



The Conference Board  
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***The Uncertain Future of Executive and Board Compensation***

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**Steven Hall**  
Managing Director  
Steven Hall & Partners  
645 Fifth Ave., 6<sup>th</sup> Floor  
New York, NY 10022  
212-488-5400  
shall@shallpartners.com

## *Highlights of the Last Year*

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- Financial failures
- New administration
- Government intervention
  - Financial firms
  - Auto industry
- New legislation
  - TARP
  - Stimulus bill
- Activities of State Attorney Generals
- AIG retention payouts
- Madoff

## *Highlights of the Last Year (cont'd)*

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- Concerns about executive compensation and practices are no longer a US-only issue
  - Australia
  - Canada
  - France
  - Germany
  - Japan
  - United Kingdom
  - G-20 (banking)

## *Uncertainties and Unknowns*

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- Economic conditions
- Best practices – today and in three years
- Outcome of proposed / not yet proposed Government legislation
- Integration of risk management into compensation programs
- Future changes to the ISS / RiskMetrics guidelines
- Media coverage
- Shareholder sentiment

## *What Do We Know?*

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- Shareholders and the American public are not happy
- Compensation levels have been flat or down
- Goal-setting is challenging for both short-and long-term plans
- Equity programs are under stress
- Severance and change-in-control benefits are under pressure
- New legislation is assured in the next year that will impact executive compensation
- Disclosure rules will be changing
- ISS / RiskMetrics assault on “poor pay practices” will continue to be a concern for Directors

## *Elements of Good Governance Related to Executive Compensation Design*

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- Well-defined and current compensation philosophy
- Compensation proposals / recommendations by management based on business objectives
- Engaged and knowledgeable Compensation Committee / Board
- Thoughtful process of consideration
- Clear understanding of the short- and long-term business plan
- Use of tally sheets
- Consideration of disclosure requirements and transparency
- Consideration of risk implications

## *Risk as Part of the Compensation Program*

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- Is this really a new concept?
- Probable need to discuss risk management and relationship to compensation in CD&A
- Process to identify risk is unclear
- Design features to manage risk
  - Performance metrics and goals
  - Reduced leverage and caps
  - Deferral subject to clawback
  - Longer vesting for equity incentives
  - Share ownership guidelines to / after retirement

## *Risk – Executives Have Significant Capital at Risk*

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- Current value of CEO holdings in Top 200 companies is equal to \$112 billion
  - Has declined \$17 billion since last September
- Values lost
  - Bear Stearns – Over 33% employee ownership
  - Lehman – Over 25% employee ownership
    - CEO paid over 75% in shares in 2007, significant ownership
  - AIG – Value of Greenberg's equity declined more than \$2 billion
  - General Motors – R. Wagoner - approximately \$12 million in non-qualified pension value lost in bankruptcy

## *Government View of Curbing Risk*

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- Determine total remuneration
- Two-thirds of total to be in the form of salary
  - Part paid weekly
  - Part deferred and paid out over two to three years, subject to clawback
- One-third to represent incentive pay – short- and long-term

Reaction on Wall Street has been to increase base salaries, even at non-TARP firms

## ***Assessment of Risk***

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- Significant uncertainty as to how to approach
- Risk assessment
  - Does the program encourage excessive risk-taking?
  - Will the program serve to attract, retain and motivate executives?
  - Are the elements of compensation properly balanced to reflect risk profile?
  - Are the performance criteria supportive of the business plan?
  - Do the performance metrics reasonably reflect expectations and the business plan?
  - What undesirable risks / behavior could the program be incenting?

## *Design Considerations for the New Environment*

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- Realities
  - Shareholders expect top-tier performance measured by stock price appreciation / total shareholder return
  - On an annual basis, shareholders expect no / low bonuses for performance that is below expectations
    - CD&A disclosure requirements make awarding incentives difficult when goals not met
  - Setting both short- and long-term performance objectives on an absolute basis has never been more difficult
  - It is doubtful that total compensation delivered in a mostly riskless form would be acceptable to any shareholders other than the Government
  - Equity allocations are rising and often constrained by ISS / RiskMetrics caps

