



Compensation Committees - Governance and Compensation Trends

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- **Delegated by the Board of Directors and stock exchange listing requirements and subject to fiduciary duties in state of incorporation**
 - Duty of Care - Make decisions that are informed
 - Duty of Loyalty - Act without conflict and always put interests of company before those of individual director
 - Business Judgement/Acting in Good Faith - Act in good faith in accordance with corporate governance practices
- **Responsibilities - Historical**
 - *Primary roles are to make certain that first-rate leadership is in place and then ensure that a program perpetuating such leadership is operative ... encouraged to adopt a charter which outlines the role and duties of the committee expected by the full board.....Conference Board 2001 CC Best Practices*

■ Responsibilities defined

- Establish Charter of duties/responsibilities
- Articulate pay-for-performance philosophy
- Approve employment agreements with key executives
- Approve CEO and other officer pay levels and plans, including special situation (e.g. change in control, spinoff)
- Ensure executive succession planning and CEO evaluation
- Respond to shareholder concerns regarding shareholder dilution
- Determine participation in compensation plans
- Ensure total compensation is reasonable as compared to competitors and based on current resources
- Produce Compensation Committee report (now CD&A prepared by management and CC report)

- **Minimum requirements (NASDAQ)**
 - Does not require Compensation Committee, however CEO and executive officer compensation determined by majority of the independent directors
- **Minimum requirements (NYSE)**
 - Compensation Committee (unless controlled company)
 - Written charter of purpose and responsibilities
 - » Committee report
 - » Review/approve goals and objectives for CEO
 - » Evaluate CEO performance
 - » Determine (committee or independent board members) CEO compensation
 - » Recommend to the board non-CEO compensation, incentive compensation plans and equity plans
 - » Evaluate the Committee's performance

- **More rigorous examination of overall program “fit and finish”**
- **More formal CEO evaluation process**
- **Reconsideration of process by which pay of CEO’s subordinates decided**
- **Greater focus on previously “less-disclosed” elements of compensation**
 - Over time, reductions in perqs, severance and CIC benefits
- **Significant challenges in employee and labor relations**
- **Higher levels of executive pay**
- **Much more emphasis on director pay**
 - Data readily accessible
 - Press and investor focus on governance issues

- **CD&A must describe CEO's role in pay decisions for named executive officers**
 - What “checks” should there be on CEO's sole decision-making?
- **CD&A must discuss differential treatment of named executive officers**
- **Most companies unlikely to change roles of decision-makers; however, clarification or formalization is likely**
 - Committee approval of individual goals in addition to performance measures
 - Mid-year updates on individual/business unit performance?
- **How do Boards develop opportunities to get to know the direct reports?**



Charter Definition -- Scope and Nature of Authority

ISSUE/PLAN	EMPLOYEE CATEGORY	NATURE OF ACTION
<ul style="list-style-type: none">▪ Hire▪ Fire▪ Performance Review▪ Salary▪ Incentives▪ Equity▪ Perquisites▪ NQ Benefits▪ Employee Benefits▪ Employment contracts▪ CIC / Severance	<ul style="list-style-type: none">▪ Section 16▪ Other Executives▪ Managers and Professionals▪ Exempt▪ Non-exempt▪ Hourly▪ Part-time	<ul style="list-style-type: none">▪ Advise/review▪ Recommend▪ Approve

- **CEO compensation**
 - Approve relevant goals
 - Evaluate performance
 - Establish pay levels
- **Compensation program management**
 - Compensation of individual Section 16 officers
 - Management incentive plan parameters
 - All equity plans
- **Succession**
 - Assuring availability of candidates
 - Orderly transition
 - Maintaining investor confidence
- **Board remuneration?**

- The extent of Committee’s involvement in ABC’s compensation programs is summarized on the following pages

Compensation Committee Responsibility Matrix		
Program	Committee Reviews and Recommends to Board of Directors	Committee Is Briefed On, but Takes No Action
Base Salary	<ul style="list-style-type: none"> ➤ Salary increases for NEOs ➤ Comparative framework and competitive position for executive compensation 	<ul style="list-style-type: none"> ➤ Salary budgets for broad-based employee population
Annual Bonuses <ul style="list-style-type: none"> ▪ Base bonus ▪ Supplemental bonus 	<ul style="list-style-type: none"> ➤ Prospective performance measures and goals for NEOs ➤ Award opportunity levels for NEOs ➤ Certification of goal achievement – prior year ➤ Payouts for NEOs ➤ Bonus pools for Key Employee population (if applicable) 	<ul style="list-style-type: none"> ➤ Bonus payouts to key employees versus approved pools
Equity Pay	<ul style="list-style-type: none"> ➤ Stock option awards for NEOs ➤ Performance-based restricted stock grant for NEOs ➤ Prospective performance measures and goals for performance-based restricted stock ➤ Certification of goal achievement ➤ Pool of shares for broad-based employee stock option grants ➤ Equity plan design features 	<ul style="list-style-type: none"> ➤ Total distribution against pool ➤ Individual stock option awards to broad-based employee population ➤ Equity plan communication programs
Executive Benefits	<ul style="list-style-type: none"> ➤ Implementation and design of any supplemental benefit plans for NEOs <ul style="list-style-type: none"> ▪ Deferred Compensation Plan 	<ul style="list-style-type: none"> ➤ Selection of investment managers/administrators ➤ Enrollment and communication materials
Contractual Arrangements	<ul style="list-style-type: none"> ➤ Terms of employment agreements for NEOs ➤ Change in Control policy for any employees 	<ul style="list-style-type: none"> ➤ Communication materials

Committee Responsibilities and Activities (cont'd)

