

CSUITE

INSIGHT

PERSPECTIVES:

How
Employees,
Shareholders,
and Regulators
View
**COMPENSATION
ISSUES**

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A MATTER OF PERSPECTIVE

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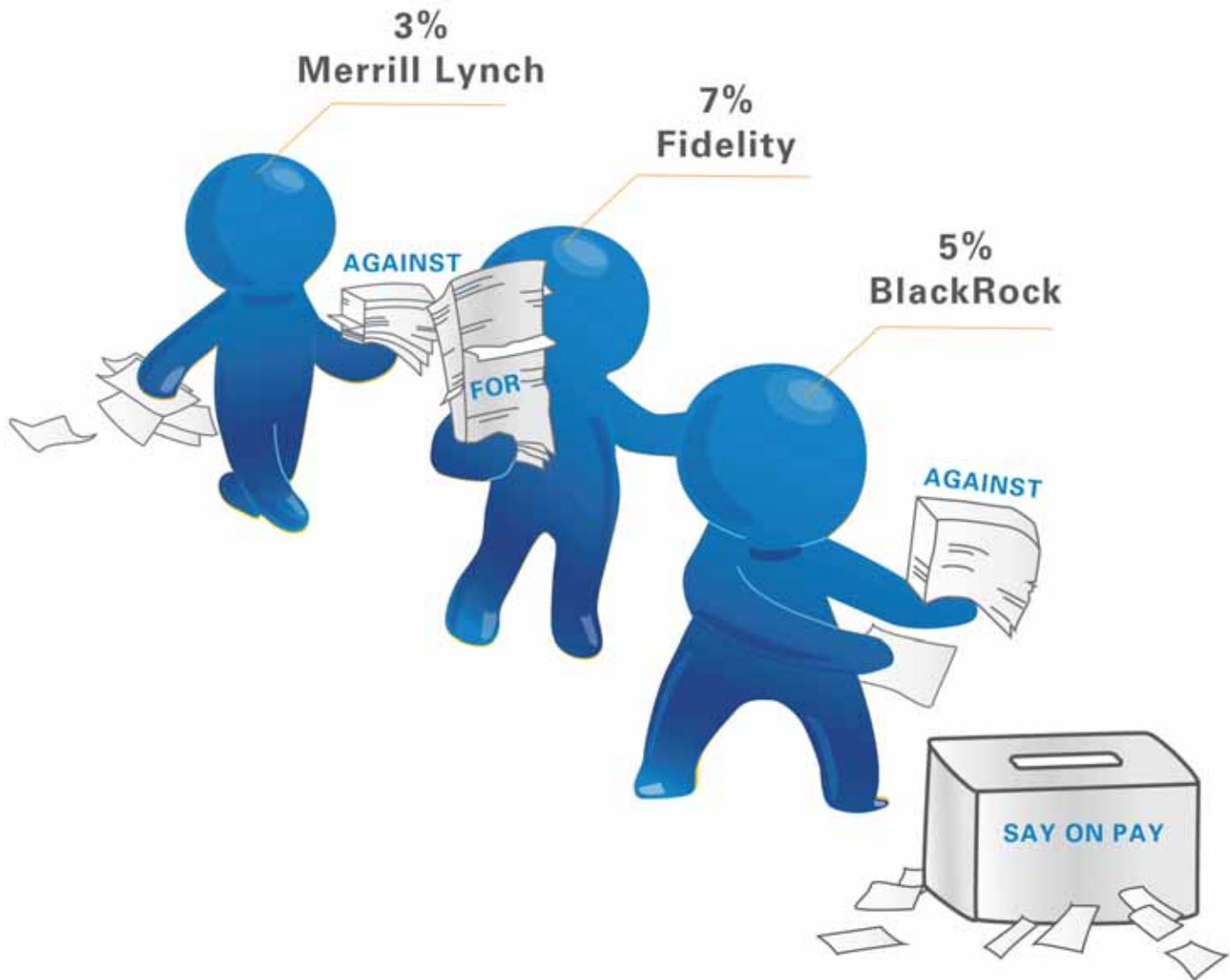
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David has led Equilar from a pure start-up since its inception in 2000 to one of the most respected and trusted names in the executive compensation industry.

