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Going Up

What's Driving CEO Pay Growth

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Apology Issued on Stock Options

MINNETONKA, Minn., May 2 (Reuters) — The chief executive of UnitedHealth Group apologized to shareholders at the annual meeting Tuesday, saying he regretted that the issue of stock options had become a huge news event for the typically low-key company.

UnitedHealth had granted stock options to the chief executive, William W. McGuire, worth some \$1.6 billion, drawing criticism from institutional and individual shareholders as well as investigations into their timing.

Looking tense at times, Mr. McGuire told shareholders: “With perfect hindsight we perhaps should have moved to make adjustments in our options program as quickly as our business was growing. But this was not necessarily apparently without the benefit of that hindsight. In any event, we can only act now.”

About 200 shareholders showed up on a sparkling spring day in this Minneapolis suburb, with some intent on holding the company’s feet to the fire. In a typical year, a few dozen shareholders attend the meeting.

“I was always steadfast in my belief that the amount of shares being granted were obscene,” Larry Larson, a retired Minneapolis-area schoolteacher who owns about 800 UnitedHealth shares, told Mr. McGuire during a question-and-answer session.

“I grant you many more sleepless nights so you might make better decisions for this company in the fu-



Eric Miller/Associated Press

William W. McGuire is chief executive of UnitedHealth Group.

calls to withhold votes from Mr. McGuire and three other directors because of the options issue, shareholders endorsed all four directors for reelection.

In addition, shareholders rejected a proposal that would have required directors to be elected by a majority vote rather than a plurality.

In the board vote, Mr. McGuire and one director, Douglas Leatherdale, were returned by 96 percent of voters while James Johnson and



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Discussion Topics

- ✓ Some history
- ✓ Why does pay keep going up?
- ✓ Slowing down the escalator



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Some History

Decade

1890s	Stock Options	
1900s	Stock Grants	} DuPont
	Stock purchase plans	
	Freestanding dividend equivalents	
1910s	Cash bonuses	} General Motors
1920s	Economic value added	
	\$1mm pay package	} Bethlehem Steel
1930s	Dividend equivalents and options	
	SARS	} Marshall Fields
	Option pricing	} Pan Am
1950	Tax law: restricted stock options (RSOs)	



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Some History (continued)