## ***Design Considerations for the New Environment (cont'd)***

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- Realities (cont'd)
  - Executives hold a lot of underwater stock options which have questionable retention value
  - Say-on-pay will likely be mandated in the next 12 months
  - Comparator groups will receive greater scrutiny; may need to consider differentiation among key positions
  - Pay for failure is unacceptable

## *Expectations for the Future*

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- Base salaries
  - Slower growth for senior executives (non-financial companies)
- Annual incentives
  - Caps on incentive payouts
  - Mandatory deferral with clawback provisions
  - Greater flexibility in goal-setting during period of uncertainty
  - Continued focus on quantitative results vs. qualitative results
  - Increased consideration of what constitutes threshold and extraordinary performance

## *Expectations for the Future (cont'd)*

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- Long-term incentives
  - Options
    - Reduced eligibility
    - Smaller piece of the LTI pie
    - Increased holding requirements
    - Longer vesting?
  - Time-vested restricted stock
    - Declining usage as economy strengthens
    - Longer vesting?
  - Performance plans
    - Increased usage
    - Difficulty in setting business goals
    - Relative vs. absolute performance?
    - Equity vs. cash

## *Expectations for the Future (cont'd)*

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- Benefits and perquisites
  - Use of corporate aircraft will decline slowly
  - Tax gross-ups on benefits / perquisites viewed very unfavorably
- Other
  - Reduction in severance and CIC benefits
  - Reduction / elimination of excise tax gross-ups
  - Cutback in use of contracts

## *Director Remuneration – The Environment*

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- Shareholder and media focus is on executive compensation
  - Little attention given to Director pay
- Pay-for-performance struggle
  - Best practice for executives, but
  - Historically, the only performance-based pay for Directors was provided through equity-based grants
  - Coca-Cola adopted a performance-based program, but abandoned it in 2009
  - Some recent interest has arisen in incentive-based Director pay, but the number of companies that have instituted such plans is extremely limited
    - Major concerns focus on potential conflicts of interest

## *Director Remuneration – The Environment (cont'd)*

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- Recruiting Directors has become more difficult due to
  - Time commitment
    - Strongly limits sitting CEOs
  - Perceived risk
  - Limitations on number of Board memberships imposed by governance guidelines
- Director pay has generally been a function of two factors
  - Revenue size
  - Industry

However, to be competitive, the differences between industries have started to diminish
- The most prevalent trends in Director pay are
  - Shift from stock options to restricted stock
  - Shift in basis of equity grants from number of shares to dollar value
  - Elimination of meeting fees in favor of higher retainers