PERSPECTIVES — 2012

ON BEHALF OF ALL of us at Equilar, I want to welcome all speakers, delegates, and supporters to Equilar's 2012 Executive Compensation Summit in Austin, Texas. We have an intense, diverse program planned. During this year's summit we will cover topics such as The Trustworthy Leader, The Future of Regulation, Connecting Pay and Performance, and the role of the general media in reporting on executive compensation.

To the many thousands of our readers who are not attending this year's Summit, the good news is we cover these topics in this issue of *C-Suite Insight* as well.

You will find groundbreaking interviews with Amy Lyman from the Great Place to Work Institute on trustworthy leaders and successful corporate cultures; with Ken Bertsch from the Society of Corporate Secretaries and Governance Professionals on good governance in the era of Dodd-Frank and Say on Pay; and with Christine McCarthy from Orrick's Silicon Valley office on compensation and how it drives performance.

We've also received contributions for this issue from several consultants on the role of the media in reporting on executive compensation, with some very interesting comments!

There's a unique take from Bob McCormick at Glass Lewis, in which he discusses the firm's new Issuer Engagement Portal, a way to drive new, transparent communications among institutions, corporate practitioners, and Glass Lewis. We're pleased to be working with the firm to deliver Equilar's targeted reports through the portal's services.

President Obama signed the JOBS Act, which loosens some regulations to make it easier for emerging-growth companies to raise capital, as we were going to press. We have a report on it.

We also take a look at equity trends in this issue, and examine the emerging topic of realizable pay, something I think will become increasingly important in the years to come.

As always, we checked in with Seymour Cash to get his perspective. It looks as if he has to make some sacrifices in order not to make waves in the current cultural and regulatory climate.

Thanks again for your support, and please feel free to drop me a line and tell me how we're doing. ■

DAVID CHUN
CEO and Founder, Equilar
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A vertical photograph of a modern glass skyscraper facade, showing multiple floors and windows reflecting the sky and other buildings. The image is slightly blurred and has a blueish tint.

A Matter of Perspective

BY ROGER STRUKHOFF

Viewing executive compensation may be likened to the famous parable from India of the blind men and the elephant. In one version of the story, the one holding the tail thinks an elephant is like a rope; the one holding the tusk perceives the elephant as a solid pipe; the one holding the trunk believes the animal to be like a tree branch.

With executive compensation, differing points of view have an added moral dimension. Small, activist shareholders may perceive a CEO's compensation as immoral; larger, institutional investors may perceive the same package to be amoral, but excessive; a fellow CEO may consider the package to be a perfectly moral incentive to create jobs and wealth for all shareholders; and a regulator will be concerned only whether it follows whatever laws apply to it.

What industry professionals know is that executive compensation is complex; there is no simple way to create compensation packages, particularly for CEOs, and to ensure that they provide a proper risk/reward ratio that incentivizes executives to deliver short-term results and create long-term value.

VIEWING CEO PERFORMANCE

Creating a CEO's compensation package is the most complex and most visible executive compensation challenge for any board. The fundamental challenge is to determine whether target pay will drive desired levels of performance. As with all investments—and CEO compensation can certainly be viewed as an investment—prior performance is not necessarily an indication of future results.

To meet the challenge, boards today often rely on long-term incentives (LTIs) to prod executive performance, and return on investment (ROI) or total shareholder return (TSR) to measure it. The incentives presumably encourages executives to see the big picture and to resist the temptation to puff up results for the upcoming quarter. The measurements presumably encourage investors and boards to reward the top performers and to exert pressure on the laggards.

But is there a single, objective way to view performance? For example, there was a period following the dot-com crash in 2000-2001 when some of the worst ROI performers were among the most entrenched CEOs. Fast-forward to today, and a review of poor-performing companies with respect to ROI include many that are in industries that are only now recovering from the effects of the most recent economic downturn.

VIEWING COMPANY PERFORMANCE

“There is no more important proposition in economic theory than that, under competition, the rate of return on investment tends toward equality in all industries,” according to a 1963 pronouncement by Nobel economist George Stigler. This implies that it’s best to view performance from the perspective of specific industries. It also implies that current weak performers may be the best current investments, as they will presumably out-perform their peers as they return to their industry norm.

