

# Executive & Director Compensation: Where It's Going

Corporate Directors Club  
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# ■ “Yesterday’s” Drivers of Change

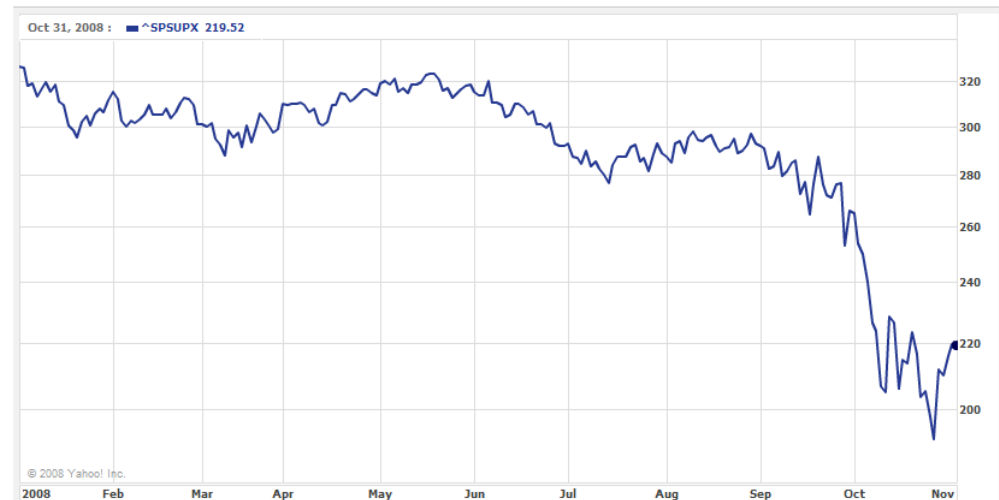
*2002 to 2008*

- **Corporate scandals (Enron/Worldcom) - executive compensation visibility**
  - **Sarbanes Oxley Act (2002)**
  - **FASB - SFAS 123R – Accounting of stock options influencing incentive practices**
  - **SEC – New disclosure requirements - mandating “one number” and more transparency of executive and director pay practices**
  - **409A – Deferred compensation legislation**
  - **ISS/Investor Power – ability to influence proxy votes**
- *Increased Board Responsibility and Risk ...and Compensation*
  - *New Long-Term Incentive Strategies*
  - *Deferred Compensation Compliance*
  - *Proxy Disclosure and CD&A*
  - *Rise of the Investor*

# Today's "Explosion" of Challenges

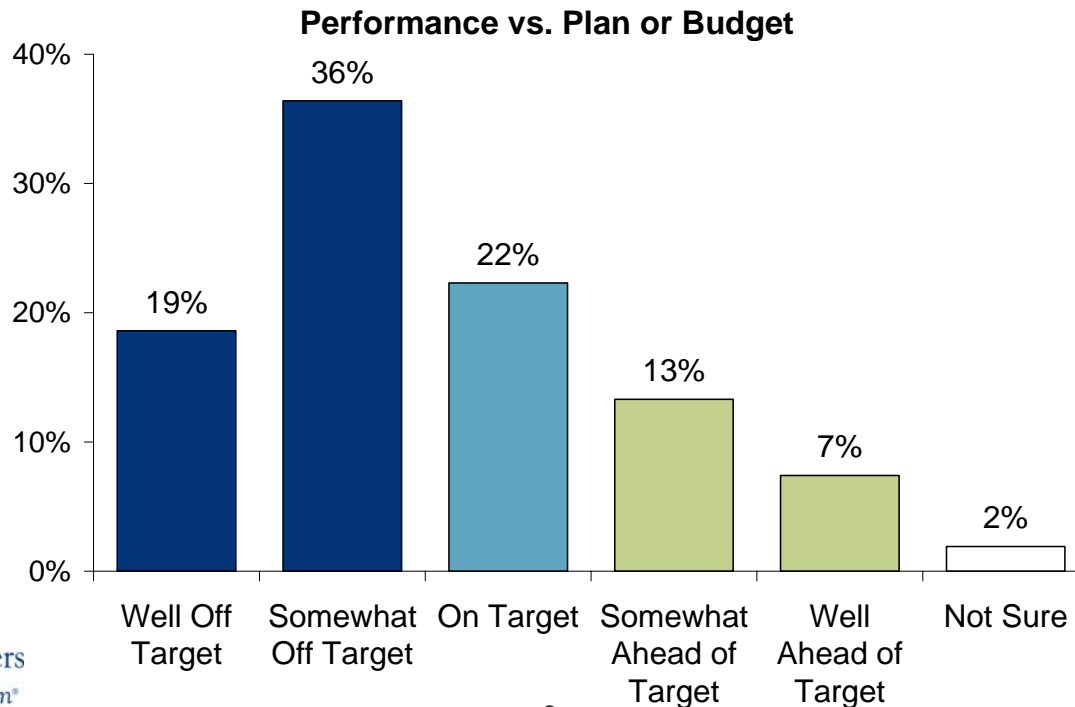
- Economic influences beyond executives' control
- Accountability for executives and board members
- The pay-performance time warp
- Defining "high performance" in today's environment
- Government's influence on executive compensation – TARP
- Resurgent investor activism under Obama administration

S&P 1500 Year to Date through November 1, 2008



## Expectations for 2008 and 2009 – November Poll

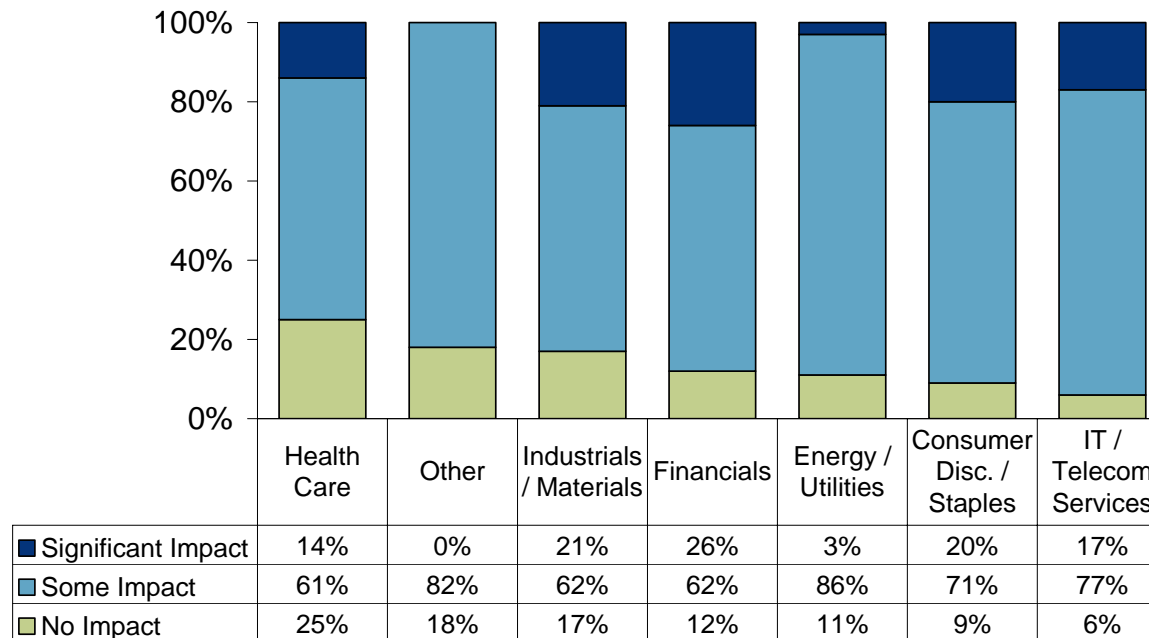
- Despite a 34% decline in the S&P 1500 through November 1, 43% of respondents reported company performance “on target” or better.  
**Possible explanations:**
  - Disconnect between operational measures and shareholder expectations on performance downside
  - Goals reset mid-year as market conditions began to deteriorate
  - Budgets or performance plans were based on attainable goals



# Impact on Compensation Due to Economic Conditions

- For those whose performance vs. plan or budget was “well off” target 41% indicated that the financial market turmoil will have a “significant impact” on decision making around compensation
- For those who described performance as “well ahead” of target, just 18% anticipated that the troubled market will have a “significant impact”