Compensation Committee Responsibility Matrix		
Program	Committee Reviews and Recommends to Board of Directors	Committee Is Briefed On, but Takes No Action
Board of Directors (BOD) Compensation	<ul style="list-style-type: none"> ➤ Structure and levels of Board compensation <ul style="list-style-type: none"> ▪ Annual retainer + Board meeting fees ▪ Equity – annual + “welcome” grants ▪ Committee compensation – Chair retainer; meeting fees 	<ul style="list-style-type: none"> ➤ Board membership needs; recruiting
Proxy Compensation Committee Report / CD&A	<ul style="list-style-type: none"> ➤ Review and revise CD&A draft <ul style="list-style-type: none"> ▪ Compensation program applicable to CEO and NEOs, and relation to company financial performance ▪ Performance and rationale for compensation paid ▪ Certification of incentive goal achievement¹ ➤ Finalize and sign Compensation Committee report 	<ul style="list-style-type: none"> ➤ Other sections / tables in proxy related to compensation <ul style="list-style-type: none"> ▪ Summary compensation table ▪ Option grant table ▪ Post-term payments
CEO and President Performance Evaluations	<ul style="list-style-type: none"> ➤ Criteria to be utilized to evaluate CEO and Pres performance ➤ Conduct review and summarize results of evaluation ➤ Communication with CEO and Pres ➤ Summary of CEO performance for proxy 	<ul style="list-style-type: none"> ➤ Results of evaluations for other executives and key employees (as applicable)
Compensation Committee Performance Evaluation	<ul style="list-style-type: none"> ➤ Criteria to evaluate Committee and member performance (meeting attendance and preparation, calendar and agenda items accomplished, etc.) ➤ Summarize and review results - identify development gaps and issues or membership needs 	<ul style="list-style-type: none"> ➤ Criteria used by other committees



Committee Responsibilities and Activities (cont'd)

Compensation Committee Responsibility Matrix

Program	Committee Reviews and Recommends to Board of Directors	Committee Is Briefed On, but Takes No Action
Review Competitiveness of Compensation <ul style="list-style-type: none"> • Executives • BOD 	<ul style="list-style-type: none"> ➤ Confirm that the compensation program is aligned with company strategy and objectives ➤ Ensure compensation levels and opportunities are competitive with changing market conditions <ul style="list-style-type: none"> ▪ Appropriate and relevant Peer Group is utilized for comparisons ▪ Program and incentive opportunities continue to retain and motivate executives ➤ Compensation levels and opportunities outlined in NEO employment agreements represent projections/checkpoints based on profitability <ul style="list-style-type: none"> ▪ Represent “minimum” compensation opportunities ▪ Not reflective of future market conditions ➤ Monitor and ensure compensation is commensurate with performance, and performance relative to Peers <p>Committee involvement/oversight</p> <ul style="list-style-type: none"> ➤ Context for comparison <ul style="list-style-type: none"> ▪ Philosophy / strategy ▪ Competitive objectives ▪ Peer Group selection ▪ Relevant size and performance measures ➤ Results, competitive posture, gaps and recommendations ➤ Review competitiveness of executive and BOD compensation biennially (every other year) 	<ul style="list-style-type: none"> ➤ Competitiveness of compensation for executives, key employees and other employees (as appropriate)

Compensation Committee Responsibility Matrix

Program	Committee Reviews and Recommends to Board of Directors	Committee Is Briefed On, but Takes No Action
Review Competitiveness of Compensation (cont'd) <ul style="list-style-type: none"> • Executives • BOD 	<ul style="list-style-type: none"> ➤ Prepare “tally sheet” annually <ul style="list-style-type: none"> ▪ Calculation of total compensation “due” executives upon termination or Change-In-Control ▪ Prepare for potential inclusion in proxy ➤ Executive compensation program and incentive plan changes ➤ BOD compensation competitive posture and recommended changes 	<ul style="list-style-type: none"> ➤ Competitiveness of compensation for executives, key employees and other employees (as appropriate)
Succession Planning	<ul style="list-style-type: none"> ➤ Succession plan for CEO under various circumstances <ul style="list-style-type: none"> ▪ Retirement / voluntary (scheduled timeframe) ▪ Death / incapacity (sudden) ▪ Other (change-in-control) ➤ Succession and development plans for CEO’s direct reports <ul style="list-style-type: none"> ▪ Succession plans for current role ▪ Development needs for future role 	<ul style="list-style-type: none"> ➤ Succession planning and development related to next level of executives

■ Meetings

- Frequent (4x or more per year)
- Sufficient meeting time
- Materials provided in advance, action items noted clearly
- Discuss at one meeting, decide at another
- Meeting minutes include a record of key deliberations and materials reviewed by the Committee
- Meet in executive session at every meeting

- Meeting Schedule/Calendar (example)

Quarter	Activity
1 st	Approve prior year incentive awards after Audit Committee certifies financials
	Set current year incentive goals
	Approve option grants (could also be fourth quarter)
	Approve salary increases (could also be fourth quarter)
	Approve proxy disclosure
2 nd	Review benefits and perquisites programs
	Review insider trading policy and activity
	Evaluate Committee performance
3 rd	Review competitive positioning of pay program
	Review performance vis-à-vis peers
	Review general trends
4 th	Early look at incentive plan results
	Approve any plan changes for coming year

- **Data**
 - Incumbent data
 - Company performance
 - Market pay data
 - Peer performance
 - Contingent payment amounts
- **Reference Manual Information**
 - Compensation philosophy statement
 - Committee charter and calendar
 - Agendas and minutes from recent Committee meetings
 - Background materials reviewed by the Committee, including reports from outside advisors
 - Incentive and benefit plan documents, plus “plain English” summary of key plan provisions

