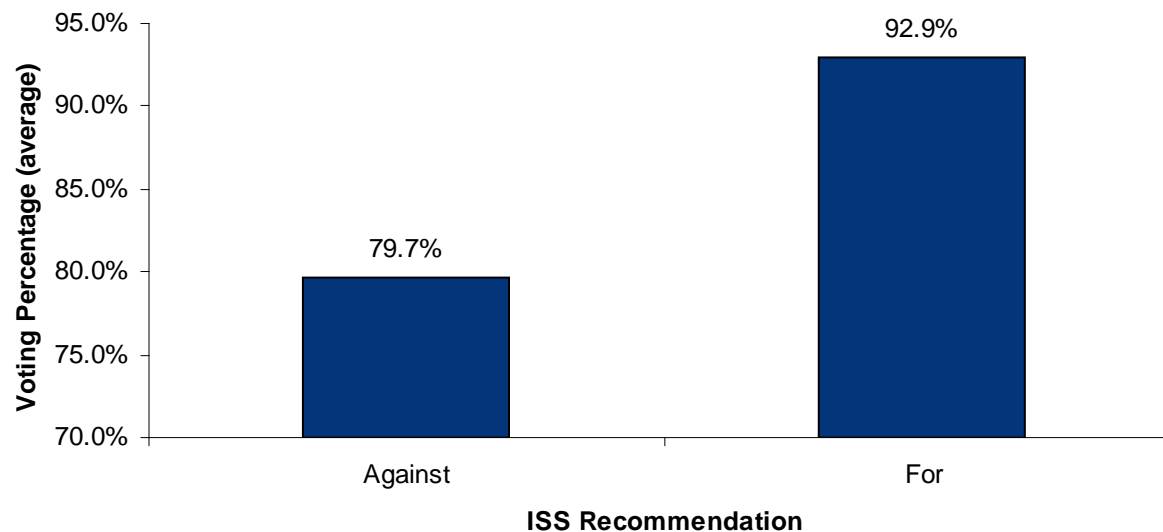
- **Institutional investors and proxy advisory firms are still formulating plans for evaluating Say on Pay across all public companies in the U.S.**
  - U.K. companies regularly engage with key investor groups in advance of submitting Say on Pay proxy materials
  - In the U.S., Regulation FD prohibits such selective disclosure or contact with investor groups
- **RiskMetrics (RMG) advises shareholders to assess Say on Pay proposal on a case-by-case basis using general principles as a guide:**
  - Maintaining appropriate pay-for-performance alignment
  - Avoiding poor pay practices as defined by RMG (e.g., “pay for failure”)
  - Maintaining an independent and effective Compensation Committee
  - Avoiding inappropriate pay to non-executive directors
  - Providing shareholders with and comprehensive disclosures
- **Glass Lewis reviews the CD&A and quantitative pay-for-performance models in determining whether pay is reasonable**
- **CalPERS expects the Board to act when shareholder proposals receive majority support (including Say on Pay) and will withhold votes for directors if no action is taken**

## ■ Role of Proxy Advisory Firms

### Management Say on Pay Proposals: All U.S. Banks from 1/1/09 to 11/04/09

- When RMG recommends “Against,” the percentage of “for” votes decreases significantly
- When RMG recommends “Against” - Low of 59%, High of 96.7%
- When RMG recommends “For” – Low of 78.9%, High of 96.7%
- No TARP banks received less than 50% support

