



Pearl Meyer & Partners  
Comprehensive Compensation®

# ON POINT

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## **PM&P on Compensation Planning: *Looking Ahead to Executive Pay Practices in 2010***

### **Executive Summary**

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## Introduction

“PM&P on Compensation Planning: Looking Ahead to Executive Pay Practices in 2010” was designed to arm executive pay decision makers with information on how others are confronting competitive and regulatory challenges in the current environment.

The survey is unique in its approach to assessing how executive pay practices are changing year-over-year, and is intended to provide “forward looking” guidance rather than “backward looking” validation. While a wide variety of data sources can answer questions such as “what did executives earn in 2008?”, very few address questions along the lines of “how do companies anticipate modifying their executive annual incentive program design in 2010?” We hope that this survey helps fill the gap.

The survey was conducted during September 2009. The 395 respondents represent organizations from a broad variety of industries, ranging from Fortune 50 members to not-for-profits and emerging high growth companies.

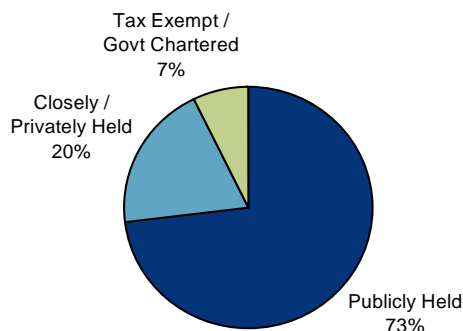
This Trends and Issues Report includes the following:

- A high level overview of the current executive pay decision making environment
- Key highlights from our survey findings on topics ranging from executive base salary changes to incentives to other areas of concern for the upcoming year

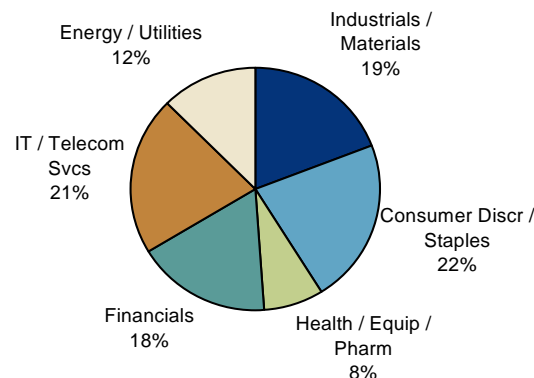
The complete results from the PM&P Compensation Planning: *Looking Ahead to Executive Pay Practices in 2010* survey are available for purchase at [www.pearlmeyer.com](http://www.pearlmeyer.com).

We hope you find this information useful. If you would like to discuss any aspect of these findings further, please contact Jim Heim at [jim.heim@pearlmeyer.com](mailto:jim.heim@pearlmeyer.com) or (508) 630-1502.

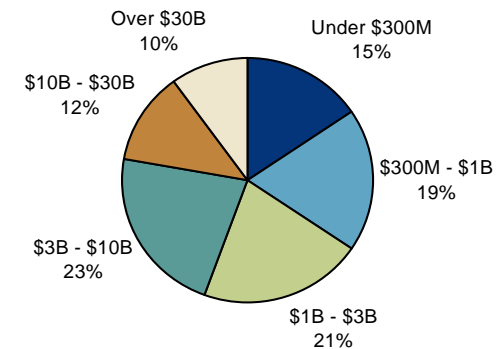
**Participants by Ownership Structure**



**Publicly Held Participants by Industry**



**Participants by Revenue, Assets or Budget**



## Summary of Executive Pay Decision Making Environment

The worldwide financial meltdown fueled an unprecedented level of outrage and activism regarding executive compensation on multiple fronts. Investors, politicians and regulators are calling on corporate leaders to redesign executive compensation programs to better focus on long-term value creation. The fallout has already begun to reframe the regulatory environment in which pay decisions are made, and pay decision makers are operating in the shadow of Say on Pay, new SEC disclosure requirements, and an expanding list of “poor pay practices” from various institutional shareholders and proxy advisory firms. These developments will have sweeping ramifications for pay programs at all public companies, as well as implications for closely held and not-for-profit entities that compete in the ongoing war for executive talent.