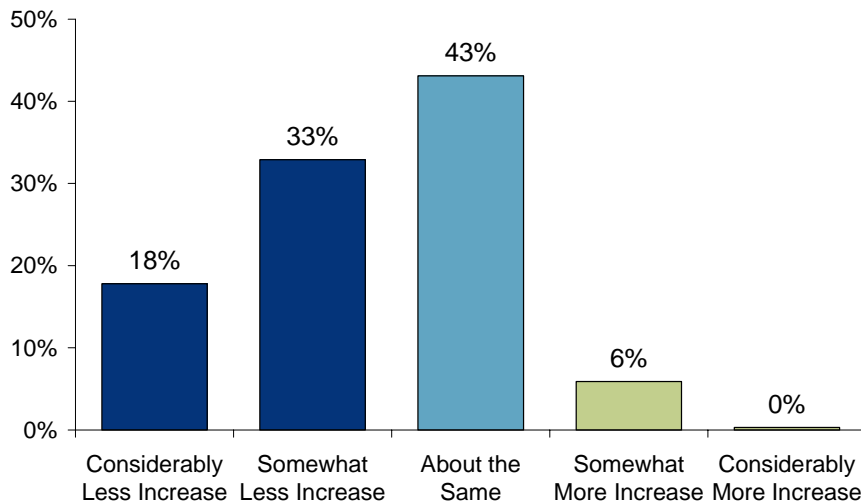
Impact of Financial Turmoil on Pay Decisions Over the Next 6 Months



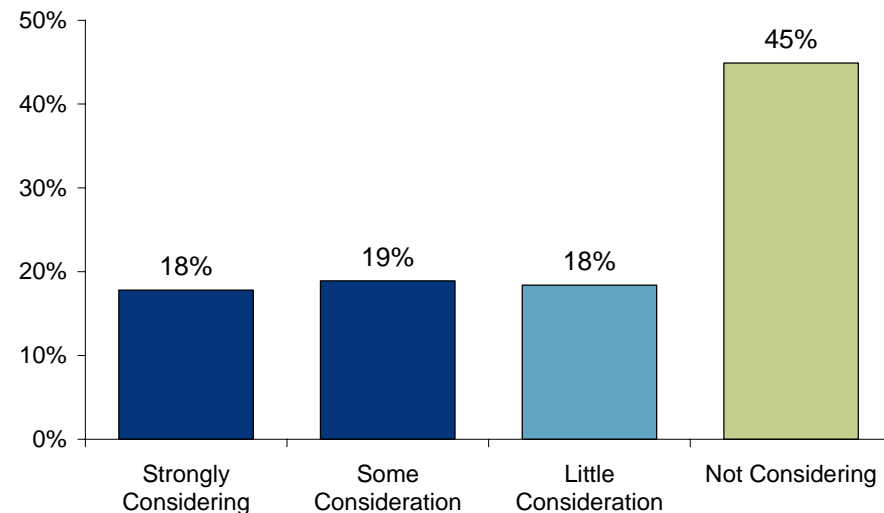
# ■ Base Salary Increases Under Consideration

- Slightly more than half anticipate that 2009 base salary increases for their executive teams will be down from a year earlier
- Roughly 18% indicating their companies are strongly considering freezing base salaries
- In addition to economic concerns, expanded proxy disclosure has prompted many Boards to ask whether annual salary increases for executives are necessary, to avoid the impression that executives are being compensated for tenure alone

Anticipated Executive Salary Increases for 2009



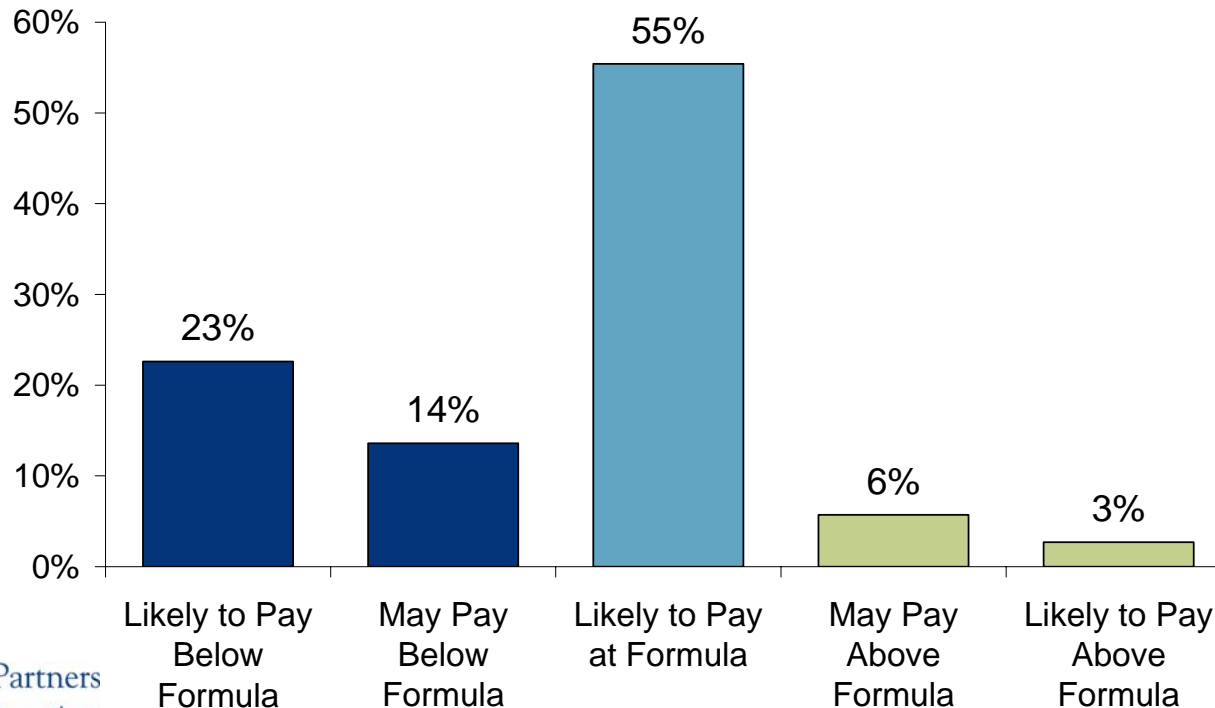
Anticipated Freezing of Executive Salaries for 2009



## ■ Negative Discretion Under Consideration

- 55% expect to pay this year's incentive payout "at formula"
- 37% may exercise discretion to pay a bonus "below formula"
- Suggests some companies believe they may need to correct a disconnect in their goal-setting process in order to better align their executive rewards with market performance