- **Reference Manual Information (cont'd)**
 - Administrative procedures/guidelines
 - Compensation histories and stock ownership levels for individual executives within the Committee's purview
 - Employment, severance and/or change-in-control agreements and associated costs
 - Proxy statement filings
 - Most recent shareholder dilution calculations/update on annual share utilization and shares available for grant
 - NYSE/NASD Listing Standards
 - Disclosure requirements
 - Sarbanes-Oxley (recapture if malfeasance)
 - SEC rules (re: insider trading, transactions reporting)

- **Purpose of Committee minutes**
 - Record actions
 - Demonstrate due diligence
 - Back up CD&A
 - Inform full Board
- **Debate over thoroughness of minutes**
- **What to include?**
 - Highlights of discussion on each issue
 - » Decisions
 - » Points made for and against
 - » Any changes made to original recommendation as result of discussion
 - Opinions/recommendations of outside experts plus their report(s)
 - Reasons for any abstention or dissenting votes on actions taken

- **Committees are not required to use outside advisors**
- **If Committee uses advisors, listing guidelines require that they report to the Committee**
- **Compensation Consultants**
 - Hired and fired by the Committee
 - Work coordinated with designated management representatives
 - Regular, direct contact with Committee chair
 - Active involvement in agenda setting; attends most meetings
 - Should not perform other work for Company without Committee approval
- **Outside counsel**
 - Often needed when contracts or a deal being negotiated
 - Should be employment law specialist
- **General counsel may be conflicted on CEO-related issues**

New Rules, New Day

- **“Say on Pay”**
 - Aflac (approved for 2009), Blockbuster and others
 - Representative Barney Frank and House approval
- **Consultant Independence**
 - Waxman letter
 - Council of Institutional Investors
- **Litigation**
 - Options scandals – \$7 mm penalty for Brocade, \$12 mm for Broadcom, Comverse, UnitedHealth Group, etc.
 - Exit pay – Countrywide, Disney, Home Depot
- **Backlash**
 - Spotlight on investor advisors
 - » Glass, Lewis – key departures after new ownership
 - Martin Lipton – “Down with Shareholder Activism”

- **Best intentions**
 - General good governance
 - Consultant selection
 - SEC disclosure
- **Defending pay decisions**
 - Peer group selection
 - Pay levels
 - Incentive plan design
 - Performance targets
 - Equity plans
 - Benefits & perquisites
- **Worst case scenarios**
 - Employment contracts & severance
 - Change in control
- **Director compensation**

Trends

- **Independent Directors**
- **Documentation and due deliberation**
 - Dig into the numbers & do the math
- **Executive sessions**
- **Annual review of committee charter, pay philosophy and best practices**
 - Does charter address external expectations and internal priorities?
 - Is pay philosophy aligned with business strategy and shareholder value creation?

Issues

- **What is the appropriate level of detail for Committee minutes?**

Trends

- **Committee directly retains its outside advisors**
 - Both management and the Committee may be involved in the selection process
 - Consultant is retained by, and reports to, the Committee
 - Work directed and approved by Committee

Issues

- **Do companies need “dueling consultants”?**
- **How “real” is the concern over conflict of interests?**

Trends

- **Expect continued expansion of disclosure requirements over time**
 - Anticipate potential public reaction to “new” information
- **New areas of disclosure impacting “best practices”**
 - Peer groups
 - Benefits and perquisites
 - Termination provisions

Issues

- **Must companies disclose incentive plan performance goals?**

Trends

- **Review and validation of key selection criteria**
 - Criteria can be varied, e.g., industry, size, financial performance, life cycle, technological sophistication, etc.
- **Same group for pay and performance comparisons**
 - Targeted pay positioning relative to the peer group should be supported by relative performance

Issues

- **Factoring differences among firms (e.g., capital structure, etc.) into pay for performance analyses**

Trends

- **Formal compensation philosophy regarding pay level and mix**
- **Balance market competitiveness with internal equity considerations**

Issues

- **How much is enough?**
- **Are annual salary increases for executives necessary (i.e., should executives get compensated for tenure alone)?**

Trends

- Balance of performance measures
- Coordination between short- and long-term measures
- Clawback/recapture provisions

Issues

- Establishing multi-year performance measures
- Selecting time-frames/frequency for long-term plans

Trends

- 360-degree perspective to target-setting
- Consider the leverage in both pay and performance ranges
- Pre-define factors that will be considered in adjusting targets to compensate for negative business conditions

Issues

- Should “forgiveness” for negative conditions be offset by reductions for “windfalls”?

Trends

- **Omnibus plans**
 - Share counting and recapture that maximizes utilization
- **Distinction between “retention” plans and “performance” plans**
- **More frequent authorization of smaller share amounts**
- **Adoption of formal equity grant administration guidelines**

Issues

- **Should cumulative holdings/prior awards be considered in determination of current/future grants?**

Trends

- **Decreasing use of perquisites**
 - Replace perquisites with other elements of compensation
 - Do not gross-up perquisites for taxes
 - No post-retirement perquisites
- **Rationalized non-qualified benefits**
 - Alignment between qualified and supplemental plans
 - Performance-based SERPs and DCPs

Issues

- **Are any perquisites “acceptable”?**

Trends

- **Internal candidates for executive positions**
- **Succession planning as a Board/Committee agenda item**
 - Should be an explicit responsibility (i.e., noted in the charter) of either the Compensation or the Governance Committee
 - Compensation structure should support retention and career growth of high-potential employees

Issues

- **How does Board/Committee develop independent knowledge of high potentials?**
- **What is the appropriate balance between board oversight and management authority?**

Trends

- **Decreasing use of employment agreements**
 - Only to the extent required, and constructed as narrowly as possible
- **Formalized severance policies**
 - Competitive severance policy addresses most executive/employee concerns
 - New quantitative proxy disclosure of severance liabilities may increase “risk” of ad hoc termination negotiations
- **Clawbacks**

Issues

- **Will proxy disclosure drive levels up or down?**
- **Do long-tenured executives really need contracts?**

Trends

- **Double-triggers**
 - Avoid automatic full vesting of performance equity awards – consider partial vesting structure that reflects time and pre-CIC performance
- **No vesting of underwater stock options/SARs**
 - Final 280G rules potentially assign parachute “value” to underwater options
- **Decreasing use of full “gross-ups”**
 - Modified cut-back alternative
 - Best after-tax value alternative

Issues

- **Should CIC result in a severance “premium”?**

Trends

- Pace of increase is slowing
- Restricted stock/RSUs in lieu of options
- Higher retainers in lieu of meeting fees

Issues

- Can pay be too high (affecting perceived independence)?