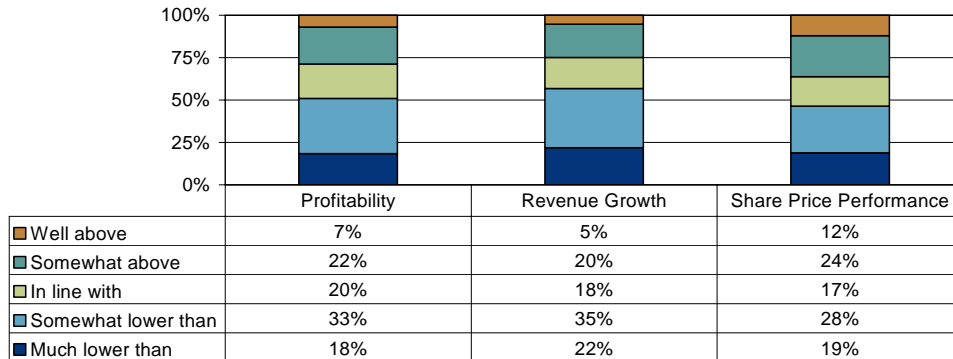
Executive pay decision makers are facing challenges that include:

- Assessing the appropriateness of compensation peer groups
  - Ensuring a proper frame of reference for decisions
  - Increasing transparency of the benchmarking process
- Rebalancing the mix of short- and long-term compensation
  - Validating a proper emphasis on long-term value creation
  - Revisiting the definition of “long-term”
- Proper evaluation of compensation program risk
  - Focusing on the Financial Services and Banking sectors
  - Encouraging entrepreneurship while discouraging unnecessary and excessive risk-taking
- Goal-setting and metric selection
  - Setting multi-year goals is difficult given volatile market conditions
  - Requiring more sophisticated analysis to identify true “value drivers”

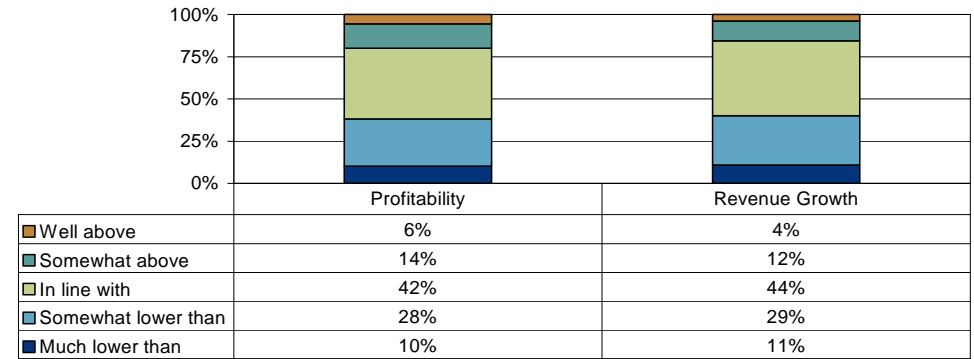
## Company Performance and Impact on Decision Making

Company performance is down year-over-year across all industry categories, and more respondents indicate their companies are not meeting their own internal budget goals than report they are exceeding internal benchmarks.