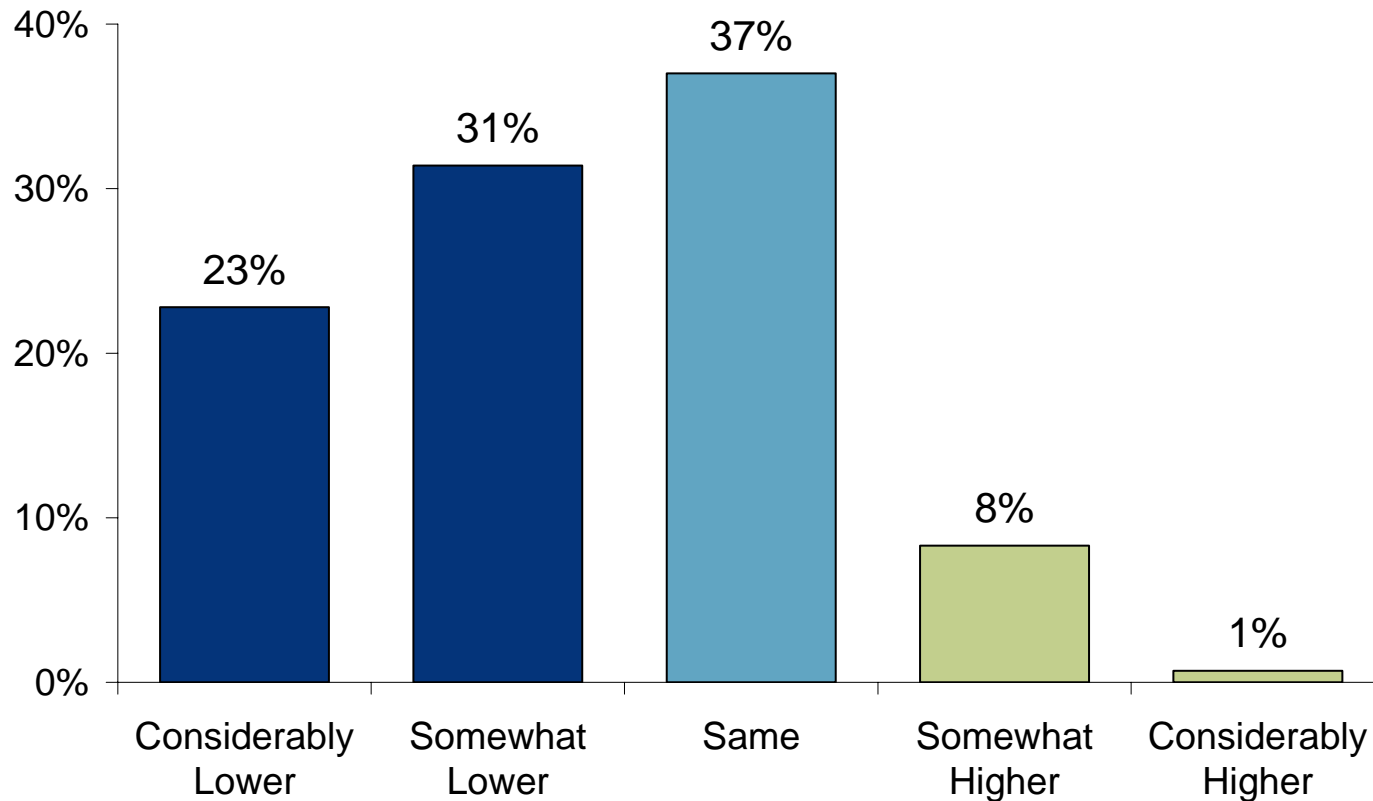
Anticipated Discretion on Executive Bonus



## Equity Value Likely to be Impacted

- Half of respondents anticipate that the value of this year's award will be lower than last year

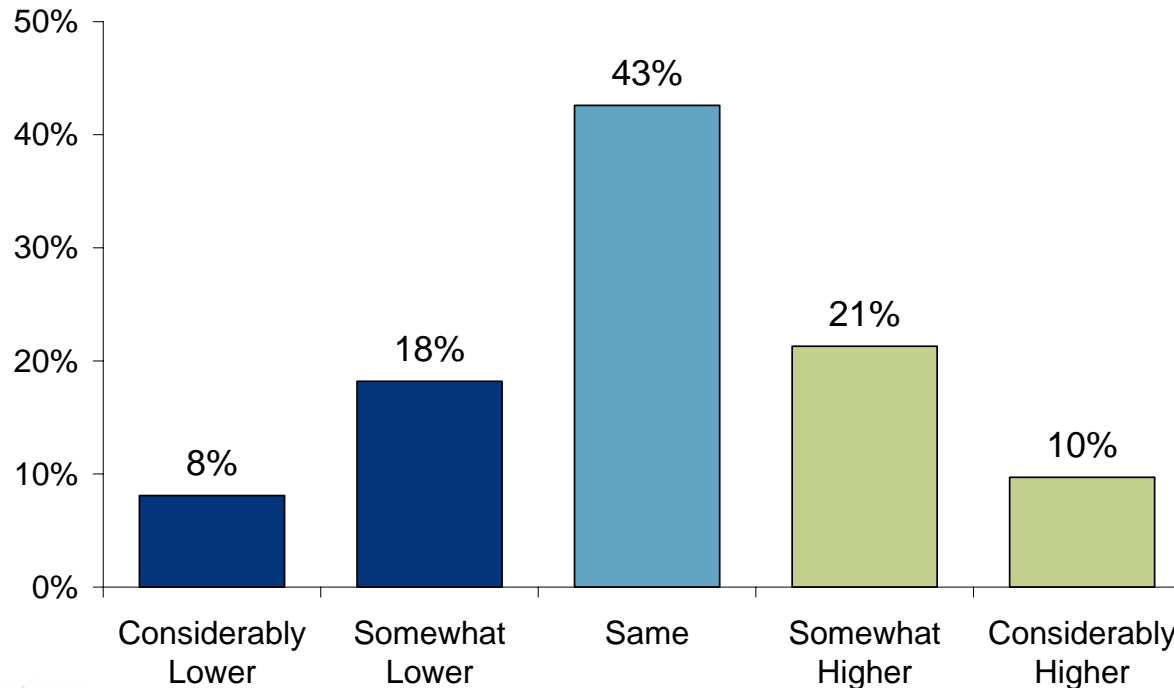
Economic Value of LTI vs. Last Year



## ■ But, Burn Rate May be Adjusted

- Projections for this year's burn rate suggests that firms will be granting a similar number of shares to executives
- Only 4% said they are likely to allow executives to exchange outstanding underwater options in the next 6 months. However, this is a topic that is likely to receive growing attention over the next year

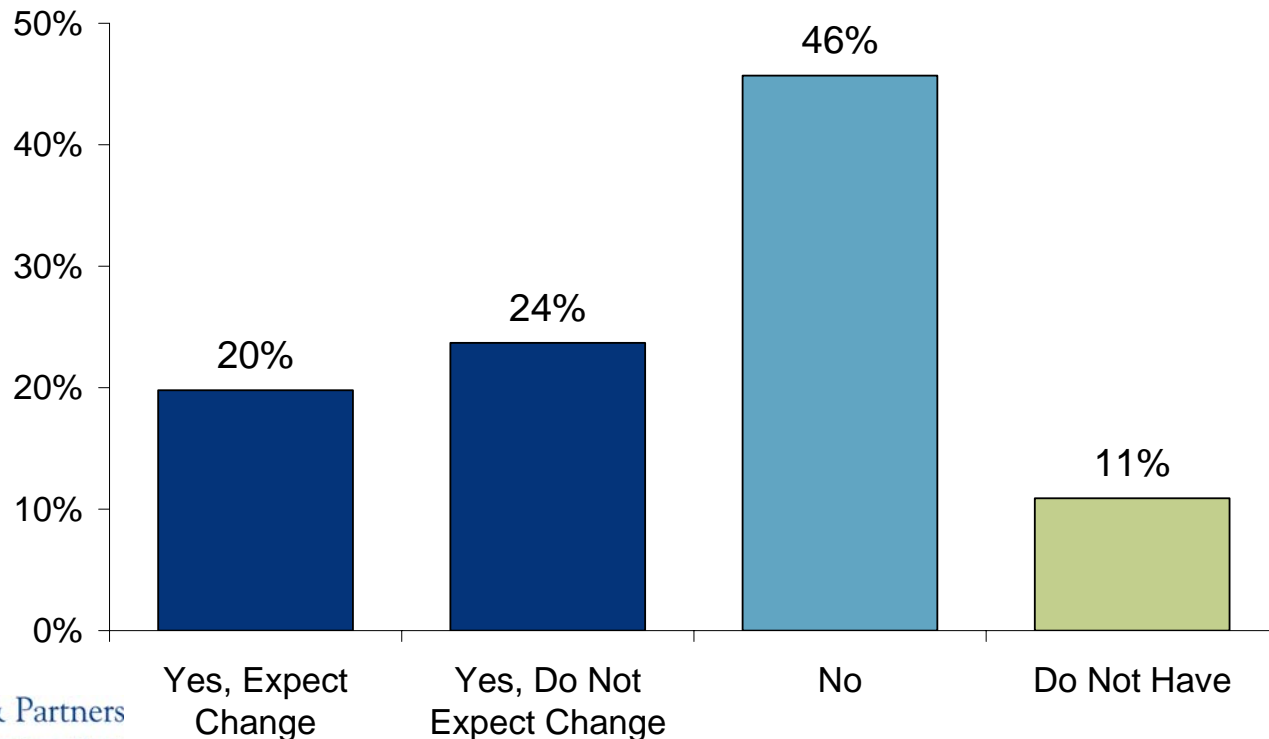
Expected Burn Rate vs. Last Year



## Severance Plans Under Review

- Half of respondents whose companies have severance or CIC arrangements anticipate reviewing these programs over the next 12 months
- About 1 in 5 anticipating that they will make modifications to those arrangements