- **Compensation philosophy**
 - How does our philosophy support our Company culture?
 - What aspects of our philosophy and programs are unique to us?
- **Program design**
 - What long-term (career, 10+ years) retention tools do we have in place for the next generation of leaders?
 - Do our programs provide sufficient flexibility to reward our “stars”?
 - In what areas is our executive compensation program most vulnerable to shareholder criticism?

- **Performance measures**
 - How do industry analysts assess our performance relative to our peers?
 - » What measures do they use?
 - » How do we rate?
 - What is the rationale for our STI measures?
 - » How do we set performance levels?
 - » Over the past 10 years how often have we missed threshold? beat maximum?
 - How do the LTI performance goals compare to the Company's strategic plan?
 - » If the Company can't set LTI performance goals, then what is the basis for business planning, capital resource planning, etc.?

■ Market Data

- What were the screening criteria used to develop the peer group?
 - » What companies were specifically included or excluded (despite meeting/not meeting the criteria)?
- Why is our pay peer group different from our comparators for performance?
- If regression data is used, what is the variance (R-Square)?
 - » What does explain pay differences among the comparator companies?

- **Range of pay opportunity**
 - What is the least amount our executives might reasonably earn next year?
 - » Is it too much (i.e., is there enough risk)?
 - » Is it too little (i.e., does it create retention risk)?
 - What is the most our executives might earn?
 - » Is it too much (i.e., could it be viewed as a windfall)?
 - » Is it too little (i.e., not enough to reward the extra effort)?
 - Under what circumstances could pay be “out of sync” with shareholder returns?
 - Does our relative performance rank match our relative pay rank?

- **CEO Compensation**
 - How has our CEO's pay increased over the past 5 years in comparison to:
 - » The pay of other NEOs
 - » The pay of our top (20) executives
 - » The pay of our average employee
 - » The growth in our earnings
 - » TSR
 - Why does the CEO (or any other senior executive) need a salary increase every year?
 - » How have our executive salary increases compared to our rank-and-file increases?

- **Benefits & Perquisites**
 - What benefits will our executives accumulate under the SERP if they work to age 65? to early retirement age?
 - » Are the levels appropriate?
 - » How do they compare to the retirement benefits of other employees?
 - » How do incentive awards impact retirement benefits?
 - What is the business purpose for each of our benefits and perquisites?
 - Does the overall benefits & perquisites package represent a competitive advantage or disadvantage in recruiting and/or retaining talent?

- **Severance & CIC**
 - Do CIC benefits represent a “neutral” incentive to doing a deal, or do they
 - » Cause executives to shy away from a deal?
 - » Encourage executives to sell the Company?
 - Why does a long-tenured executive continue to need an employment contract?

Executive Compensation Trends



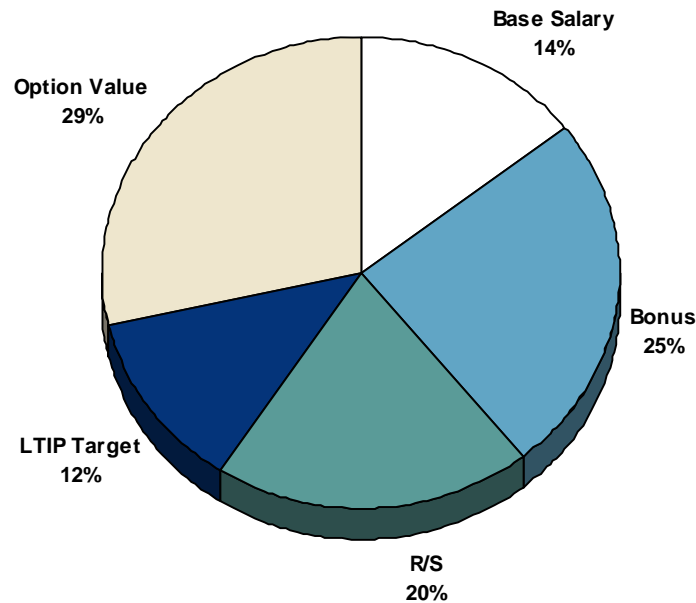
CEO Pay 2006/2007 vs. 2005/2006 – Same CEOs

	Average			Median - Same CEO (163 companies)		
	2006/07	2005/06	% Change vs. 2005/06	2006/07	2005/06	% Change vs. 2005/06
Salary	\$1,213	\$1,174	+3.3%	\$1,187	\$1,100	+7.9%
Bonus	3,466	3,202	+8.2%	2,310	2,250	+2.7%
Total Cash	\$4,679	\$4,376	+6.9%	\$3,500	\$3,400	+2.9%
LTIP Target	2,823	1,525	+85.1%	1,900	0	--
Restricted Stock	2,556	2,794	-8.5%	1,273	1,078	+18.1%
Stock Option Value	2,867	3,603	-20.4%	2,152	2,505	-14.1%
Total Direct Compensation	\$12,924	\$12,299	+5.1%	\$10,681	\$10,608	+0.7%