But does that perspective account for companies that are simply failing? Compare an investment in PanAm several years ago with an investment in Apple. Both investments would have assumed that these former greats would return to their respective industry norms. We now know one of them did, to put it mildly, while the other did not.

From a worker’s perspective, though, which companies are the better employer, in these and other industries? From a regulator’s perspective, who are the bad actors? The results will often vary dramatically from the investor’s perspective.

VIEWING INCENTIVES

Viewing LTIs is also an inexact science, complicated by cults of personality at the CEO level. Two years ago, very few people would’ve recognized the name Tim Cook. In 2011, he was the most highly compensated public CEO in the world. He benefited from taking the reins from the most iconic CEO of this era and driving the company to continued eye-popping success.

His compensation package, like that of Steve Jobs before him and of most public CEOs, does not hinge on salary and bonus. In Tim Cook’s case, restricted stock units (RSUs), or stock grants, pumped up his 2011 compensation to \$378 million.

It is significant to note that these vest over a period of 10 years, though. Assuming a straight-line vesting drops his 2011 compensation to around \$40 million. One can assume federal and state income taxes consumed about half of that amount. Still not bad for a day’s work—but the shareholders’ perspective shows a \$500+ billion market cap for Apple and earnings per share of \$12.30 in the most recent quarter.

The most famous siblings of RSUs, stock options, are glibly featured in popular entertainment as an easy way to entice employees and make them rich. But they are often offered to non-executive employees as well. Stock options are often delivered in greater amounts than what would be received in restricted stock.

Yet the value of an option can only be captured if the stock price grows, something most non-executive employees have little control over. An option might be seen more as a gift for these employees than an incentive to work harder. Others believe the option is the truest form of motivating employees to grow the company. It’s a matter of perspective as to whether options are viewed as serious incentives or nice bonuses for those with fortunate timing.

THE MEDIA VIEW

Which brings us to media coverage, increasingly pop-oriented, and another area of varying perspective. *C-Suite Insight* is, of course, part of the media, privileged to all freedoms of the First Amendment and the right to be wrong. So in this area, we asked several industry consultants their opinion of general media coverage.

What emerges is the general idea that general media tend to take a simplistic approach to issues that appear complex to industry professionals. Their answers can be found in “Consultant’s Corner” elsewhere in this issue of *C-Suite Insight*.

NEW POPULIST VIEWS

Moving from popular to populist, the United States has witnessed a pair of disruptive movements recently, both of which offer perspectives on business and have shaped the culture:

- the Tea Party movement, dating to the 2008 presidential campaign but kicked into high gear by a harried performance by Rick Santelli on CNBC from the floor of the Chicago Board of Trade in February 2009
- the Occupy movement, which got off to a slow start but has maintained a presence in New York and other cities, and a seemingly intractable presence in some other places.

Both movements are rooted in the Great Recession, whether protesting reactions by the federal government to the recession, or taking a position on wealth distribution and taxes, or protesting Wall Street practices in general.



Recruiting a board member?



THE REGULATORY VIEW

Echoes of both movements are found in the Say on Pay provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, a historical piece of legislation that will affect business for many decades.

Perceptions of the legislation could not vary more widely. In the course of interviewing dozens of strong personalities for *C-Suite Insight* over the past couple of years, we've heard sentiment ranging from Dodd-Frank described as a "feather duster" (for not going far enough) to the opinion that both Dodd and Frank should be in jail (for going too far).

A SUMMARY VIEW

The fundamental question related to executive compensation, particularly CEO compensation, is, "is he or she worth it?" There may be no more difficult question to answer in the world of business. For all of the charts and graphs, deep wells of statistics, and evolution of dry, neutral business-speak, the reality is that the final determination of a specific pay package can be viewed in a number of ways, from any perspective. ■

In the final analysis, it seems that each of the blind men feeling the elephant may have a better grasp of the situation than they are generally given credit for. They, at minimum, are honestly describing which piece of the elephant they're holding. They seem to have no hidden agendas. Can modern-day investors, regulators, consultants, activists, and executives say the same?

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INTERVIEW WITH **ROBERT MCCORMICK**

Glass Lewis, based in San Francisco, is an independent, governance analysis and proxy voting firm. It serves institutional investors globally that collectively manage more than \$15 trillion in assets, with research focused on the long-term financial impact of investment and proxy vote decisions.