Expected to Review Severance Arrangements



## ■ Increased Regulatory Environment Likely

- **“Say on Pay” – Up or down vote on executive compensation**
  - Activist institutional investors expect passage
- **Emergency Economic Stabilization Act - Capital Purchase Program**
  - Applies to the CEO, CFO and three most highly compensated executives (SEO's) – both public and private companies
  - Pay can't encourage or reward unnecessary and excessive risk taking
  - Compensation Committee must meet with senior risk officers (SROs) within 90 days after purchase - to discuss incentive arrangements and ensure SEOs are not encouraged to take unnecessary and excessive risks
    - » To be reviewed annually. Compensation Committee to certify annually
    - » SEC has expressed desire to include in CD&A for all companies
  - Clawback of SEO compensation required to recoup amounts paid based on financial restatements / performance metrics deemed materially inaccurate
    - » Applies to all SEOs, not just CEO and CFO
    - » Applies to public and private companies
    - » Not exclusively triggered by financial restatements
    - » Does not limit recovery period to previous 12 months
    - » Covers more than material inaccuracies related to financial reporting (e.g. performance metrics for awarding bonuses and incentive compensation)

## ■ Increased Regulatory Environment Likely

### ■ Capital Purchase Program (CPP) – Continued

- Golden Parachutes Under the CCP:
  - » Any payment triggered by an applicable severance from employment
  - » Payments in excess of three times the executive’s “base amount” are prohibited
  - » Applies to:
    - Company unilateral decision to terminate
    - Contract non-renewals
    - Voluntary termination by the CEO for “good reason” (due to change in CEO’s employment relationship) or if CEO had information that absent a quit the Company would have terminated employment
  - » Does not apply to:
    - Qualified retirement benefits
- CEO compensation in excess of \$500,000 is non-deductible (while Treasury holds an equity or debt position)
  - » Applies to public and private companies
  - » No exceptions for performance-based compensation, commissions, grandfathered agreements

## ■ Implications

- **Landscape of executive compensation is going to change.**
- **Expect to see:**
  - Strong likelihood of greater regulation of executive compensation
  - Overall more investor influence (including government as investor)
  - Increased focus on incentive compensation (balancing risk-based incentives with performance-based incentives)
  - Clawbacks will become common, accepted practice
  - Possible caps in severance benefits
  - Lower deductions for executive compensation
  - More focus on regulatory compliance (CD&A, regulator review)
  - Greater time commitments of Compensation Committee
- **Emerging concerns:**
  - Less focus on performance-based pay?
  - More focus on fixed compensation and benefits?
  - Is that the right result?
  - Letting the tail wag the dog

# ■ NACD/PM&P Director Study – 1400 Companies

- Data points with a notable year-over-year change, or that are new to the NACD/PM&P study have been highlighted

Board Composition and Structure					
	<u>Smaller</u>	<u>Small</u>	<u>Medium</u>	<u>Large</u>	<u>Top 200</u>
No. of companies	324	255	302	319	200
Median Term Length (yrs)	2	1	3	1	1
<i>% with 1 year term</i>	50%	51%	47%	51%	74%
<i>% with term &gt;1 year</i>	50%	49%	53%	49%	27%
Median Director Age (yrs)	61	60	61	62	61
<b>Median Director Tenure (yrs)</b>	<b>7</b>	<b>7</b>	<b>7</b>	<b>7</b>	<b>7</b>
Retirement Age (yrs)					
<i>Prevalence of disclosure</i>	20%	20%	48%	65%	81%
<i>Median Ret. Age</i>	72	72	72	72	72
<i>Age Range (25th-75th Perct.)</i>	70 - 75	70 - 73	70 - 72	70 - 72	72 - 72
Median No. of Directors	8	8	9	10	11
<b>Number of Boards</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>2</b>
Board Composition (Median)					
<i>Male</i>	100% (a)	92%	89%	89%	83%
<i>Female</i>	0%	8%	11%	11%	17%

(a) On an average, the Smaller companies have 93% male directors and 7% female directors.

Definitions. Smaller: \$50-\$500 million revenue; Small: \$500 million - \$1 billion revenue; Medium: \$1 - \$2.5 billion revenue; Large: \$2.5 - \$10 billion revenue; Top 200: >\$10 billion revenue

# As Expected, 2008 Growth Rates Were More Modest Than the Recent Past

## Historical Year over Year Trends in Total Direct Compensation

	2008	2007	2008 vs. 2007	2007 vs. 2006	2006 vs. 2005	2005 vs. 2004	2004 vs. 2003	2003 vs. 2002
Smaller	\$ 78,698	\$ 81,951	(4%)	7%	16%	11%	36%	(10%)
Small	116,625	114,000	2%	2%	7%	15%	20%	11%
Medium	134,619	132,699	1%	5%	2%	16%	23%	9%
Large	166,250	156,818	6%	7%	8%	16%	22%	7%
Top 200	213,899	205,759	4%	5%	12%	11%	14%	1%

Director compensation methodology was modified in 2007. Values based on Old Methodology for comparable year-over-year growth rates

# Board Compensation by Pay Element

## Median Total Direct Compensation and Year over Year Comparisons

	Smaller		Small		Medium		Large		Top 200	
	2008	vs. 2007	2008	vs. 2007	2008	vs. 2007	2008	vs. 2007	2008	vs. 2007
<b>Board Compensation</b>										
Retainer	\$ 25,000	0%	\$ 31,200	4%	\$ 40,000	14%	\$ 50,000	11%	\$ 70,000	17%
Meeting Fees (a)(b)	10,000	0%	10,500	0%	12,000	(11%)	14,500	16%	16,000	0%
Total Stock (c)	32,798	(6%)	52,111	(10%)	65,000	(10%)	85,000	2%	120,000	9%
Stock Options (a)	34,658	(9%)	35,501	(29%)	53,007	(10%)	62,500	(6%)	69,813	3%
Full Value (a)	39,188	4%	52,400	(3%)	56,486	4%	75,000	7%	110,000	10%
Total Board Compensation (c)	68,009	(3%)	98,000	2%	116,084	(3%)	149,886	5%	190,000	0%
<b>Committee Compensation</b>										
Total Committee Fees (b)	9,333	7%	12,813	6%	14,934	5%	15,625	2%	14,165	(17%)
<b>Total Direct Compensation (c)</b>	<b>\$ 78,698</b>	<b>(4%)</b>	<b>\$ 116,625</b>	<b>2%</b>	<b>\$ 134,619</b>	<b>1%</b>	<b>\$ 166,250</b>	<b>6%</b>	<b>\$ 213,899</b>	<b>4%</b>
TDC per Meeting	4,994	(1%)	6,765	5%	7,909	(1%)	9,520	5%	10,844	6%
Total Board Cost	470,816	5%	827,750	5%	1,068,368	0%	1,434,500	4%	2,233,463	10%
Board Cost % of Revenue	0.20%	6%	0.12%	7%	0.07%	4%	0.03%	0%	0.01%	10%

(a) Board meeting fees, stock options and full-value share awards reflect median of those using pay component