FY09 Expected Performance vs. FY08

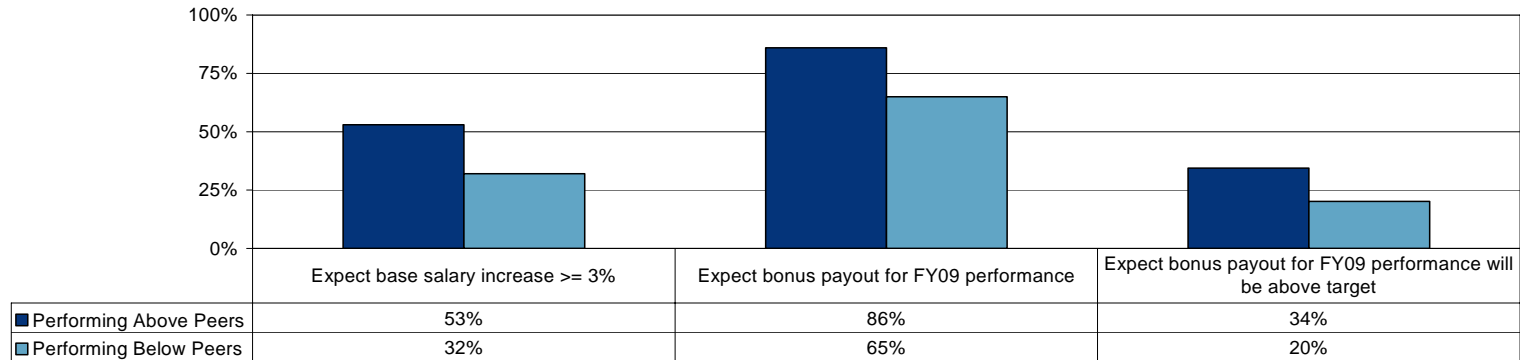


FY09 Expected Performance vs. Internal Budget



Respondents who expect FY09 performance will be “above peers” differ from those anticipating poorer relative performance.

Respondents Expecting FY09 Performance "Above Peers" vs. Those Expecting Performance "Below Peers"

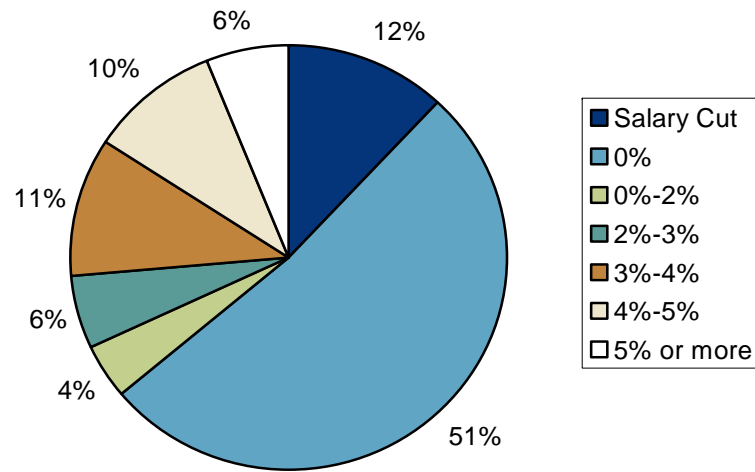


**PM&P Observation:** Decision making is especially difficult among “poor performers”, as the importance of differentiating pay based on contribution and perceived “fairness” increases even as the award pool shrinks. While executives expect pay-for-performance, a “no payout” result that is perceived to be linked primarily with external market factors is demotivational, and top talent is always a retention risk.

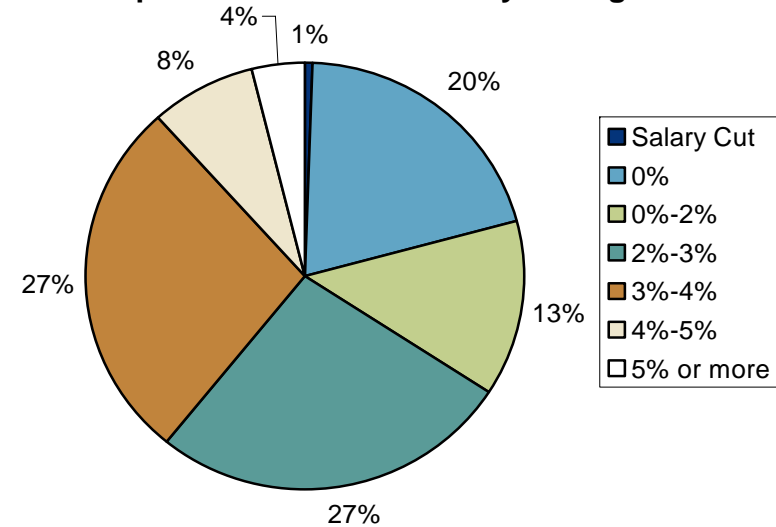
## Executive Base Salary Changes

Respondents are coming off a year (FY09) in which 64% either froze or decreased executive base salaries. Anticipated FY10 increases are modest, with 20% anticipating a salary freeze, and 54% anticipating an increase in the 2% - 4% range (below the historic 4% average of the past two decades).