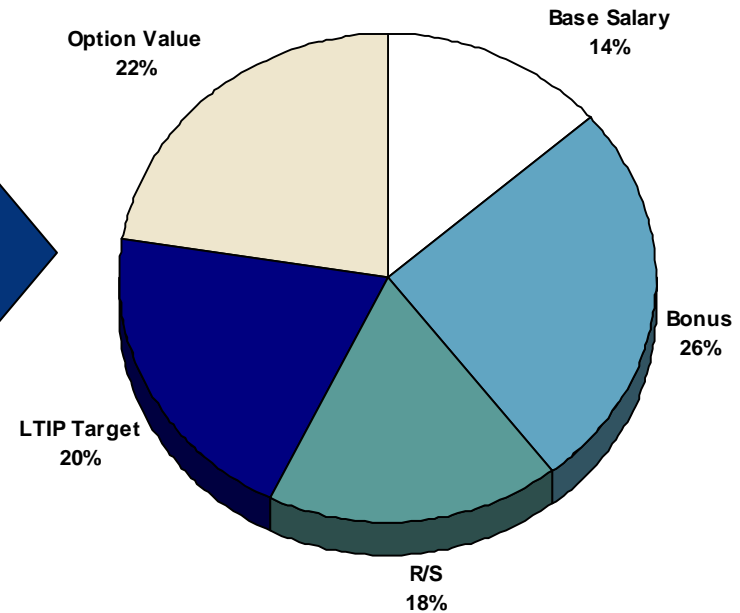
Data based on PM&P analysis of CEO pay for the 200 largest U.S. publicly traded companies. Data analyzed from 2006 and 2007 proxy statements, respectively.

Average CEO Pay Mix – All CEOs

2005/06 Average TDC - \$12,380,055

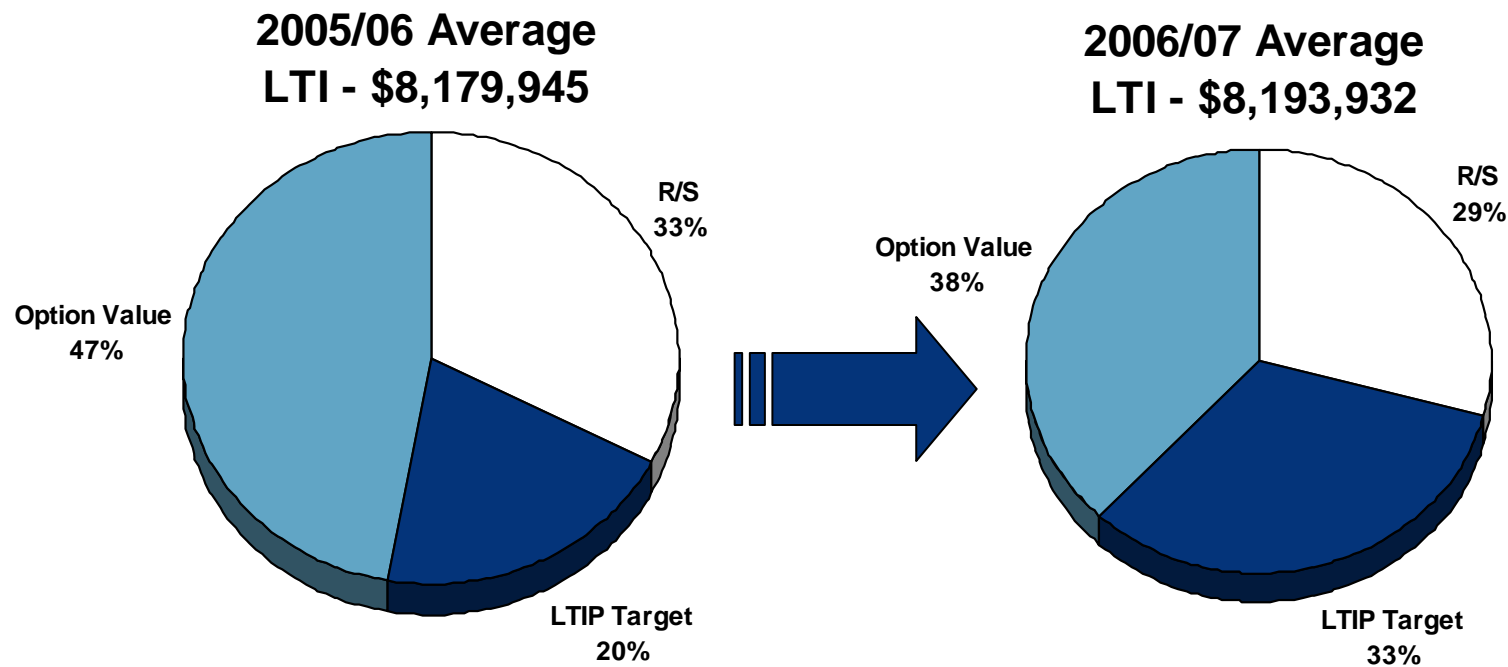


2006/07 Average TDC - \$12,891,864



Data based on PM&P analysis of CEO pay for the 200 largest U.S. publicly traded companies. Data analyzed from 2006 and 2007 proxy statements, respectively.