The firm was founded in 2003, now has 300 employees, and has a mission to “empower institutional investors to make sound decisions by uncovering and assessing governance, business, legal, political and accounting risk at more than 23,000 companies in 100+ countries.”

Robert McCormick, Esq. is the firm’s Chief Policy Officer. He earned his law degree from Quinnipiac University School of Law after graduating with honors from Providence College. He serves on the International Corporate Governance Network’s Cross-Border Voting Practices and Securities Lending committees.

C-Suite Insight interviewed him recently on the topic of the new Glass Lewis Issuer Engagement Portal, which launched in April 2012.

“IT’S IMPORTANT FOR US
TO BE TRANSPARENT IN
DESCRIBING HOW WE
DEVELOP OUR POLICIES.”

C-Suite Insight: How long has the portal been in development, and what is its main purpose?

Bob McCormick: The Issuer Engagement Portal has been in development for more than a year. It's part of our new website, and is designed to facilitate communication among institutions, issuers, and Glass Lewis.

The portal brings even more transparency to what we're doing, and allows further, direct engagement among all parties. It provides a way to allow companies a view into how we make our guidelines and develop our research.

CSI: Tell us more about how it facilitates communication.

Bob: We think that's its most important aspect. The portal enables companies to set up a meeting to discuss a specific proxy report, or to discuss governance issues in general. So we expect issuers—who are not our clients—to benefit from the resources made newly available to them through the portal.

The Issuer Engagement Portal can also be used to set up a proxy talk—our conference-call series for discussing particular issues during the pending proxy solicitation period—or if a company files additional information, to let us know if they think there's an error in their report.

CSI: And you can follow up on these requests?

Bob: Yes, the portal provides us a means to track the various inquiries, then make sure we respond accordingly and in a timely manner. To be sure, we have historically done what we think is a good job of making sure we're responsive to companies, (but) the Issuer Engagement Portal

allows us to formalize things and respond on a very systematic basis.


We think the portal also provides a very good feedback loop for issuers as they go onto the site. There is a menu of things for them to report back on. Feedback is automatically logged into our CRM system, enabling a Glass Lewis professional to take possession of it and respond to it.

CSI: So it seems you're building new transparency into what the firm does.

Bob: Since we don't do any direct consulting for companies, but only work with investors, we're able to focus on providing great information to institutional investors. As part of that process, we continue to push companies to provide more information, more rationale, and more explanation about their practices. In turn, we feel it's important for us to be transparent in describing how we develop our policies.

The portal provides transparency into our own research process and lets issuers understand what we're doing. Our new website also has a FAQ portion that allows issuers to understand the mechanics of our research process and the things that we weigh as we write reports.

CSI: How does this differ from other industry practices?

Bob: People who know us know that we have a purview into the world different from that of our competitors, and that we look at things on a case-by-case rather than an academic basis. Rather than try to fit square pegs into round holes, we always use bounded judgment when we write the reports, to make sure that we're truly looking at long-term shareholder value. 

Note: The Glass Lewis Issuer Engagement Portal also has a connection with Equilar. When issuers need to see a copy of their report, they will be able to go to Equilar to purchase it. They can purchase reports that show what Glass Lewis is saying about their peer companies.

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Consultant's Corner

At *C-Suite Insight*, we're able to rely on thoughtful analyses by the numerous industry consultants who double as our readers. For this issue, we introduced the topic of succession planning.

Here are answers we received from some of the top people in the business to the following question:

What do you think of the media's overall coverage of executive compensation, and what have been the effects?



Jim Barrall
Partner
Latham & Watkins

Over the last 10 years – generally since the 2002 enactment of the Sarbanes-Oxley Act and in the wake of the SEC's 2006 compensation disclosure rules and the enactment of the Dodd-Frank Act in 2010 – the financial press generally has done a good job of covering the impact of these developments on executive pay and corporate governance.

In the earlier years, much of the coverage spotlighted perceived compensation abuses, with the salutary effect of causing Boards and companies to eliminate many of them. Since Dodd-Frank, the press's job has gotten harder as the issues (such as analyzing the alignment of a company's pay and financial performance) have become more complex and less generic, even as the press faces increasing pressure from the 24-hour news cycle and severe time and space constraints.