### FY09 Base Salary Changes



### Expected FY10 Base Salary Changes

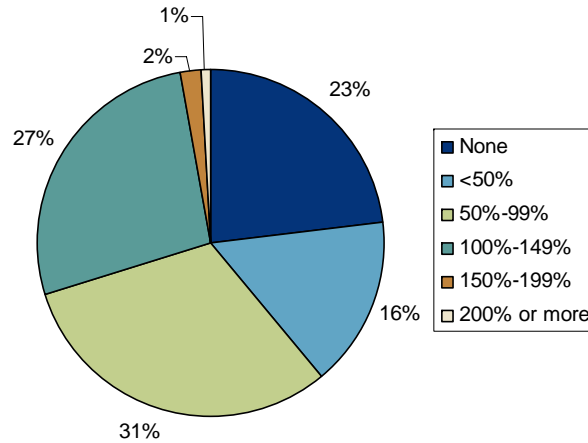


**PM&P Observation:** Even among companies that expect strong performance in FY10 (i.e., believe their performance will be “above peers”), planned base salary increases are modest. Only 11% of these strong performers expect an FY10 executive team base salary increase of more than 4%. Companies are very hesitant to increase fixed costs given volatile market conditions. Retention concerns are likely be addressed in other ways (e.g., through the use of special one-time equity awards).

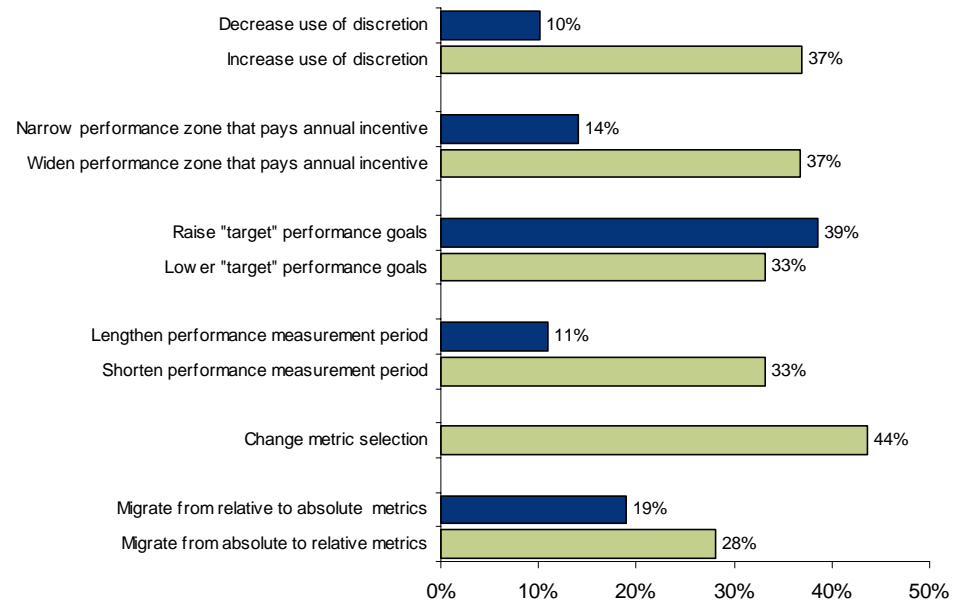
## Modifications to Annual Incentive Program Design and Payout Levels

More than one out of five respondents paid no annual incentives for FY08 performance, and 23% anticipate no payout for FY09. Of those who do expect a payment for FY09, the majority expect to pay “below target”. Moving away from the question of annual incentive payouts and towards issues relating to program design, a significant number of companies contemplated or modified plans in 2009, or expect to relook at incentive plan designs in 2010.