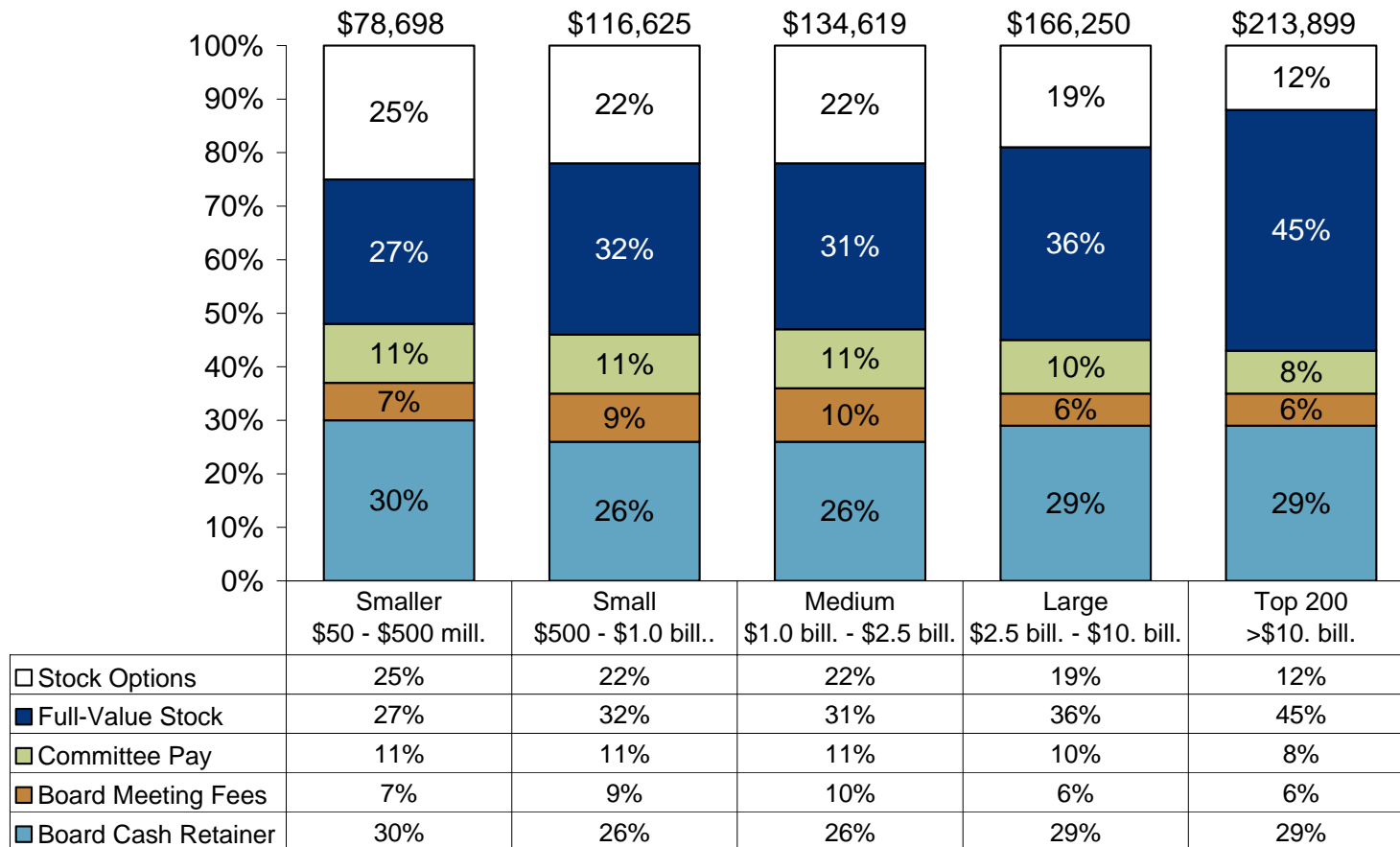
(b) Includes board meeting fees and committee fees paid in cash and/or stock

(c) Median figures are non-additive

# Resulting Pay Mix is Fairly Consistent Across Size Groups

- As company size increases, pay is more heavily weighted towards equity in the form of full-value shares

## 2008 Median Total Direct Compensation By Size



## Smaller Companies Follow the Lead of Top 200 with Regard to Composition of Pay

- Decline in Board meeting fee prevalence among all size groups
- Increase in use of full-value shares; decrease in use of options
- Committee pay remains a significant component of total direct compensation among all size groups

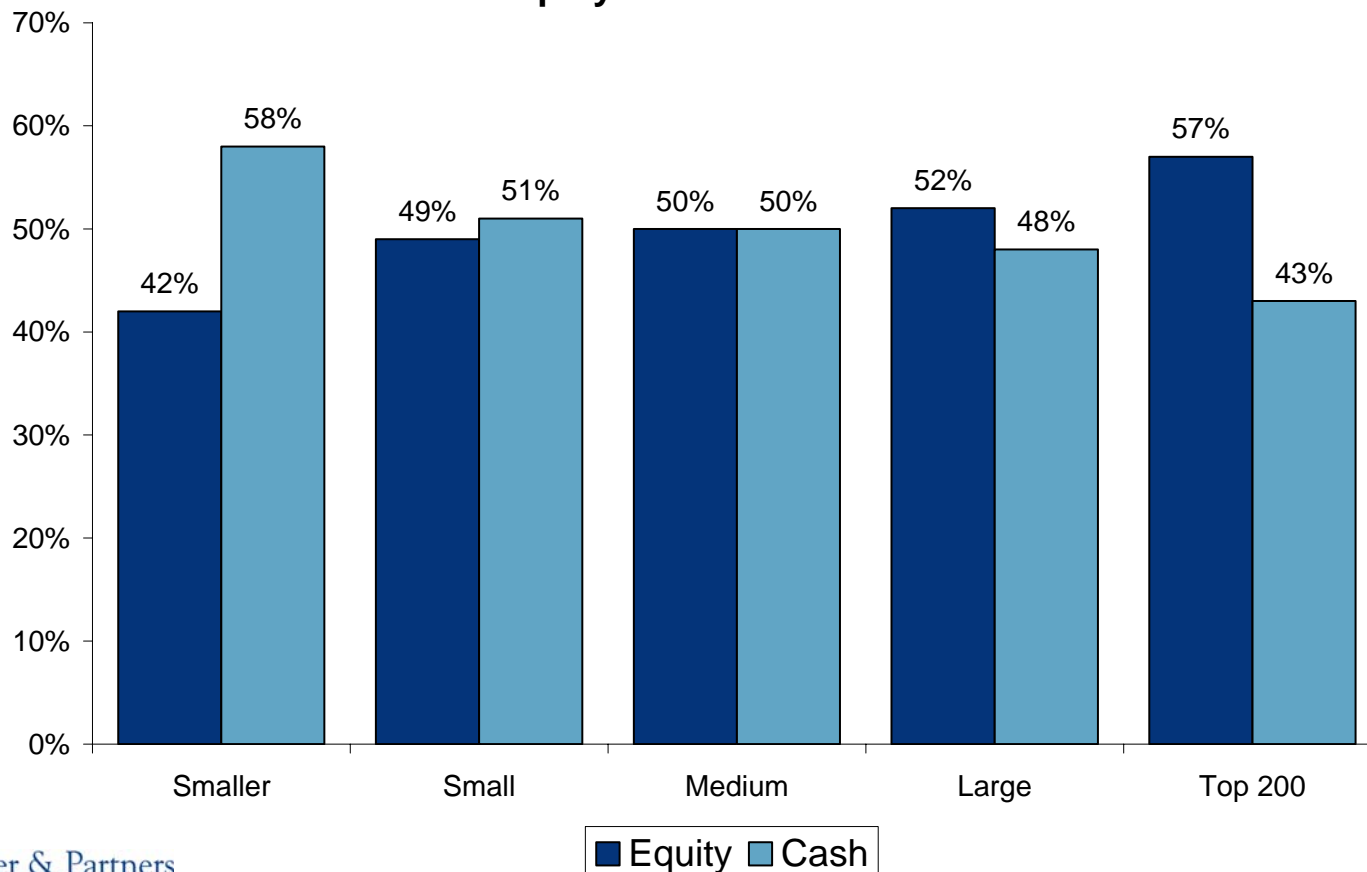
### Prevalence of Pay Element By Company Size

	Smaller	Small	Medium	Large	Top 200
<b>Board Compensation</b>					
Cash Retainer	94%	95%	98%	98%	97%
Board Meeting Fees	68%	73%	71%	60%	41%
Full Value	48%	73%	72%	85%	92%
Stock Options	48%	34%	43%	37%	30%
<b>Committee Compensation</b>					
Chair Retainer	79%	88%	90%	92%	94%
Chair Fees	7%	8%	11%	6%	5%
Member Retainer	30%	25%	28%	37%	39%
Member Meeting Fee	63%	69%	70%	62%	50%