Even so, the press generally has worked conscientiously to understand and fairly present the issues, unlike other parts of the media, which seem more interested in sensationalism and political activism of various stripes.

Jim Barrall is a partner of Latham & Watkins LLP, which specializes in executive compensation and corporate governance matters, working with Boards, Compensation Committees, companies and executives. He is the Global Co-Chair of the firm's Benefits and Compensation Group.

Mr. Barrall is a frequent author and lecturer on executive compensation, corporate governance and disclosure topics. He has served as a contributing editor, columnist and op-ed writer for various publications, including *Agenda*, *The Conference Board*, *Executive Compensation Strategies* and the *Los Angeles* and *San Francisco Daily Journals*.

LATHAM & WATKINS LLP



Michael Melbinger
Partner
Chair, Employee Benefits and
Executive Compensation Practice
Winston & Strawn

As with every topic they cover, most of the media's coverage of executive compensation is sensationalized and inaccurate. Few media folks seem to have the interest or inclination to understand the nuances of executive compensation—especially the reporting requirements of the SEC. However, having said that, the media definitely has played a role in the improvement of corporate America's executive compensation practices since 2001, along with the SEC, the courts, the plaintiffs' lawyers and even the U.S. Congress.

The SEC wisely has chosen not to limit or restrict how corporations pay their executives, but only to require them to report compensation in detail—as it's said, "sunlight is the best disinfectant."

Sophisticated investors and other professionals read the SEC reports, but the media broadcasts this compensation information to all. Having sat through hundreds of board and compensation committee meetings, I can tell you that no executive or board member likes to be criticized by the media.

Mike Melbinger is a partner in the law firm of Winston & Strawn LLP, and global head of the Firm's Executive Compensation and Employee Benefits Practice. Mike is also an Adjunct Professor of Law at both the University of Illinois College of Law and Northwestern University School of Law.

He is the author of the CCH treatise *Executive Compensation*, now in its Second Edition, the American Bankers Association's *Compliance Guide to Employee Benefit Trusts*, and more than 75 articles on executive compensation and employee benefits topics. He is also on the editorial boards of *myNQDC.com* and *Practical Tax Strategies*, and the "Melbinger's Compensation Blog" for *CompensationStandards.com*, the oldest and most widely read blog on the topic.

WINSTON
& STRAWN
LLP



Gregg Passin
Partner
Mercer

While the media can play an important role in the executive compensation discussion by uncovering certain poor practices, too often reportage of executive compensation can lack the necessary context. For example, coverage of executive compensation levels often lacks consistency across outlets to allow readers to understand whether they are reading about compensation granted in a given year or compensation realized in a given year but actually representing many years of results.

Furthermore, coverage often does not provide information on how to interpret compensation levels relative to performance results. High compensation is often criticized even if accompanied by strong financial results. Most companies work very hard to determine the right pay-performance alignment and commensurate level of compensation payout, but the reader may not get that perspective, which has helped to cause confusion about, and often disproportionate responses to, executive compensation.

Gregg Passin is a Partner at Mercer, based in New York. He is Mercer's US Leader for Executive Rewards and also leads their Global Human Capital M&A Initiative. He counsels public and private companies on global compensation and corporate governance issues relating to senior executives, boards, and professional services firm partner and professional populations.

His clients span such industries as law, accounting, and consulting, real estate/REITs, media and communications, manufacturing, utilities, financial services (insurance/reinsurance, commercial and investment banking), and consumer goods and retailing. His particular expertise is in incentive plan design, partnership compensation, private equity portfolio company compensation, and ownership transactions.

Prior to joining Mercer, he was a partner with Sibson Consulting, managing their New York and London offices, and also worked at Merrill Lynch and Frederic W. Cook & Co. Gregg received a BA in History from Yale and an MBA from Wharton School.

MERCER



Brian Robbins
Partner
Simpson Thacher & Barlett

The extensive media coverage regarding executive compensation (and review of compensation issues generally by institutional shareholders services) in the aftermath of the recent financial crisis has, paradoxically, often presented an unfair characterization of compensation levels and practices, yet ultimately has resulted in enhanced scrutiny by corporate boards and compensation committees of the nexus between pay and performance.