**Expected FY09 Annual Incentive Payout as Percent of Target**



**Actions Contemplated in FY09 or FY10**

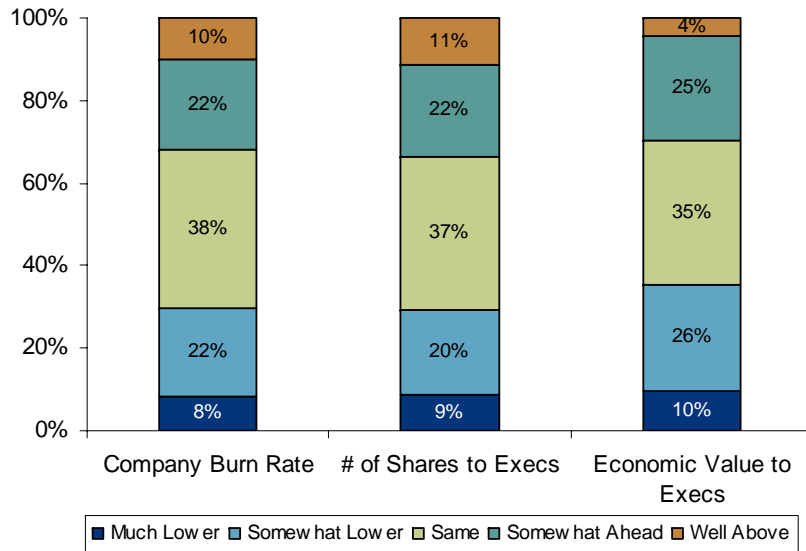


**PM&P Observation:** The “Actions Contemplated in FY09 or FY10” table shows that, in general, companies are considering the types of actions that might be expected in a down economy (the olive bars). An exception is that 39% have contemplated raising “target” performance goals—however, many of these firms are coupling that increase in “target” with a widening of the performance zone that will pay an annual incentive. In other words, executives must deliver stronger results than in the past to reach “target”, but they also begin to earn annual incentive dollars at a lower level of “threshold” performance. Widening the performance zone can help to ensure a company does not underpay executives if the economy takes a turn for the worse, or overpay when it recovers.

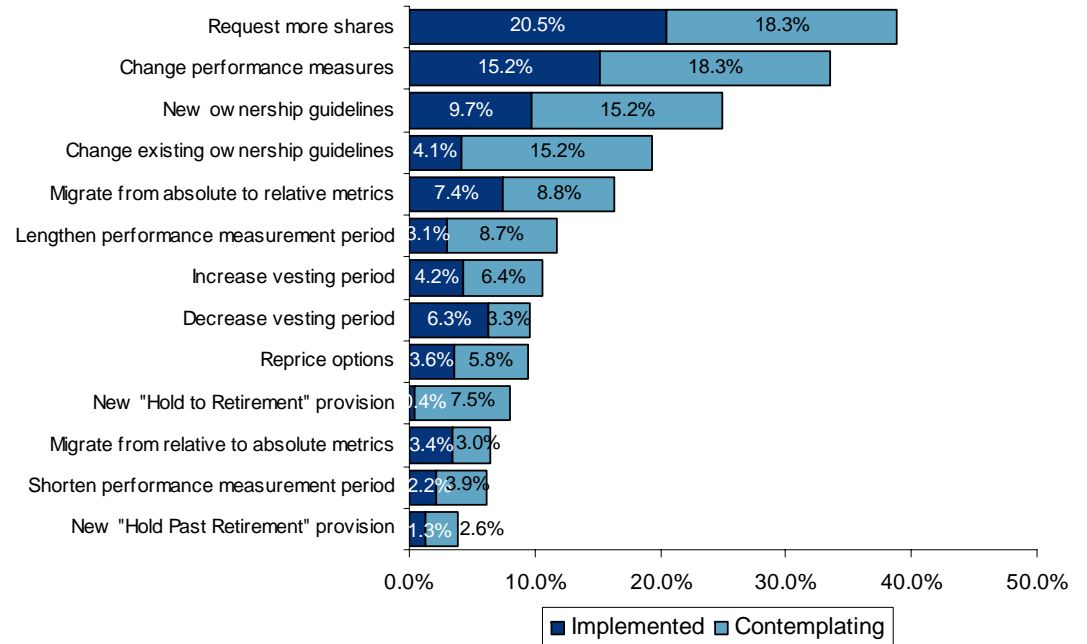
## Modifications to Long-Term Incentive Program Design and Award Levels

In the aggregate, respondents indicated that there will be relatively little change year-over-year with respect to grant levels, while change appears to be slow but steady with regard to LTI program modifications that various pay critics have termed “best practice” (e.g., stock ownership guidelines, hold-until and hold-through retirement provisions, and longer performance measurement and vesting periods). (Please note that the charts for this section consider publicly-held respondents only.)