# More Companies are Delivering a Greater Portion of Compensation Through Equity

- Except for the Smaller and Small size cuts, the majority of companies in each size cut is in compliance with NACD's Best Practice of providing at least 50% of compensation to directors in equity

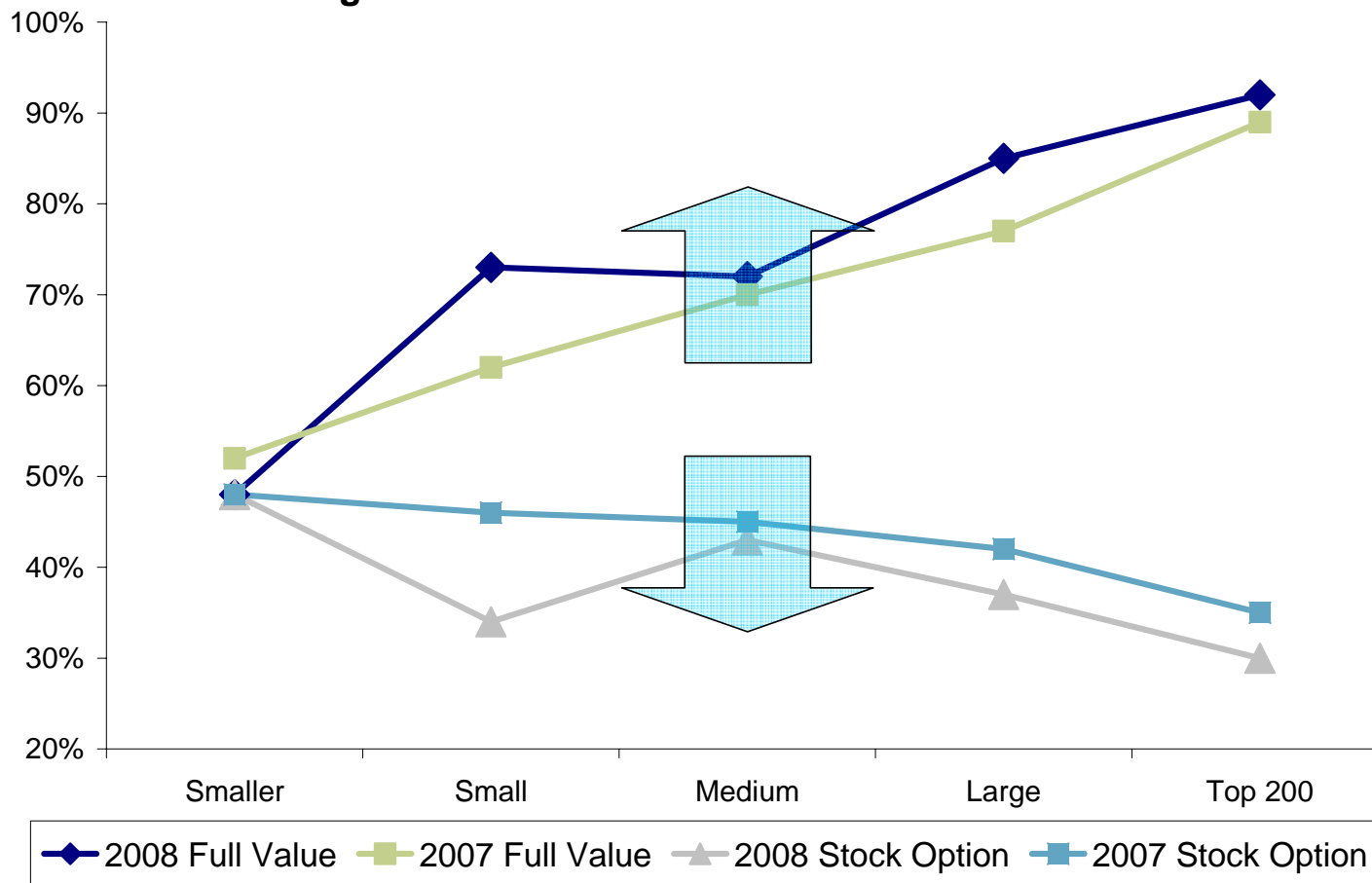
2008 Median Equity vs. Cash Mix as a % of Total



# Generally Full-Value Share Prevalence is Greater than 50%

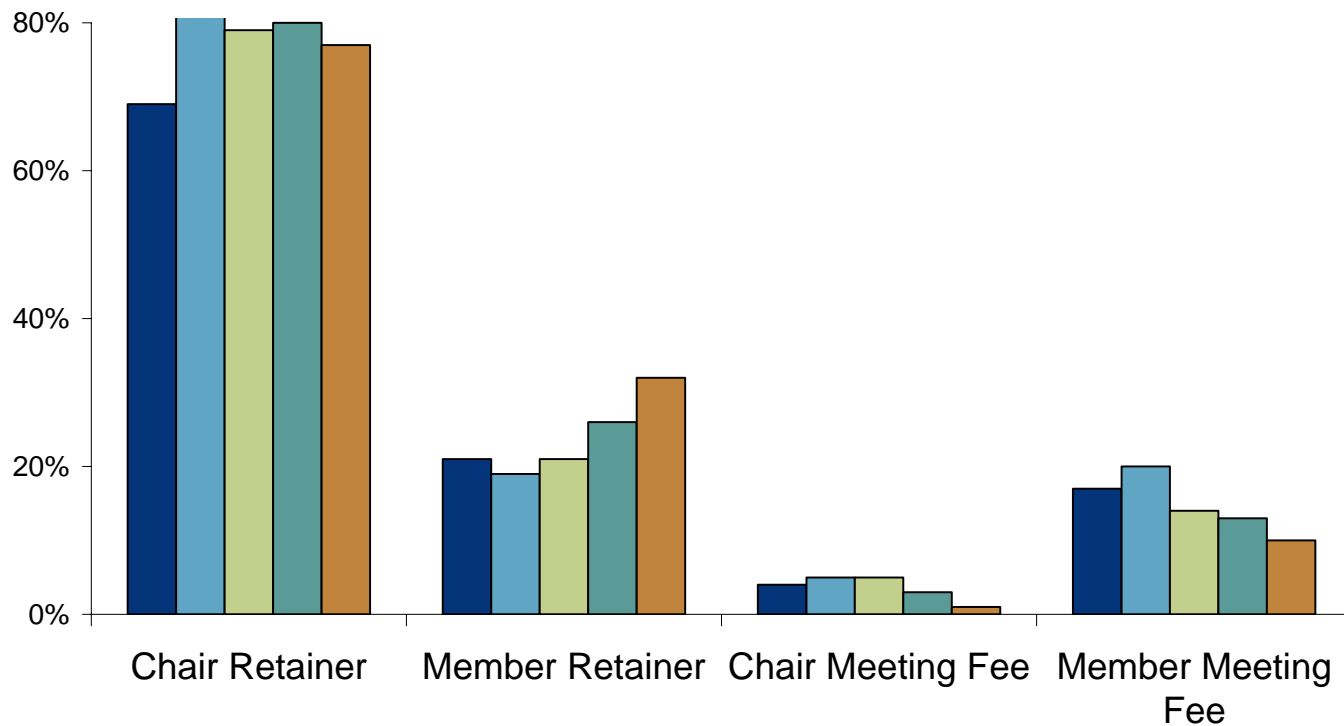
- From 2007 to 2008, use of full-value share use increased, while option use decreased

