Update on Executive Compensation

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Executive Compensation Overview

- Economy
- Demographics
- Legislation/Regulatory
Change in Total Executive Compensation S&P 500—Top Five

2007  +1.3
2008  -6.8
2009  -10.3
2010  +28.2
2011  +6.2
Economic Impact

- Worldwide Economy
- Net Income
- Stock Price
- Shareholder Return
- Growth
- Shareholder Expectations
Demographics

- Baby Boomer Bubble
- Skill Sets of Next Generations
- Technology
- Multi-Cultural
Regulatory

- Historical
  - ERISA
  - IRC 162(m)
  - 280(G)
  - 409A
  - FAS123(R) (ASC Topic 718)
  - SEC Proxy Disclosures—CD&A
Regulatory—Continued

• Emergency Stabilization Act of 2008
  – Established “Troubled Asset Relief Program” (TARP)
  – 766 companies (mostly banks) received loans
  – Loans @ 5% interest/dividend (Great deal for Uncle Sam!!!)
  – Over 50% have now paid loans back—represents vast majority of money
  – Primarily small banks which haven’t paid back loans
    - difficult capital market
TARP—Executive Compensation Restrictions

- No variable compensation for up to top 25 highest paid
- No severance for top 5 plus next 5 highest paid
- No tax gross up for top 5 and next 20 highest paid
- Mandatory risk assessment of all employees variable pay plans
TARP Restrictions—Continued

- Mandatory Clawback
- Only variable allowed is restricted stock grants to maximum of \( \frac{1}{3} \) annual compensation
- IRC 162(m)(5) decreased to $500,000 from $1,000,000
TARP—Consequences

• Higher CEO turnover—one study showed 33% for TARP versus 10% for non-TARP
• Difficulty recruiting talent
• Base pay increasing for TARP at 12% (2010 over 2009) versus non-TARP at 2%
• General reduction in alignment of pay and company performance
Dodd Frank

- Passed in July 2010
- Impacts publicly held companies
- Continued reaction to economy and Wall Street
- Primary impact on executive compensation process and disclosure versus pure limits
Dodd Frank—Main Executive Compensation Provisions

- Risk assessment of pay plans
- Clawbacks
- Say on Pay voting, frequency of Say on Pay
- Consultant disclosure
- Board Compensation Committee Independence
- CEO/Employee pay ratio disclosure
- Say on Golden Parachute
Employers/Boards Reactions To-Date

- More emphasis on performance based compensation
- Establishing internal CEO/employee pay ratio
- Contracts
  - Cutting back on 280(G) gross-ups
  - Lower severance awards
  - Fewer executives have contracts
  - Multiple triggers in change in control contracts
Employers/Boards Restrictions—Continued

• Compensation Committees re-examining compensation strategy - particular mix of fixed versus performance based compensation
# Case Study

## Sample Summary Compensation Table

### Company A

<table>
<thead>
<tr>
<th>Year</th>
<th>Salary</th>
<th>Bonus</th>
<th>Stock Awards</th>
<th>Option Awards</th>
<th>Incentive</th>
<th>Deferral</th>
<th>All Other</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>CEO</td>
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<td>2011</td>
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<tr>
<td>2009</td>
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### Company B

<table>
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<th>Year</th>
<th>Salary</th>
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<th>Stock Awards</th>
<th>Option Awards</th>
<th>Incentive</th>
<th>Deferral</th>
<th>All Other</th>
<th>Total</th>
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</thead>
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Case Study Review

- Congruity of Summary Compensation Table and CD&A
- Footnotes and other Charts/Exhibits
- Short versus Long Term Performance
- Pay for Performance
- Internal Equity among Executives
Ideas/Concepts for Implementation

• Show Board Compensation Committee scenarios for linkage between strategy, performance, fixed/variable, actual versus target
• Use 5 and 10-year look backs and forward projections
• Understand industry and competitive performance
• Understand what “drives” executives
Questions?

Thank you!