Further, the pervasiveness of media attention with respect to compensation issues was likely a contributing factor to the barrage of new legislation and regulatory activity in the compensation area. While competitive information and benchmarking has been an important tool for compensation committees for years, there does appear to have been significant improvement in the scope and targeted nature of information being made available to, and considered by, compensation committees in connection with the design and implementation of compensation programs in the last several years.

Brian Robbins is a Partner at the firm and the Head of the Firm's Executive Compensation and Employee Benefits Practice Group. He has extensive experience in the areas of executive compensation, employee benefits and ERISA and routinely advises the Firm's corporate clients in connection with compensation and employment matters and has represented numerous high profile senior executives in connection with the negotiation of employment and termination agreements.

Mr. Robbins works closely with the firm's numerous private equity and leveraged buyout fund clients in order to assure qualification as "venture capital operating companies" and "real estate operating companies" to avoid ERISA fiduciary and potential prohibited transaction concerns.

Mr. Robbins received his B.A. from Amherst College in 1985 and his J.D. from the Columbia University School of Law in 1988 where he was a Harlan Fiske Stone Scholar and an editor of the Columbia Journal of Law and Social Problems.

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David Wise
Senior Principal & Director
of Practice Development
Hay Group

What I learned about reporting during my time working on Capitol Hill and in political PR is that rather than inundating readers and watchers with facts, details and context, you'll often communicate with them more effectively if you roll up messages into attention-grabbing headlines. It's all led to executive pay stories focused purely on the "what" and the "how much" without the "why". Too much of what gets reported today is one frame of the story, with none of the subplots.

As we all know, thoughtful executive pay programs are about much more than the "how much," and the detail and context don't often lend themselves to the way stories are written. One of the first things one learns to do in PR is to write a press release, which is that "perfect article" that tells the organization's side of the story.

For public companies, the CD&A disclosure is that "perfect article," and in the era of thoughtful pay programs getting boiled down to the bullet points, companies need to "nail it" with their CD&A each and every year.

David Wise is a Senior Principal and Director of Practice Development in Hay Group's executive compensation practice. He has advised Boards and executives at a number of leading public and private organizations, including Morgan Stanley, Anheuser-Busch InBev, IAC/InterActiveCorp, Rock-Tenn, CenturyLink, General Nutrition Centers, The New York Times Company, Johnson & Johnson, and New York Presbyterian Hospital.

He is a frequent speaker at national and regional conferences, and is regularly featured in national newspapers, magazines and television outlets, including The Wall Street Journal, BusinessWeek, US News & World Report, Forbes, and CBS Evening News with Katie Couric. David holds an M.B.A in Management of Organizations from Columbia Business School, and a B.A. in Organizational Behavior and Management from Brown University.

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Christopher Dohrmann
Executive Director
Norse Solutions

Over the past several months, I have been lucky enough to view media reports on executive compensation from around Europe and the US. There is a common theme, the introduction of a sense of a populist criticism, and a loss of objectivity in most of the reporting. That is unfortunate as I believe the media has an obligation to educate as well as to report.

Most of the audience reading print articles or viewing television reporting are not extremely familiar with executive compensation, or the unique factors that affect the amounts paid; labor market, competition, past innovation record or proven history of success. I know the audience understands these issues innately, as there are vigorous and heated debates over amounts paid to quarterbacks, mid-fielders, pitchers or box office stars. It is unfortunate that the discussion is not extended to officers at firms that may have a more direct impact on the fortunes of readers/viewers, or generation of profits contributed to 401K or retirement accounts.

The public needs to realize if they own a share of stock, they have an obligation to understand the company, and do the research, and they can affect the situation should they disagree. They should at least invest time in reading about corporate goals in compensating executives, as least as much as they would investigate the next Top 10 movie star or Laker point guard.

Efforts by Equilar and other firms to raise awareness of overall compensation paid, in an objective and complete manner, can only help the situation, and offset what I hope is a short-lived emphasis on class warfare and slanted reporting.

Chris Dohrmann is a seasoned professional and subject matter expert in the Equity Compensation practice. Chris has almost 30 years of management experience in many different areas of the equity business from systems and product development to sales and client management.