**Management Say on Pay Proposals - Banks**

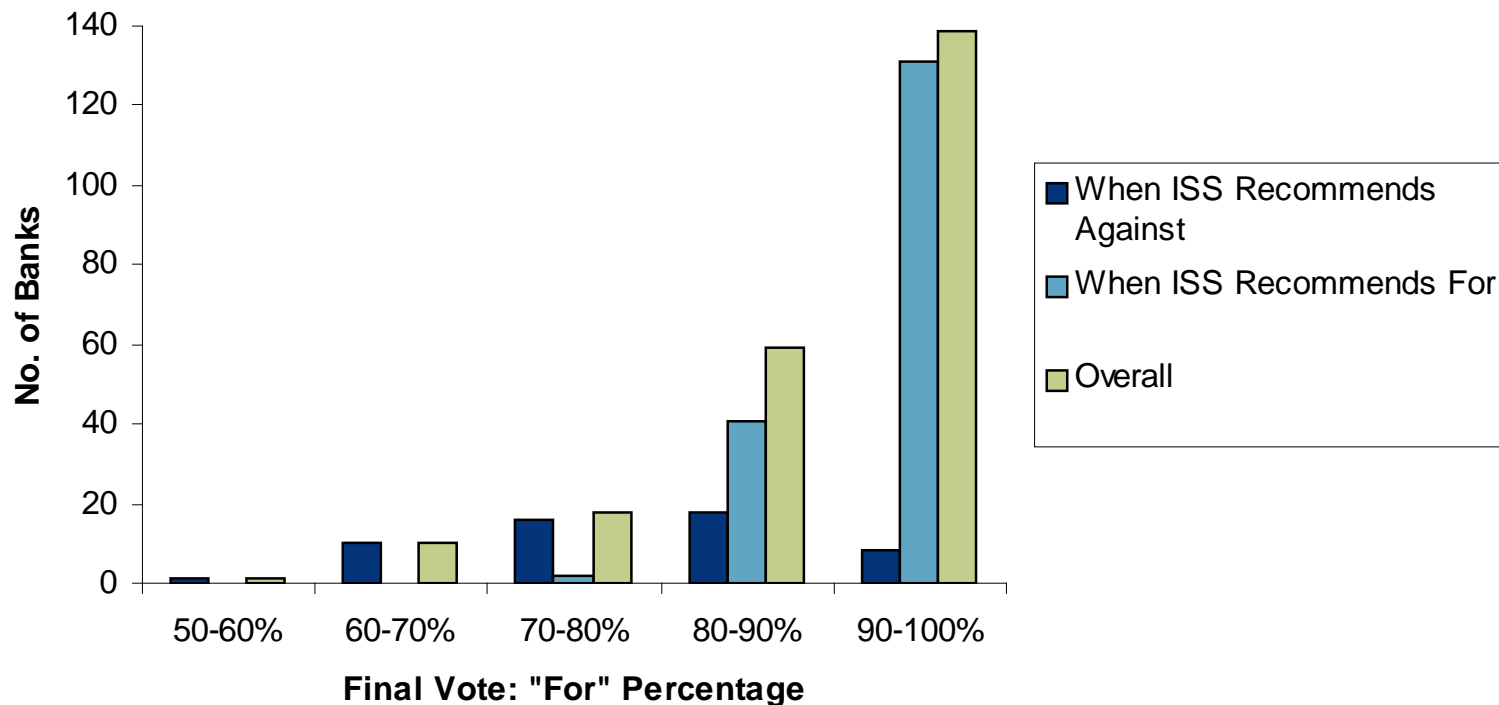


Note: Voting percentage determined by the following formula: “for” votes divided by the total of “for” votes plus “against” votes

## ■ Role of Proxy Advisory Firms

### Management Say on Pay Proposals: All U.S. Banks from 1/1/09 to 11/04/09

#### Distribution of Voting Percentages



Note: Voting percentage determined by the following formula: "for" votes divided by the total of "for" votes plus "against" votes