### Expectations for FY09 LTI



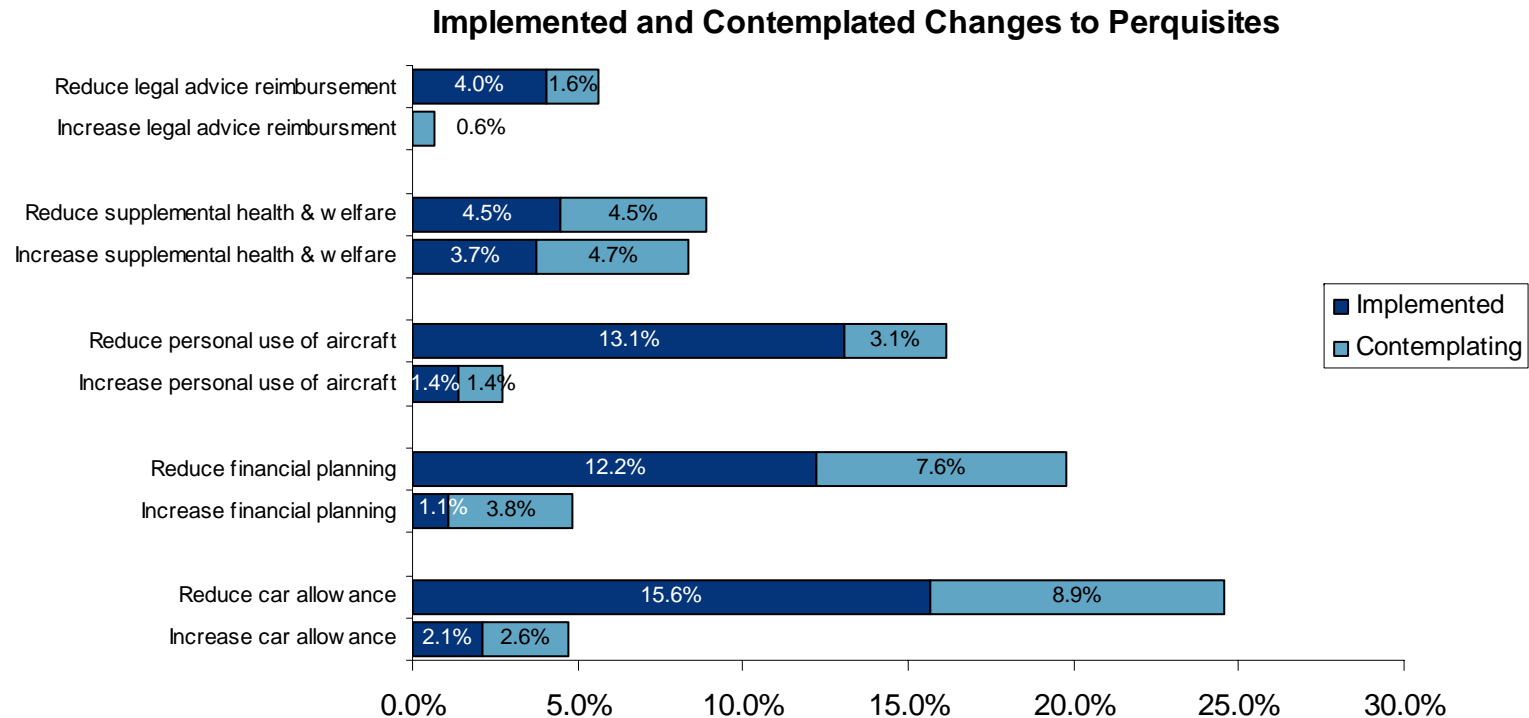
### Implemented and Contemplated Changes to LTI Programs



**PM&P Observation:** As companies consider the level of risk in their compensation plans, it is important to ask the question “Do our plans focus executives on long-term performance that aligns with shareholder interests?” Stock ownership and retention requirements are among the tools that help companies to maintain a long-term view of performance and reduce the likelihood that executives will take undue risks. Companies should also consider the full range of upside/downside payouts under incentive payouts, which requires that LTI awards be calculated under best, realistic, and worst case stock price/payout scenarios.

## Perquisites

The prevalence of various traditional executive perquisites continues to wane.