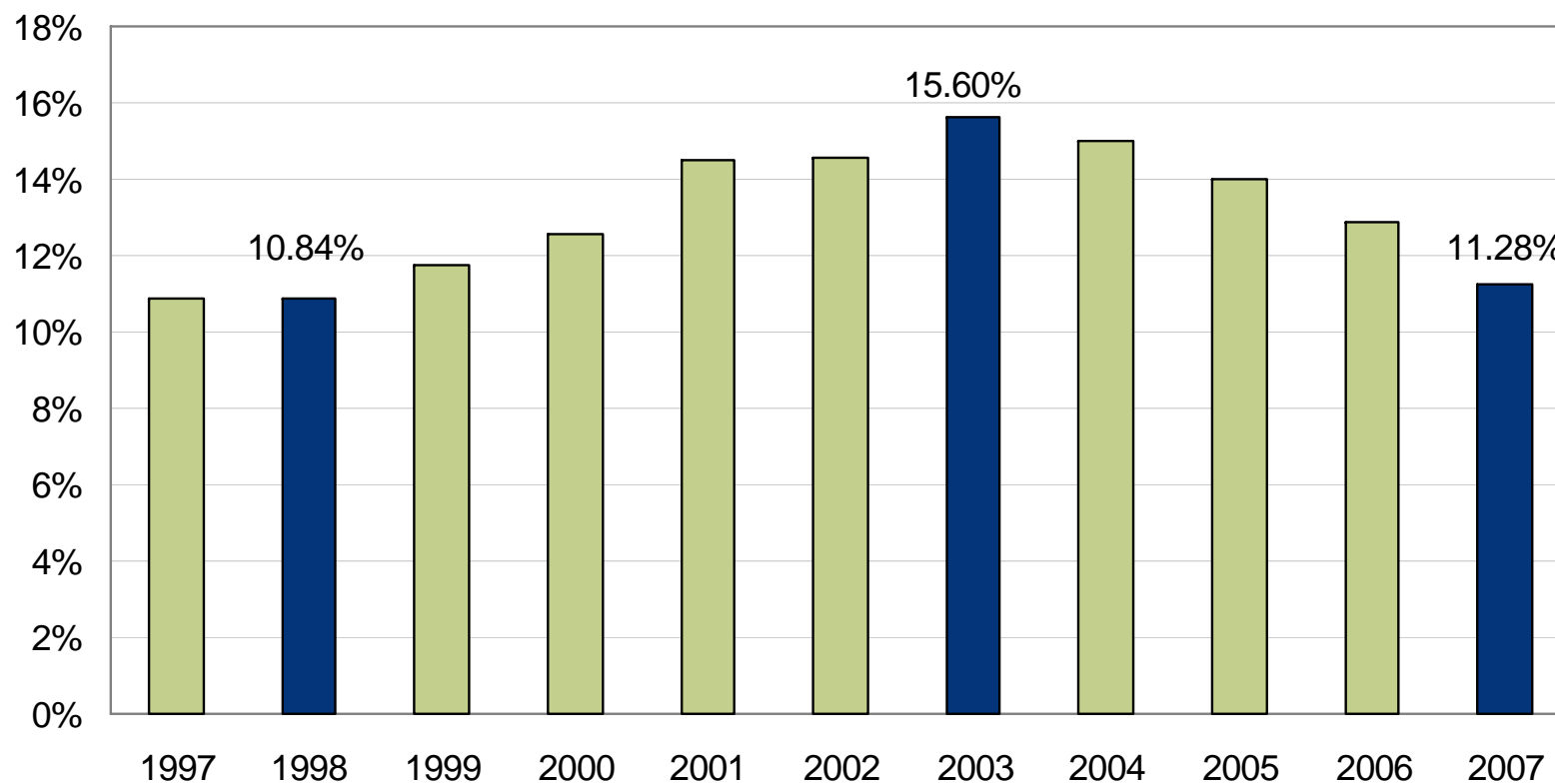
Average CEO Long-term Incentive Mix – All CEOs



Data based on PM&P analysis of CEO pay for the 200 largest U.S. publicly traded companies. Data analyzed from 2005/2006 and 2006/2007 proxy statements, respectively.

- **Overall, stock overhang levels are declining across industries**
 - Stock option usage continues to decline
 - Restricted stock and LTIP grants on the rise, as RS can deliver equal value as stock options while using fewer shares and to:
 - » Combat SFAS 123R
 - » Manage overhang and burn rates judiciously
 - » Align executives to key business / financial initiatives
- **Omnibus plans increase with share counting and recapture provisions**
- **Increased discussion around risk-adjusted returns in determining ratio of options vs. restricted stock**
- **More frequent authorization of smaller share amounts**
- **New equity grant administration guidelines**