# Proactive Steps to Prepare for Say on Pay

## *Issues That Should Be Focused On Now*

- **Improve Knowledge of Say on Pay**
  - Understand *your* institutional shareholders' views
    - » Rely on proxy advisory firms to guide vote
    - » Vote based on independent voting policy
  - Review copies of shareholder advisory firm reports and findings
  - Remain current on Say on Pay issues
    - » Legislation (HR 3269, S 1074, HR 2861)
    - » Proposals at other companies (especially peer group and industry)
- **Evaluate Compensation Programs**
  - Conduct a critical review of total compensation
    - » Direct compensation (e.g., salary, annual incentive, long-term incentives)
    - » Peer group and pay strategy positioning
    - » Executive benefits and perquisites
    - » Severance and change-of-control policies
    - » Pay- performance relationships
  - Identify any perceived “poor pay practices” and possible corrective adjustments
  - Test pay programs to ensure a strong pay-for-performance linkage
  - Consider future pay decisions in the context of a Say on Pay vote
  - Conduct risk assessment to ensure incentive programs do not motivate “unnecessary and excessive risk-taking”

## Proactive Steps to Prepare for Say on Pay (con't.)

*Issues That Should Be Focused On Now*

### ■ Engage with Shareholders

- Review and identify opportunities to engage in direct communications with key institutional shareholders
- Ensure compliance Regulation FD regarding selective disclosure of material non-public information and contact with investors
- Review Company bylaws to understand how abstentions would count in a Say on Pay vote
- Develop a strategy for communicating with executive/employee shareholders

### ■ Improve Compensation Disclosure

- Identify opportunities to improve CD&A development and disclosure process (e.g., more time, more coordination, more analysis, executive summary)
- Review CD&A, compensation tables and related narratives to ensure disclosure is complete, concise and not subject to interpretation
- Securities and Exchange Commission (SEC) Enhancements to Disclosure for 2010

## ■ Key Questions for Say on Pay Preparation

Category	Key Questions
<b>Philosophy</b>	<ul style="list-style-type: none"> <li>• How does our philosophy support our Company's strategies, vision and culture?</li> <li>• What is our "mix" of compensation; what is most emphasized?</li> <li>• Are we able to recruit and retain the right people?</li> </ul>
<b>Overall Design</b>	<ul style="list-style-type: none"> <li>• Are our programs fundamentally competitive in terms of components, mix, and levels?</li> <li>• Do our programs provide sufficient flexibility to reward our "stars"?</li> <li>• Where is our program most vulnerable to shareholder criticism?</li> </ul>
<b>Measures &amp; Goals</b>	<ul style="list-style-type: none"> <li>• Do we have the right short-term and long-term measures?</li> <li>• Are our performance goals aligned with our strategic plan and outlook?</li> </ul>
<b>Performance Leverage</b>	<ul style="list-style-type: none"> <li>• Do we have an appropriate linkage between pay and performance?</li> <li>• Do we set threshold and maximum performance goals commensurate with pay opportunities?</li> </ul>
<b>Risk</b>	<ul style="list-style-type: none"> <li>• Do our programs have any features that could encourage "excessive risk taking?"</li> <li>• Do we have the proper mix of incentives and penalties?</li> </ul>
<b>Retention</b>	<ul style="list-style-type: none"> <li>• Do our programs promote the retention of top talent?"</li> <li>• Are we at risk of losing any key people?</li> <li>• Do we have succession plans in place for critical roles?</li> </ul>
<b>Perquisites</b>	<ul style="list-style-type: none"> <li>• Do we have a sound business purpose and rationale for any perquisites?"</li> </ul>
<b>Severance</b>	<ul style="list-style-type: none"> <li>• Do we have a sound business purpose and rationale for our severance agreements?</li> <li>• Should we phase out severance over an executive's career with the Company?</li> </ul>
<b>Disclosure</b>	<ul style="list-style-type: none"> <li>• Does our disclosure accurately and completely reflect our process and analysis?</li> <li>• How could our disclosure be improved to support SEC requirements, Say on Pay, etc.?</li> </ul>
<b>Conflicts</b>	<ul style="list-style-type: none"> <li>• Do any of our Committee members have a conflict of interest?</li> <li>• Are our outside advisors conflicted by other business relationships with the Company?</li> </ul>