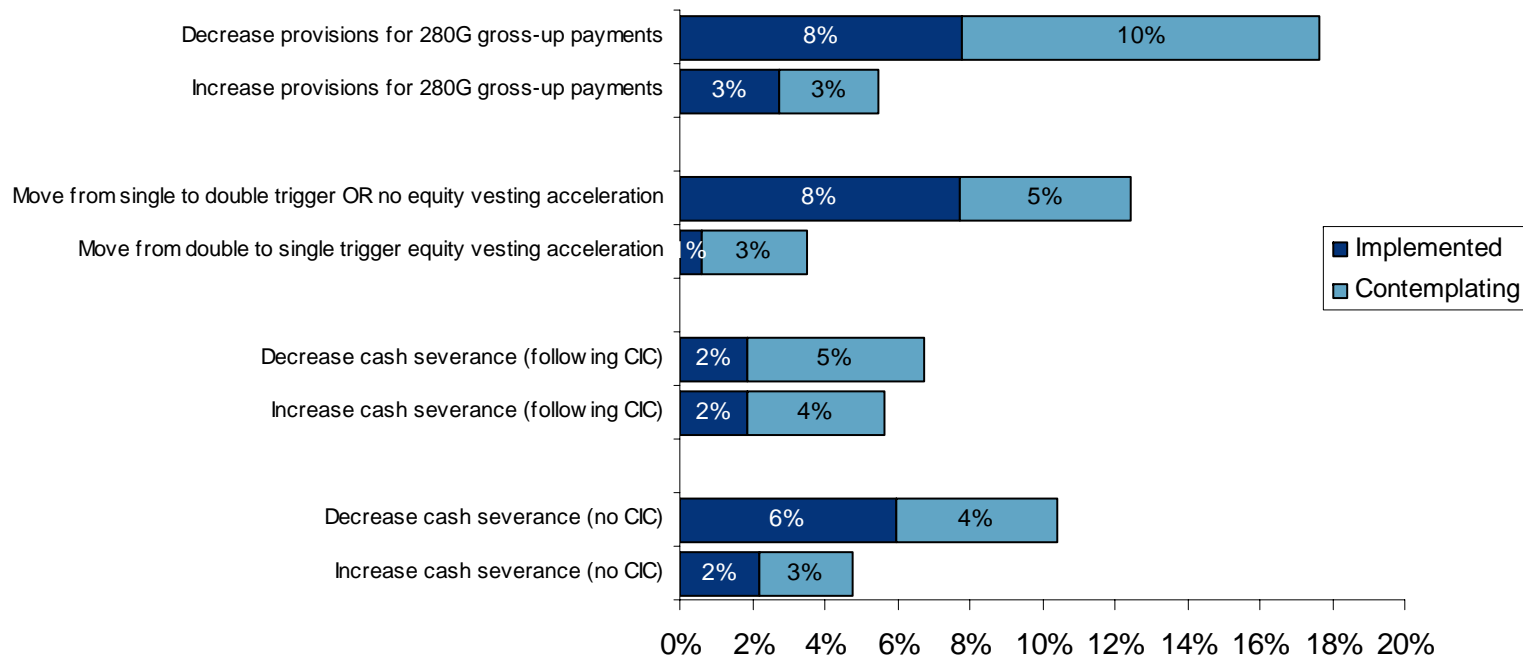


**PM&P Observation:** Executive perquisites are a small percentage of total compensation value, but a significant driver of shareholder and employee dissatisfaction. We recommend eliminating executive perquisites that generally lack a legitimate business purpose and that other employees must cover on their own, such as personal use of a corporate aircraft; a car allowance and/or company car; club dues; and tax preparation services. In contrast, executive perquisites with a potentially legitimate business justification include business use of a corporate aircraft; a home security system; or a periodic physical exam.

## Severance and Change-in-Control Payments

While the vast majority of respondents did not revise their severance or CIC arrangements in FY09, the trend is clearly toward decreasing benefits. (Please note that the chart for this section considers publicly-held respondents only.)