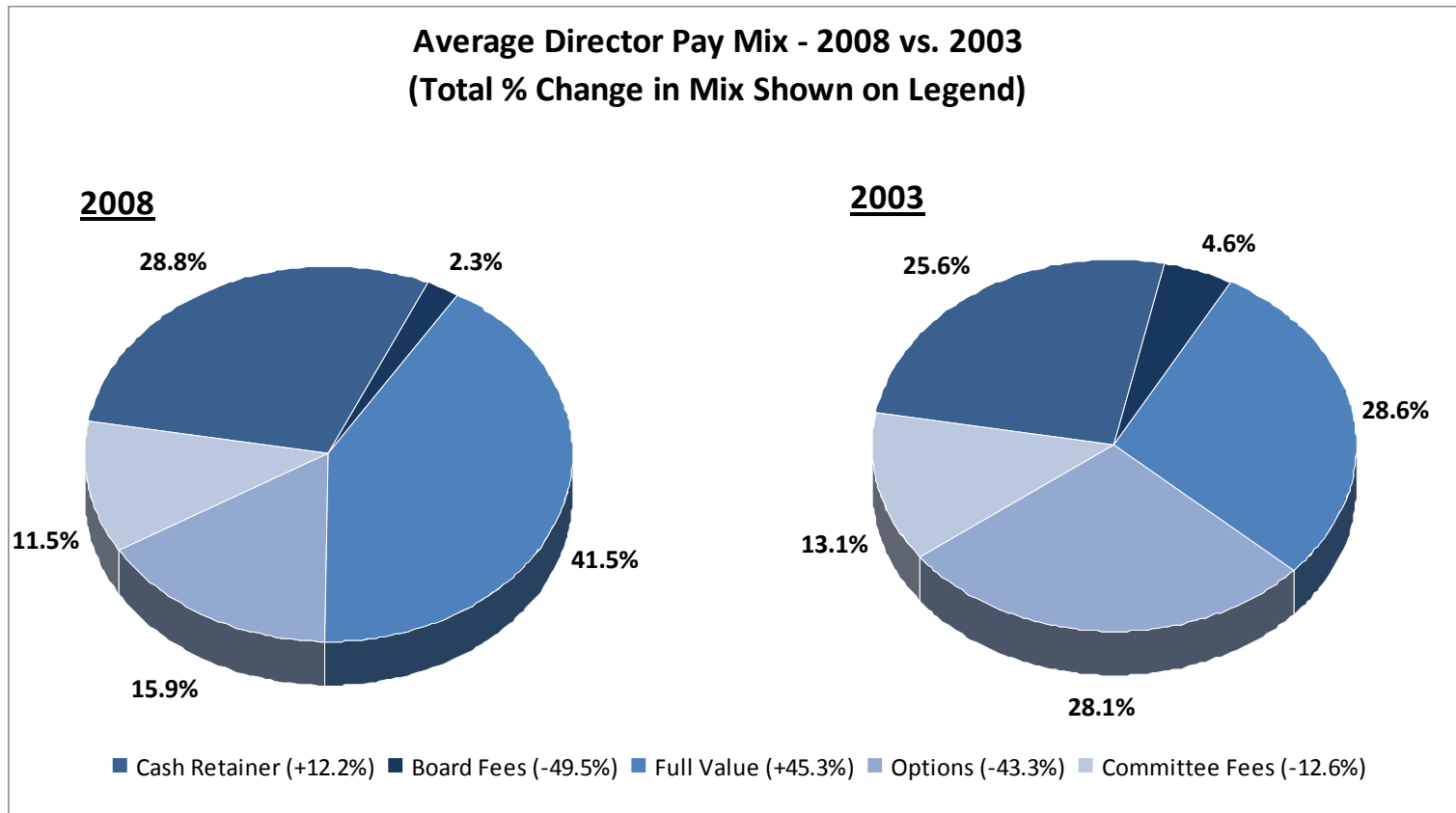
## Director Remuneration – The Environment (cont'd)

- Among the Top 200 Companies, average Director compensation has increased 39% over the last five years, or about 7% per annum

Top 200 Companies		
Average		
Year	Director Comp.	2008 vs.
2008	\$244,899	---
2007	250,835	-2%
2006	232,648	+5%
2005	221,090	+11%
2004	195,442	+25%
2003	176,673	+39%

- Decrease shown from 2007 to 2008 mainly a function of declining equity values for companies that grant fixed numbers of shares with lower stock prices
- Determination of grant size
  - 60% cash denominated
  - 25% number of shares denominated
  - 15% both

## Director Remuneration



	Average Director Pay Mix					
	<u>Cash Retainer</u>	<u>Board Fees</u>	<u>Full Value</u>	<u>Options</u>	<u>Cmte Fees</u>	<u>Total</u>
2008	28.8%	2.3%	41.5%	15.9%	11.5%	100.0%
2003	25.6%	4.6%	28.6%	28.1%	13.1%	100.0%
% Change	+12.2%	-49.5%	+45.3%	-43.3%	-12.6%	---

## *Director Remuneration – The Future*

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- Slower growth in compensation levels
- Continued shift away from meeting fees
- Continued focus on share ownership requirements

## *Important To Dos*

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- Review compensation philosophy
  - Is it still appropriate for senior executives?
  - Is it appropriate for the broader population?
- Review the compensation program
  - Does the program support the strategy?
  - Does the program comply with the philosophy?
  - Does it manage risk for all employees?
    - Are the risk levels appropriate for different levels of employees?
- Consider the issue of risk
  - Process / responsibility
  - Linkage to compensation
  - Disclosure

## *Important To Dos (cont'd)*

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- Consider the holding power on executives
  - Is there adequate “glue” on key people?
  - Great executives can always find new positions
  - The time to worry about retention is before people start leaving
- Stay flexible with regard to compensation decisions
- Use strong communications to explain the compensation program
  - Shareholders
    - CD&A
    - Meetings
  - Executives
    - Clarify equity grant policies if a new approach is used
  - Employees
    - Written
    - Town Hall meetings
    - Clear understanding at the supervisor level