## ■ Summary of RMG “Poor Pay Practices”

- **Egregious employment contracts**
  - Contracts containing multi-year guarantees for salary increases, bonuses and equity compensation
- **Excessive perks/tax reimbursements**
  - Overly generous perquisites, which may include, but are not limited to the following: personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances
  - Reimbursement of income taxes on executive perquisites or other payments
  - Perquisites for former executives, such as car allowances, personal use of corporate aircraft or other inappropriate arrangements
- **Abnormally large bonus payouts without justifiable performance linkage or proper disclosure**
  - Performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance
- **Egregious pension/SERP (supplemental executive retirement plan) payouts:**
  - Inclusion of additional years of service not worked that result in significant payouts
  - Inclusion of performance-based equity awards in the pension calculation
- **New CEO with overly generous new hire package**
  - Excessive “make whole” provisions
  - Any of the poor pay practices listed in this policy
- **Option backdating and other excessive compensation payouts or poor pay practices**

## ■ Summary of RMG “Poor Pay Practices” (con’t.)

- **Excessive severance and/or change in control provisions**
  - Inclusion of excessive change in control or severance payments, especially those with multiple in excess of 3x cash pay
  - Payments upon an executive’s termination in connection with performance failure
  - Change in control payouts without loss of job or substantial diminution of job duties (single-triggered)
  - New or materially amended employment or severance agreements that provide for modified single triggers under which an executive may voluntarily leave for any reason and still receive the change-in-control severance package
  - Liberal change in control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring
  - New or materially amended employment or severance agreements that provide for an excise tax gross-up -- modified gross-ups would be treated in the same manner as full gross-ups
  - Perquisites for former executives such as car allowances, personal use of corporate aircraft or other inappropriate arrangements
- **Dividends or dividend equivalents paid on unvested performance shares or units**
- **Poor disclosure practices**
  - Unclear explanation of how the CEO is involved in the pay setting process
  - Retrospective performance targets and methodology not discussed
  - Methodology for benchmarking practices and/or peer group not disclosed and explained
- **Internal Pay Disparity**
  - Excessive differential between CEO total pay and that of next highest paid named executive officer (NEO)

## ■ SEC Proposed Enhancements to Disclosure

- **Discussion of Risk Management and Compensation**
  - New CD&A Section will discuss how the Company's overall compensation policies for employees create incentives that can affect the Company's risk and management of that risk
- **Reporting of Equity Awards Using Grant Date Value**
  - Compensation tables will reflect full grant date fair value for grants made during the year, rather than accounting accrual during the year (which may relate to current and prior grants)
- **Additional Compensation Consultant Disclosures (including fees)**
  - If consultant (or any affiliate) played a role in determining or recommending executive and director compensation **and also** provided additional services to the Company, must disclose:
    - » Nature and extent of all additional services provided
    - » Aggregate fees paid for executive and director compensation services
    - » Aggregate fees paid for additional other services
    - » Whether the decision to engage the consultant for other services was made, recommended, subject to screening or reviewed by management
    - » Whether the Board or Compensation Committee approved all services provided

## ■ SEC Proposed Enhancements to Disclosure (con't.)

- **Director and Director Nominee Disclosure**
  - Specific experience, qualifications, attributes or skills that qualify the person for service on the Board or a specific committee, including the person's risk assessment skills or other expertise
  - If material, disclosure should cover more than the past five years
  - Any public company directorships held at any time during the past five years (not just current directorships)
  - Any legal proceedings in which the director or nominee was involved during the prior ten years
- **Company Leadership Structure: Chairman, CEO, Lead Director**
  - Describe the leadership structure and explain why it is appropriate given the company's specific characteristics
  - If the same person is Chairman and CEO, discuss whether there is a lead independent director and their specific role
  - Disclose the Board's role in risk management and the effect that this involvement has on the Company's leadership structure
- **Voting Results Reported on Form 8-K (rather than 10-Q or 10-K)**
  - Requirement to file results of a shareholder vote within four business days
- **Various revisions to proxy solicitation process**

# THANK YOU

## Questions?

Additional Resources on [www.pearlmeyer.com/banking](http://www.pearlmeyer.com/banking)

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