Long-Term Incentive Prevalence - 2008 vs. 2007



# Differentiated Committee Pay Continues to be Majority Practice Among All Size Groups

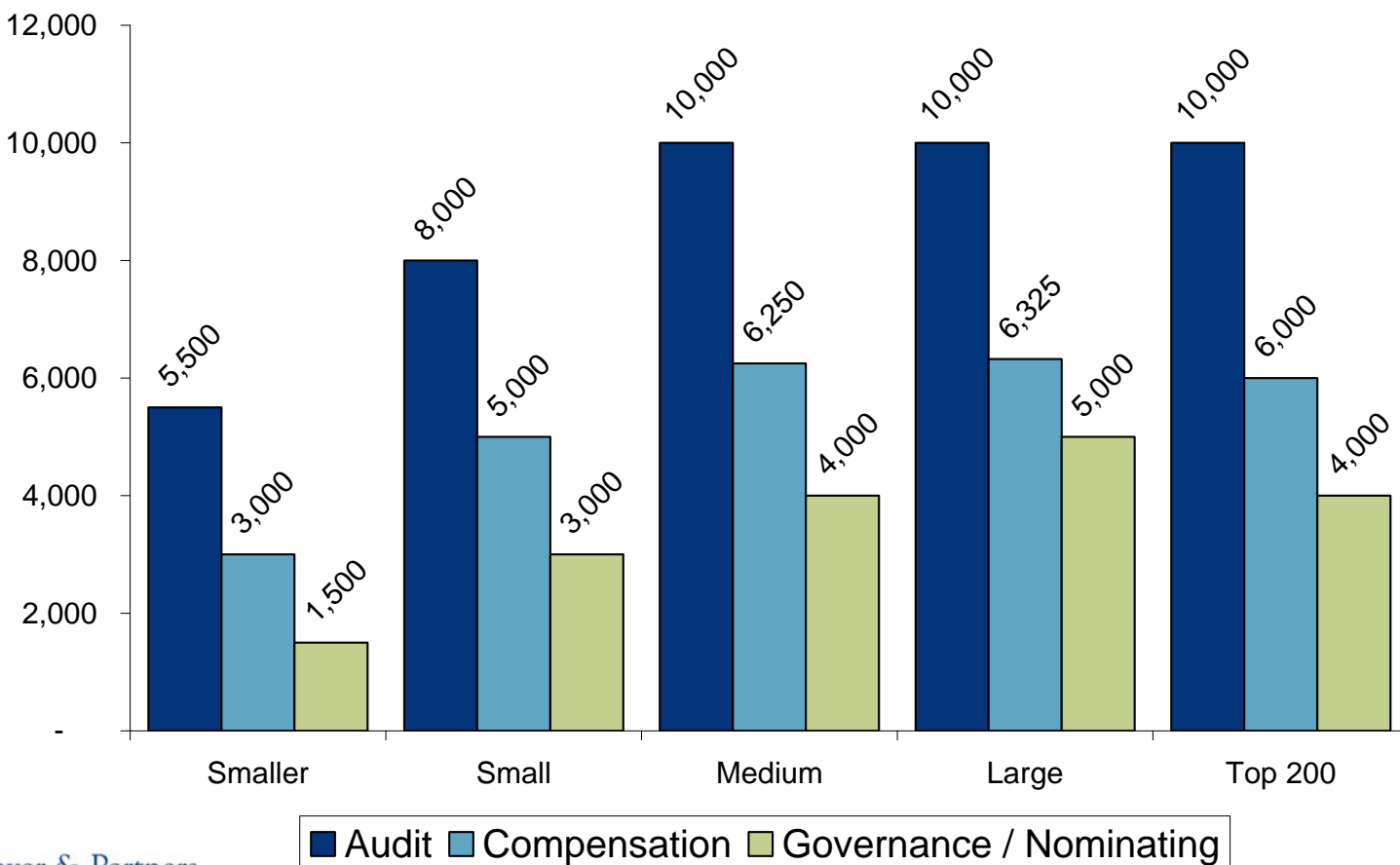
- While there was a decrease in member meeting fee prevalence, there was a significant decrease in Chair meeting fee prevalence for all size categories
- Most often, differentiation is manifested in Committee Chair pay Multiple of Other Non-Employee Director Compensation



# Audit Committee Members Earn a Meaningful Premium over Members of Other Committees

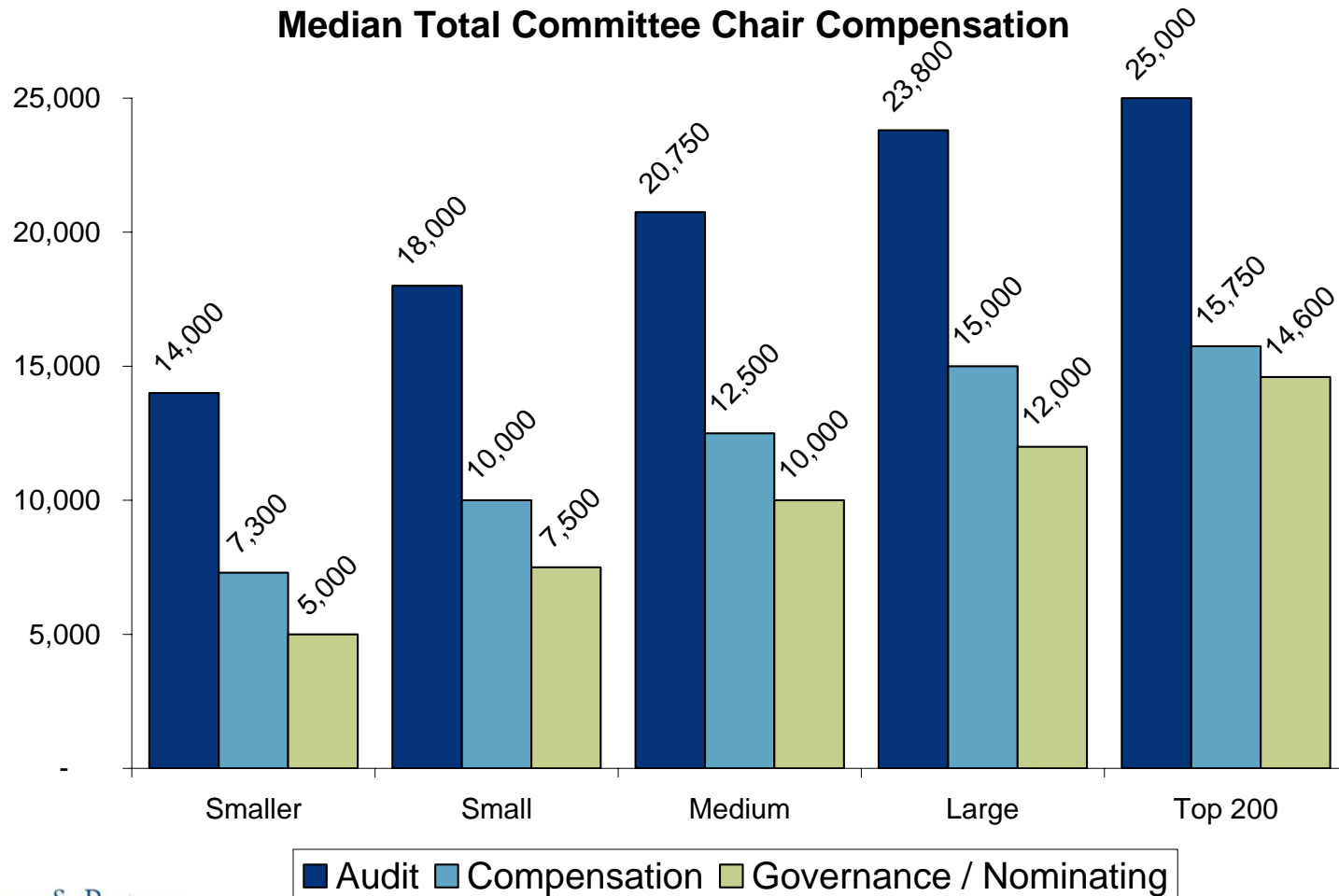
- However, differentiation between the Audit and Compensation committees continues to decline