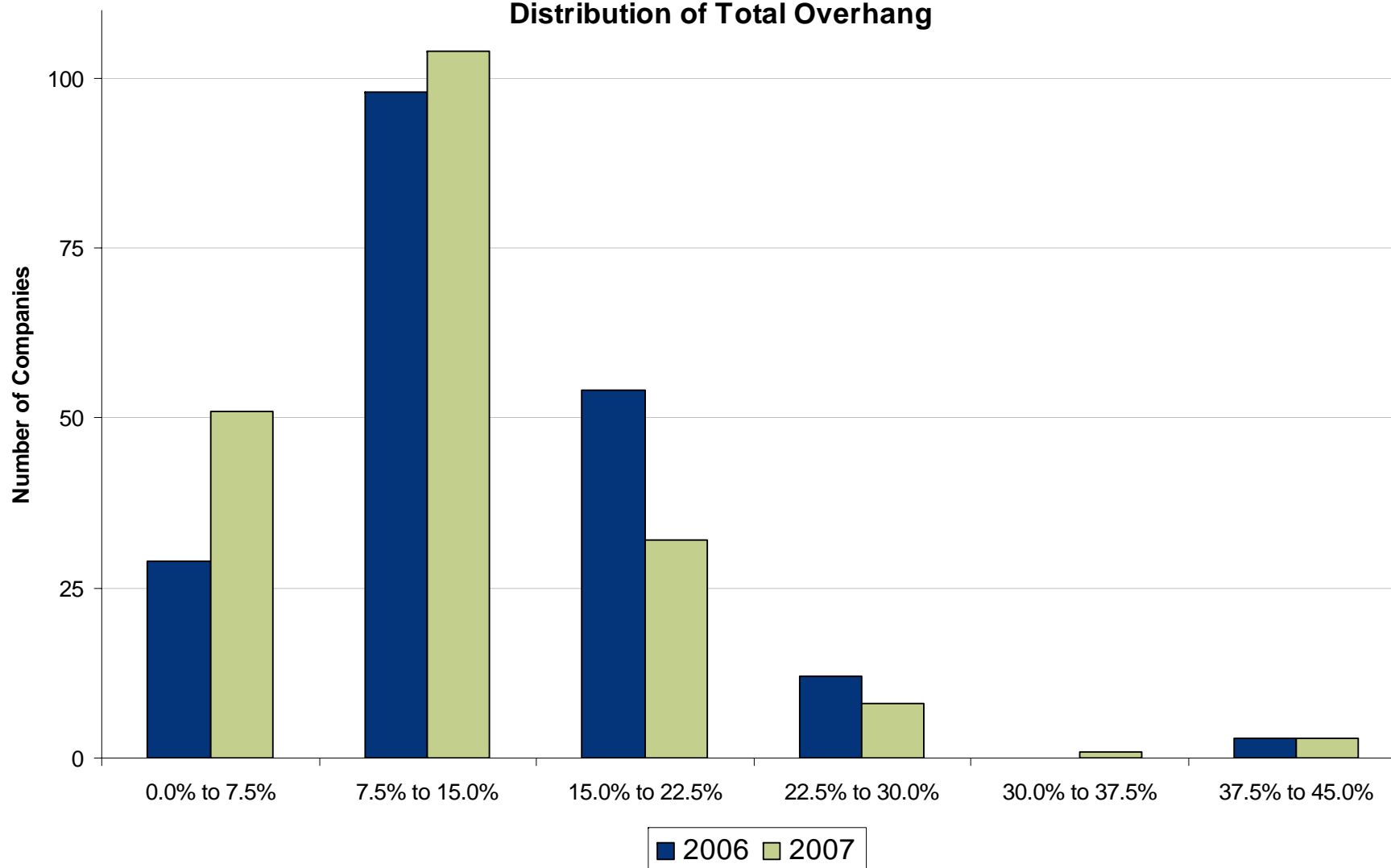
Median Shares Authorized for Management and Employee Equity Incentive Plans as a Percent of Shares Outstanding



Data based on PM&P analysis of equity awards for the 200 largest U.S. publicly traded companies.

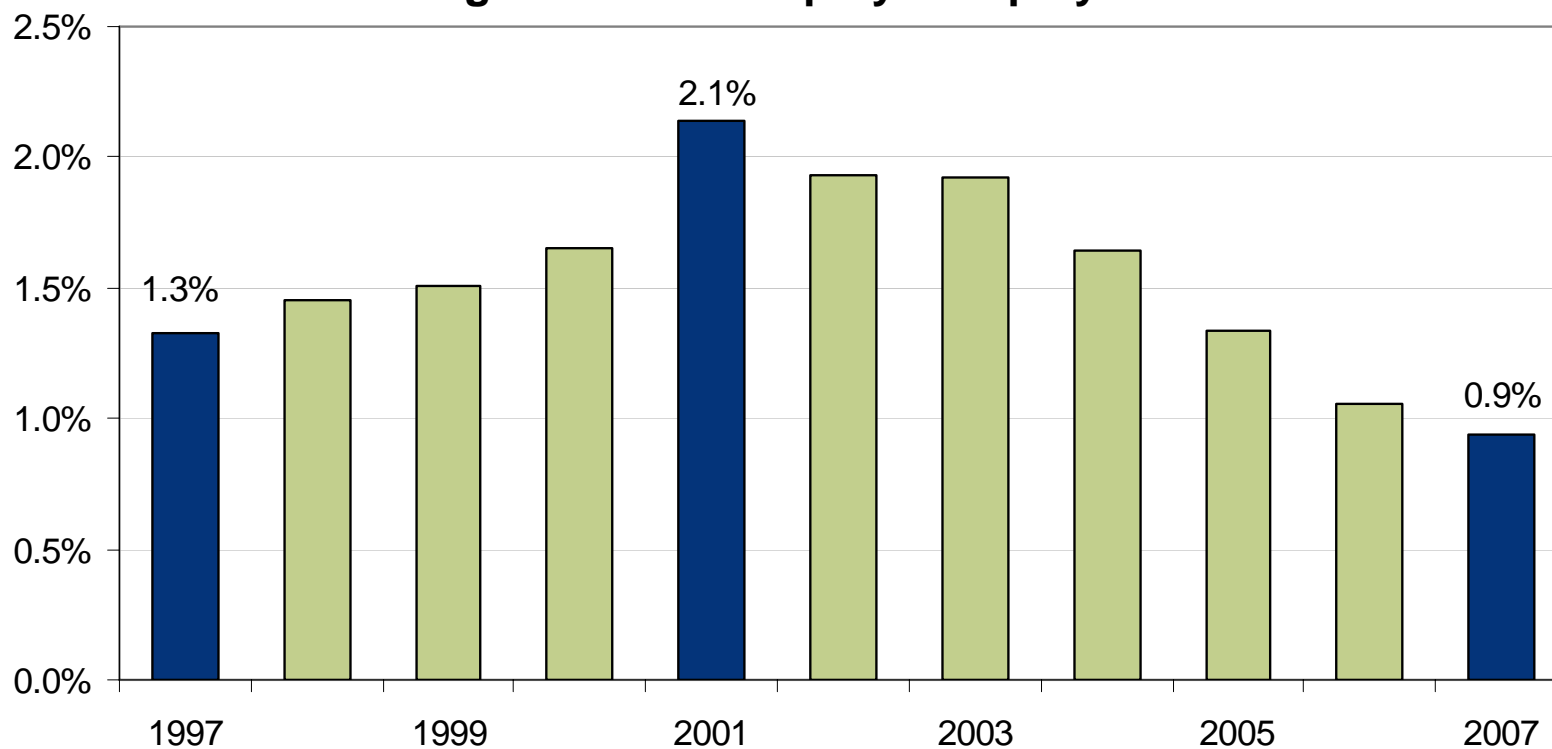
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Distribution of Total Overhang