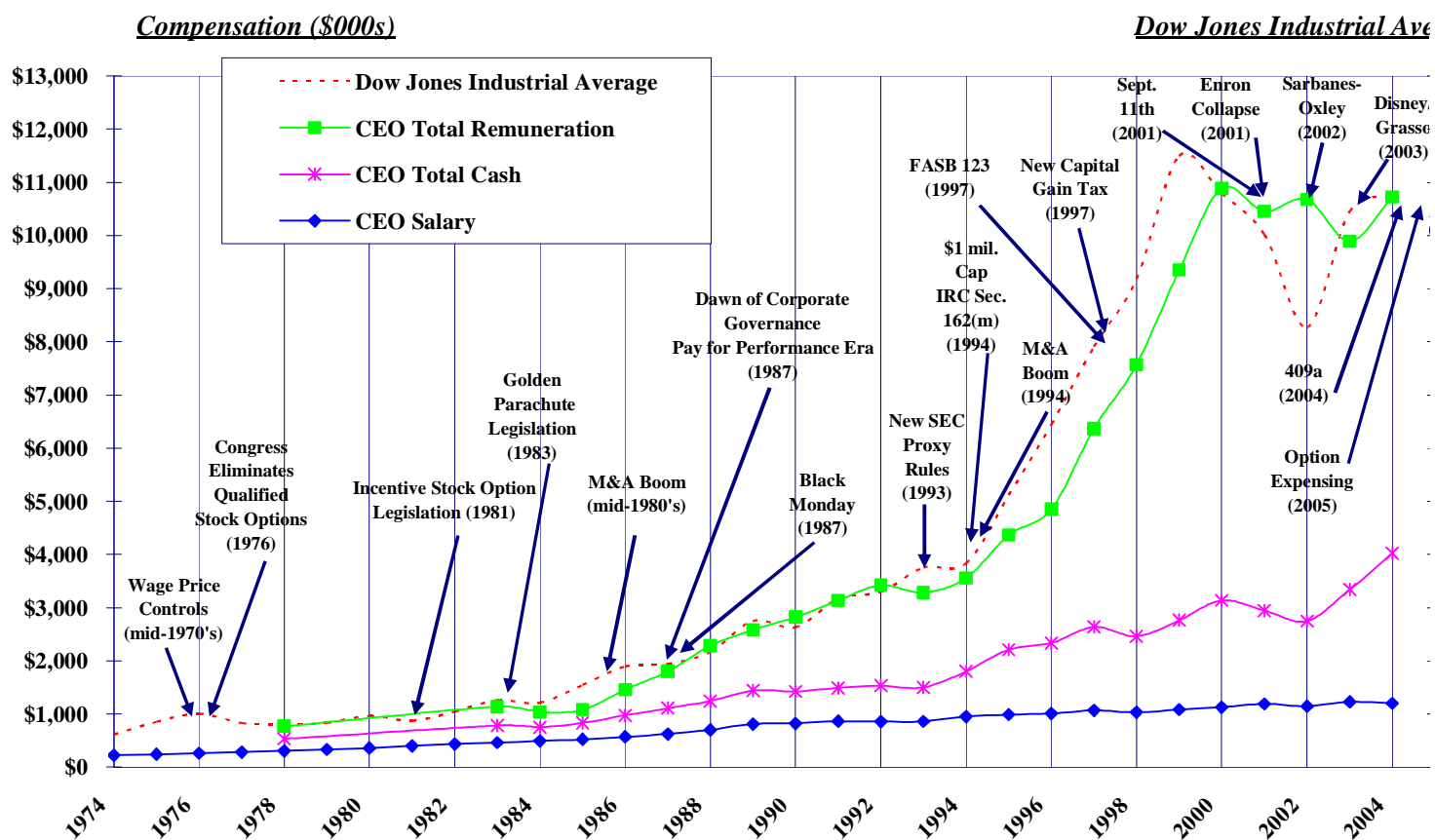
Decade

1951	AICPA Bulletin 51 (no expense for RSOs)		
1964	Tax law: Employee Stock Purchase Plans		
1967	Golden parachute	}	Conoco
1971	Performance Shares	}	CBS
1972	APB 25		
	Performance unit plans	}	Heinz
	Indexed options	}	
1974	\$1mm annual bonus	}	Revlon
1975	Time-vested restricted stock	}	Harris Bank



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CEO Compensation* – 1974 through 2004



Relationship of Dow Jones Industrial Average to CEO Total Remuneration - $r^2 = 0.95$



* Based on Pearl Meyer & Partners *Total Compensation Survey* of approximately 50 U.S. Companies.

** Dow Jones Industrial Average as of calendar year-end.

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*CEO Pay Growing Faster Than Other NEO Pay**

	CEO			Other NEOs		
	S & P 500	Midcap 400	Small Cap 600	S&P 500	Midcap 400	Small Cap 600
2003	245	182	154	212	150	142
2300	470	232	192	331	194	179
1993	100	100	100	100	100	100

*Indexes built on pay data in Bebchuk and Grinstein, 2005.



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Explanations for Rapid CEO Pay Growth

Arm’s Length Bargaining Model

- ✓ Supply and demand
- ✓ Increased executive mobility and turnover
- ✓ Availability of alternative careers
- ✓ Growing use of incentives, especially LTI



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Explanations for Rapid CEO Pay Growth

Managerial Power Model

- ✓ Bull market, coupled with “options good” mentality
- ✓ Agenda control, time and resources
- ✓ Pride, greed and avarice



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Increasing Prevalence of Employment Agreements

- ✓ Recruitment of executives from outside
 - ∅ “Locking in” past compensation accruals
 - ∅ Severance protection

- ✓ Mergers and acquisitions

- ✓ Negotiation process
 - ∅ Focused on individual
 - ∅ Emphasis on protection
 - ∅ Often driven by outsiders



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Summary Compensation Table

Name and Principal Position	Year	Total (\$)	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Stock Incentive Plan Compensation (\$)	All Other Compensation (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
PEO	_____ _____ _____							
PFO	_____ _____ _____							
A	_____ _____ _____							
B	_____ _____ _____							
C	_____ _____ _____							



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*US Birth Rates**

	<u>Births Per 1,000 Women</u>
1950	106.2
1960	118.0
1970	87.9
1980	68.4
1990	70.9
2000	66.3

*Sources: Various; data compiled by Child Trends Data Bank.



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When Dealing With Ongoing Compensation Management

- ✓ Establish and maintain rational compensation philosophy
- ✓ Balance competitive pay and competitive performance perspectives
- ✓ Put competitive pay data in its proper place
- ✓ Consider future values of compensation and associated expense



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When Recruiting From The Outside

- ✓ Multiple candidates, **even for CEO slot**
- ✓ Structure offer within *your* pay system
- ✓ Project cost of failures
- ✓ Tally sheets



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When Recruiting From The Outside

✓ **FINALLY** – *hire only hungry executives*



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Antenna Raisers for Compensation Committee Members

- ✓ Being rushed
- ✓ Unbalanced focus on market practice
- ✓ Over-emphasis on pay as retention tool
- ✓ Comparisons to actors, sports stars and hedge fund managers
- ✓ Comparisons to growth in market cap
- ✓ Continued cashing out of vested equity
- ✓ Conflict avoidance



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Compensation Committee Process

- ✓ Agenda management
 - ∅ Discuss at one meeting; decide at the next
 - ∅ Annual meeting on philosophy, pay strategy
 - ∅ Executive sessions
- ✓ Committee reference book
 - ∅ Tally sheets
 - ∅ Policy and plan summaries
- ✓ Annual review of competitive performance as well as competitive pay
- ✓ CEO performance evaluation process
- ✓ Objective, independent advice



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* Many of these items can be found on the www.compensationstandards.com website



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