Median Total Committee Member Compensation



## As do Audit Committee Chairs

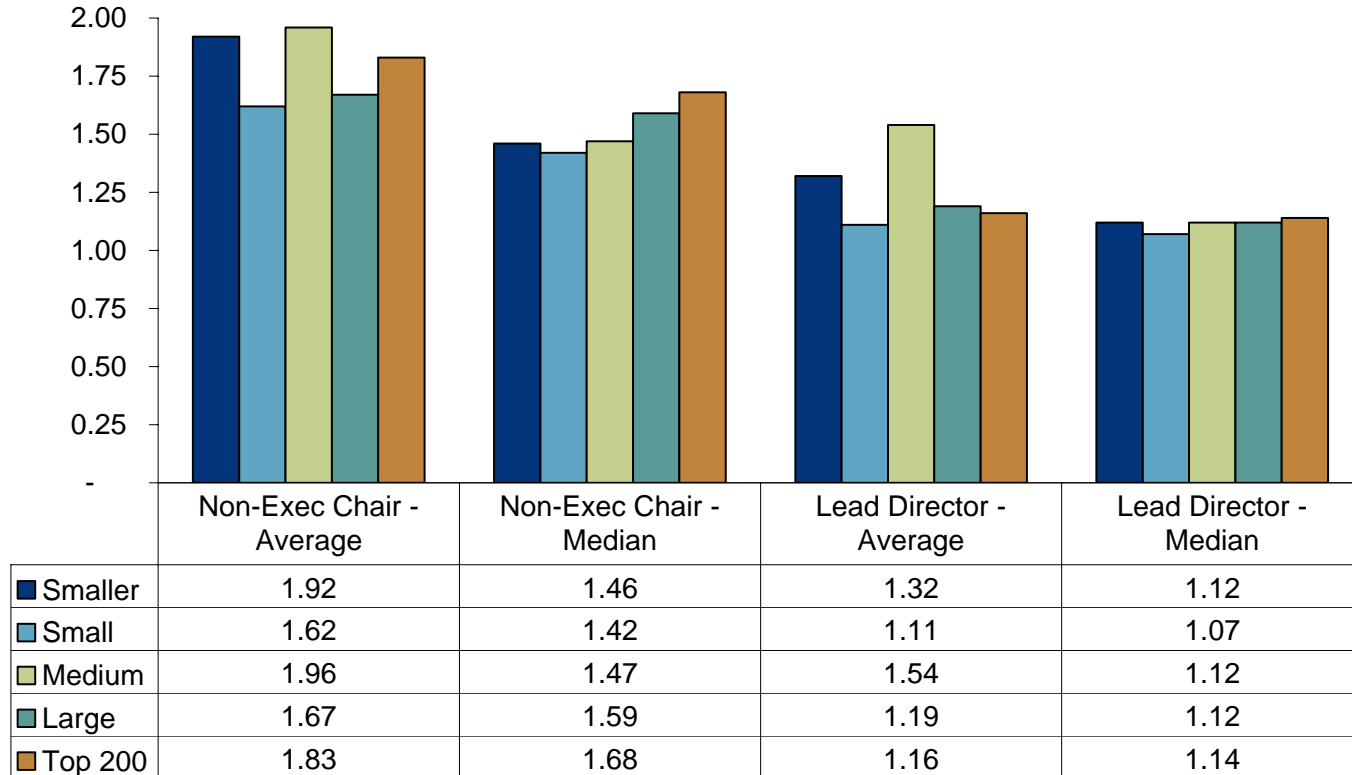
- Committee Chair compensation levels were generally equal to or greater than last year



# Prevalence of Premium Pay for Board Leadership Appears to be Consistent Across All Size Cuts

- Non-Executive Chairs receive 42% to 68% (at median) more pay than other Board members, while Lead Directors receive 7% to 14% more pay than other Board members
- Differentiation by title continues to be significant

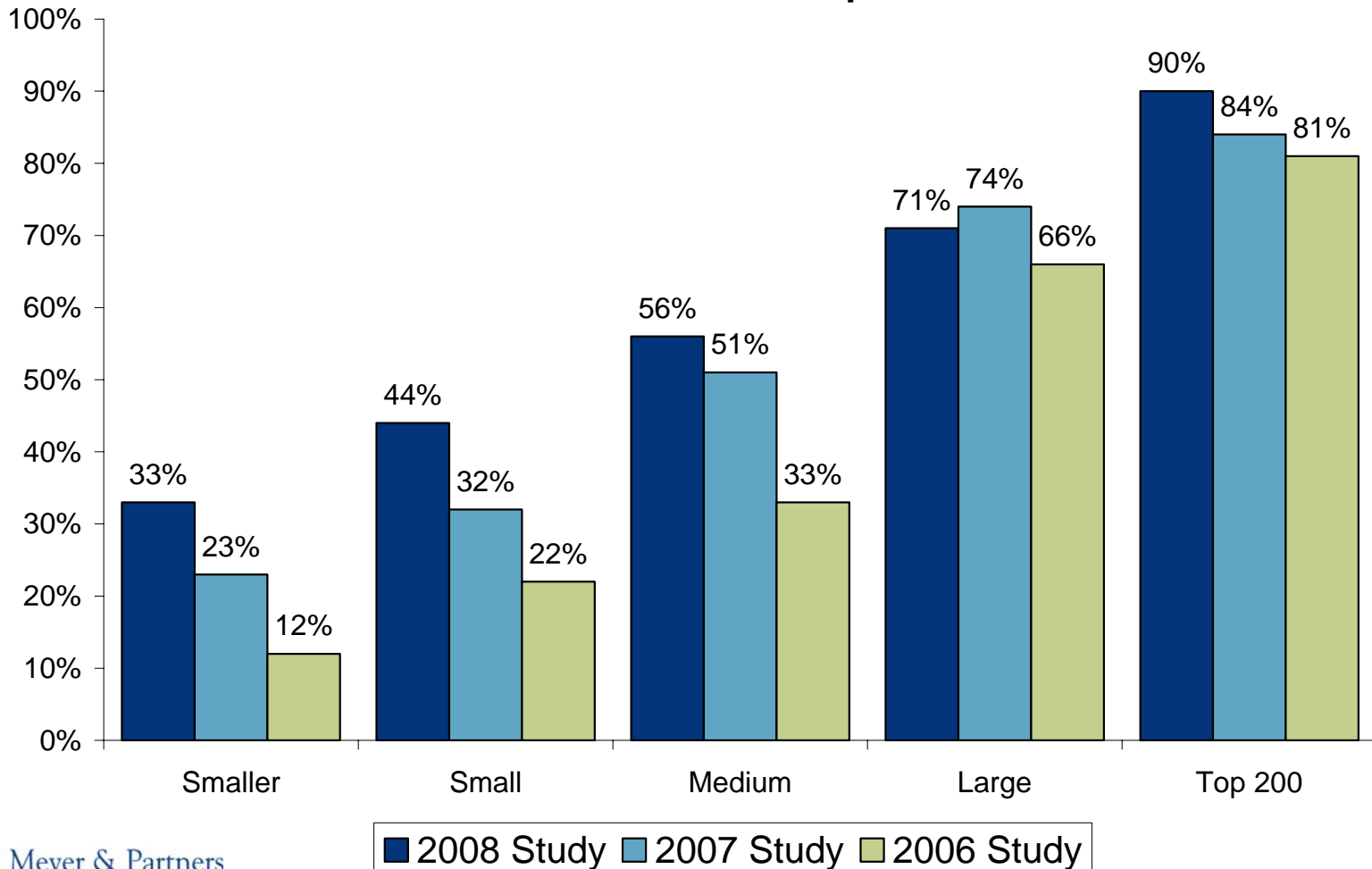
**Multiple of Other Non-Employee Director Compensation**



# Ownership Guidelines, Generally, Continue a Trend of Year-Over-Year Increase

- Reflects shares deferred to retirement in addition to formal guidelines

## Prevalence of Stock Ownership Guidelines



# Board Perquisites and Benefits are More Prevalent and More Likely to be Disclosed at Larger Companies

	Smaller	Small	Medium	Large	Top 200
% Disclosing	10%	14%	27%	44%	65%
Gift Matching / Charitable Gifts	1%	3%	11%	17%	42%
Life / Health Insurance	4%	6%	8%	8%	19%
Co. Products / Services / Discounts	0%	0%	2%	6%	12%
Car Related	0%	0%	2%	1%	2%
Aircraft / 1st / Business Class	1%	1%	3%	5%	14%
Other	5%	6%	14%	20%	35%

## ■ Items for Discussion

- **Current Economic Situation:**
  - What is the likely impact of a troubled economy on director pay programs?
  
- **Equity Grants:**
  - Fixed value vs. fixed shares?
  
- **Shift in trends?**
  - Potential Obama administration legislation could cause a shift in trends? Which ones?
  
- **Outlook?**
  - Near-term changes we foresee in director compensation program design