### Implemented and Contemplated Changes to Severance and CIC Provisions

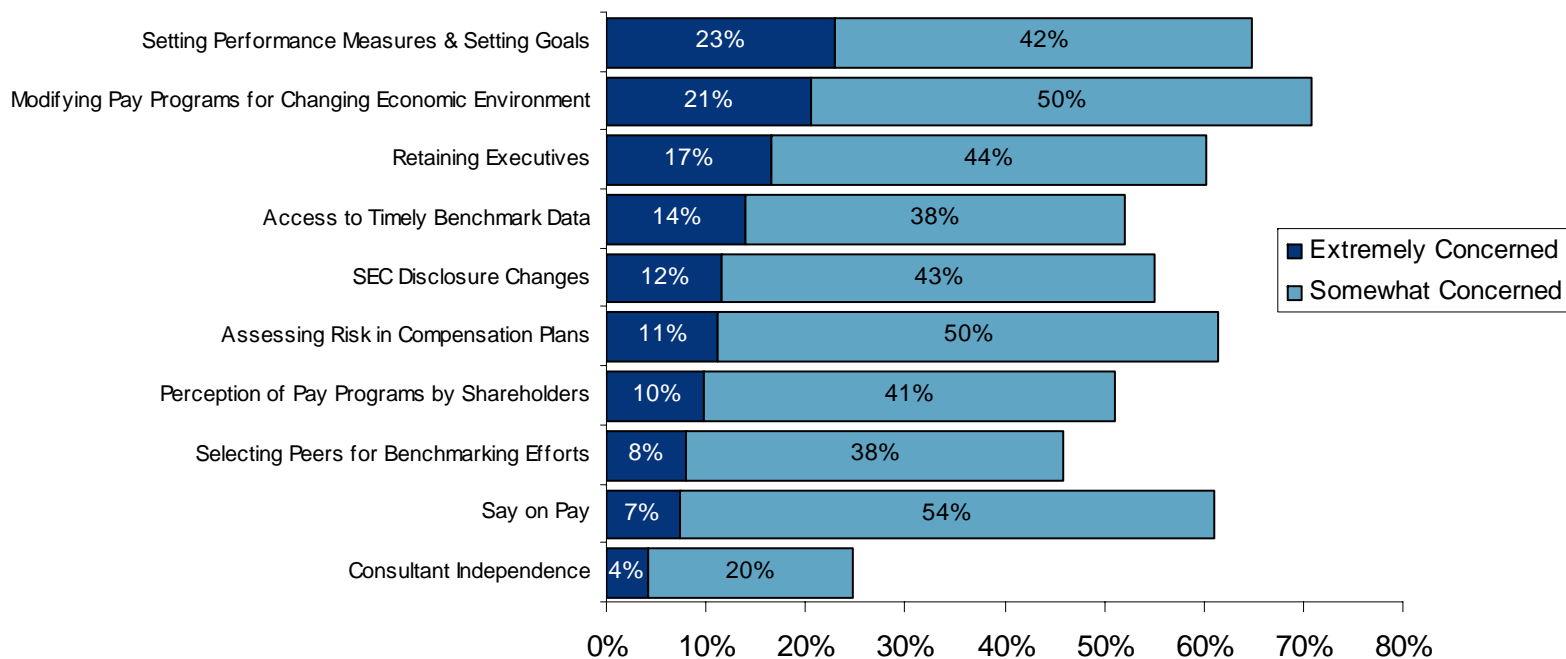


**PM&P Observation:** Executive-level severance is now the veritable poster child for egregious compensation, having been rechristened as “pay for failure”. While severance has a legitimate purpose, companies always should carefully review eligibility, potential payouts, and the conditions under which severance would be provided to executives. To ameliorate concerns about severance programs, more companies are excluding executives at later stages in their careers, reducing benefit formulas and levels, and redefining contract terms such as “Cause”, “Change-in-Control,” and “Constructive Discharge”. A challenging case that should be addressed is poor performance that falls short of the definition of “Cause.”

## Areas of Concern for 2010

As respondents consider executive pay for the upcoming year, issues relating to goal setting, pay plan flexibility and retention are front of mind, while regulatory changes are generally less of a concern.

### Areas of Concern for Upcoming Year



**PM&P Observation:** It is interesting that Peer Group selection and Say on Pay were not areas of great concern.

- Peer Group selection is the cornerstone for external benchmarking efforts. Under expanded proxy rules companies must list the firms that they use for benchmarking purposes, and these new details are receiving close shareholder scrutiny.
- A major step towards Say on Pay votes at all public companies was taken on July 31, 2009, when the House of Representatives approved the Corporate and Financial Institution Compensation Fairness Act of 2009. While mandatory Say on Pay for most public companies may well be pushed into the 2011 proxy season, 2010 executive pay decisions would then be the subject of initial Say on Pay votes.

## About Pearl Meyer & Partners

For 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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