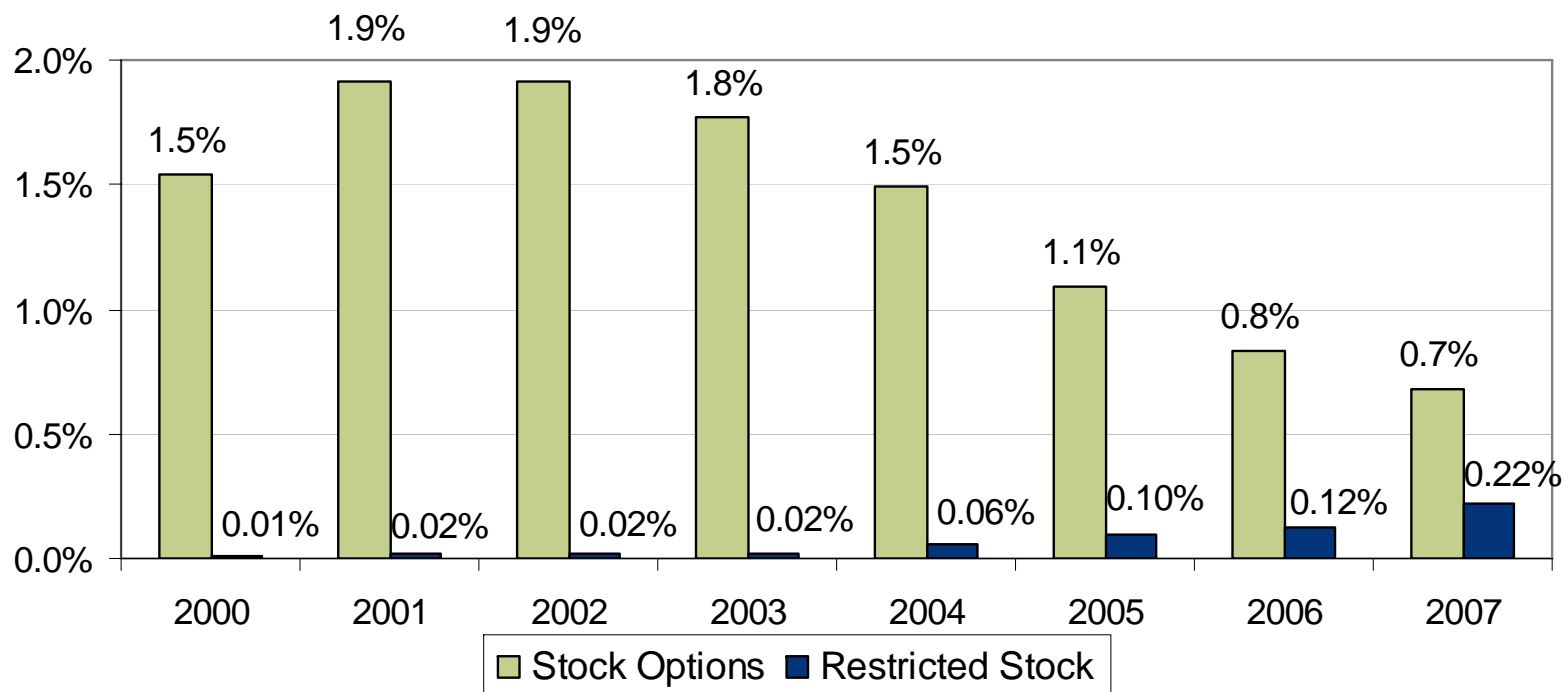
Data based on PM&P analysis of equity awards for the 200 largest U.S. publicly traded companies.

Median Shares Granted Annually for Management and Employee Equity Incentives



Data based on PM&P analysis of equity awards for the 200 largest U.S. publicly traded companies.

Stock Options vs. Restricted Stock Median Annual Grant Rates



Data based on PM&P analysis of CEO pay for the 200 largest U.S. publicly traded companies.



Stock Ownership Guidelines

	<u>Number of Companies</u>	<u>Percent of Cos. With Guidelines/ Requirements</u>	<u>Percent of Top 200</u>
Multiple of			
Salary	102	61%	51%
Salary & Retention Ratio	25	15%	13%
Salary or Shares	10	6%	5%
Total Cash	1	1%	1%
	138	82%	69%
Number of Shares			
Shares	19	11%	10%
Shares & Retention Ratio	1	1%	1%
	20	12%	10%
Holding Requirements			
Retention Ratio	8	5%	4%
Not Disclosed	2	1%	1%
Total	168	100%	84%

Time Frame and Ownership Requirements as a Multiple of Base Salary (138 Companies)

	<u>Time Frame (yrs.)</u>	<u>CEO</u>	<u>Direct Reports</u>	<u>Key Executives</u>	<u>Senior Managers</u>
Average	4.5	5.8x	3.6x	2.5x	1.5x
Median	5.0	5.0x	3.0x	2.5x	1.0x
75th Percentile	5.0	6.0x	4.0x	3.0x	2.0x
Minimum	2.0	2.0x	1.0x	0.5x	0.5x
Maximum	5.0	25.0x	10.0x	8.0x	5.0x

Data based on PM&P analysis of CEO pay for the 200 largest U.S. publicly traded companies.