Prior to joining Norse, Chris was an Executive Director responsible for Client Solutions at Morgan Stanley Smith Barney (MSSB), where he has spent the last 16 years. He has also worked in Product Management, where he was responsible for building out the platform to handle FAS reporting (under the 123R regulations). Chris was also responsible for the development of software to build the platforms which support the administration of Morgan Stanley Smith Barney's nearly 500 corporate clients.

Prior to MSSB, Chris spent 10 years at AST. In addition to systems development, Chris was responsible for managing the Call Center, the Shareholder Services Group and was part of the Client Management team. Prior to AST, Chris spent 5 years at an independent brokerage firm, Integrated Resources, where he was responsible for the Transfer Agent functions and Limited Partnership businesses.





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THE JOBS ACT PASSES *TO MIXED REACTION*

BY ROGER STRUKHOFF

WHO CAN ARGUE AGAINST THE CREATION OF NEW JOBS?

This question may have been the primary driver of new legislation known as the JOBS Act, signed into law by President Obama in April. Short for “Jump-start Our Business Startups,” the JOBS Act sailed through Congress in a relatively short period of time and represents one of the few cooperative efforts between Congress and the present Administration.

This legislation increases the number of investors a pre-IPO company may have (from 500 to 2,000) before being required to go public, defines an emerging-growth company that can benefit from the legislation as one with as much as \$1 billion in annual revenue, increases the cap for so-called mini-public offerings from \$5 million to \$50 million, and brings the idea of crowdfunding into the world of business. It also removes an 80-year-old ban on soliciting stock purchases on billboards (and the more new-fangled television and Internet).

WHAT IS IT?

The JOBS Act may sound like something that creates so-called shovel-ready jobs (e.g., construction of roads, bridges and

schools) or which offers new incentives to return manufacturing jobs to the United States. These two areas are popular political footballs to toss around during an election season.

The legislation is not that, but is a small subset of a much larger piece of legislation floating around Washington known as the Jobs (note the lower-case letters) Act.

The JOBS Act is simply one bullet point among 10 within the proposed Jobs Act. It does address another aspect of the Great American Dream, that of the doughty entrepreneur succeeding against all odds to create the latest world-class company and brand.

HOW DOES IT AFFECT INDUSTRY PROS?

Two executive-compensation professionals interviewed for this issue of *C-Suite Insight* offered no strong opinions about it but discussed in a practical way how the legislation might affect their customers.

Ken Bertsch, President and CEO of the New York City-based Society of Corporate Secretaries and Governance Professionals, said he thought “there are some good things in the act and some good opportunities for emerging growth companies,” but added

that he thought the legislation “probably is not going to cause a huge amount of change for our members, (even if) there are some problem areas they need to think through.”

(Note: the full interview with Ken Bertsch can be found on page 40 of this issue.)

Orrick’s Christine McCarthy, based in Menlo Park, CA, said she’s been thinking most about “the rules that would allow a company to stay private for a longer period of time,” the change that allows the number of investors to increase from 500 to 2,000 “with up to 500 unaccredited holders and, very

importantly, has a blanket exception for equity that’s issued to individuals pursuant to an employee compensation program.”

Furthermore, she says that “it’s not 100 percent clear if this change will include issuances to consultants as well. The way that the language is written (could mean) it’s possible the ultimate rule will capture consultants as well.” McCarthy also noted that if provisions of the JOBS Act enable companies to stay private for a longer period of time, then “from an equity plan design perspective, (the legislation) could lead to more complicated equity compensation programs.”

(Note: The full interview with Christine McCarthy can be found on page 44 of this issue.)

WHO’S IN DOUBT?

The JOBS Act has its share of doubters, if nothing else because of the speed with which it’s being enacted. SEC Chairman Mary Schapiro, for example, sent a letter prior to its passage to Senate Banking Committee members Tim Johnson (D-SD) and Richard Shelby (R-AL) stating that “a lower annual revenue threshold would pose less risk to investors.”

She also expressed concern that the legislation removing barriers between research analysts and investment bankers who

work in the same firm, noted that it will “exempt emerging growth companies from an audit of internal controls mandated in Section 404(b) of Sarbanes-Oxley,” and stated that crowd-funding needs “additional safeguards...(and should) provide for oversight of the industry professionals intermediate and facilitate” public offerings.


Additionally, Schapiro said that the SEC would normally take 18 months to interpret legislation of this magnitude, but has been given only a few months.

Concurrence of this point of view came from Janine Guillot, Chief Operating Investment Officer at major institutional investor CalPERS. In a letter to Senate leaders Harry Reid (D-NV) and Mitch McConnell (R-KY), Guillot wrote, “we believe it’s imperative that the...JOBS Act be amended to reflect the concerns (Schapiro) has raised.”

WHO’S IN FAVOR?

Entrepreneurs and investors in Silicon Valley no doubt view this as highly favorable legislation that will free them of the shackles of onerous regulation. It also allows the most prominent potential IPO candidate, Facebook, time to let its revenue grow further before its management makes the decision to go public. And indeed, even as California’s two Democratic U.S. Senators, Dianne Feinstein and Barbara Boxer, voted against the legislation, the San Francisco Bay Area’s purely Democratic House members supported it.

Meanwhile, on the East Coast, Carl Schramm, a visiting scientist at MIT, wrote in Politico that it “would seem a no-brainer...to want to increase the number of new firms going to I.P.O., but regulations, particularly Section 404(b) of Sarbanes-Oxley, have (up until now) made getting there tougher.”

The most optimistic view may come from Scott Gerber, an investor and founder of the Young Entrepreneur Council, who wrote in Time magazine that “the JOBS Act reduces many of the regulatory barriers that have, up to this point, made it nearly impossible for young startups to raise much-needed capital from investors...this historic moment is going to redefine business as we know it.” 

EQUITY TRENDS

2012 — A MOVE AWAY FROM OPTIONS

A LOOK AT S&P 1500 DATA FROM 2007-2011

THE 2012 PROXY season marks the second year in which Say on Pay proposals will appear in the proxies of publicly-traded companies. Shareholders will make their voting decisions about executive pay based on a variety of factors, including consideration of the types of equity awarded to executives. Establishing a strong equity component in an executive's pay provides a clear incentive to strive for long-term growth aligning with the interest of shareholders.

One of the important elements that will be considered when making a Say on Pay decision is a company's use of performance-based equity. Tying compensation directly to the achievement of specific goals has become more prevalent in recent years.

Many companies focus on displaying a strong "pay-for-performance" compensation strategy in their proxy statements with the use of these performance-based shares. This focus has helped drive compensation trends, as full-value shares continue to replace options as the primary vehicle through which companies grant equity.

Equilar studied companies in the S&P 1500 index in order to provide insight into these equity granting practices. Examining data from fiscal years 2007 through 2011, the research reveals that companies have continued to shift away from options while placing a greater focus on granting full-value shares.

(This article is based on a report from Equilar Inc. entitled, "2012 Equity Trends Report." For the full report, including breakdowns by market sector, please email info@equilar.com.)

STOCK-OPTION TRENDS

The number of options granted fell for the second straight year after seeing consecutive years of growth in 2008 and 2009. This growth was primarily caused by the declining stock market during those years forcing companies to grant more options to equal values given in previous years.

The recent decrease continues a trend from earlier in the decade as the use of options has been declining. Figure 1 illustrates option-grant trends at S&P 1500 companies.

RESTRICTED-STOCK TRENDS

From 2007 to 2011, the median number of total restricted shares granted annually by S&P 1500 companies increased at an annual rate of 11.3 percent, reaching a median of 425,000 in 2011. The increase is primarily attributed to 2007 and 2008 as the number of restricted shares granted has remained relatively flat since. Furthermore, the number of companies reporting restricted-stock grants increased from 80.2 percent in 2007 to 91.5 percent in 2011.

Figure 2 illustrates restricted-stock grant trends at S&P 1500 companies.

GRANT PRACTICES

From 2007 to 2011, the number of S&P 1500 companies awarding only stock options to their employees fell from 16.0 percent to 6.4 percent. In contrast, the number of companies granting only restricted stock increased from 17.2 percent to 27.9 percent.

The number of companies granting both equity vehicles had been increasing from 2007 to 2010 until the most recent year. In 2011, the number

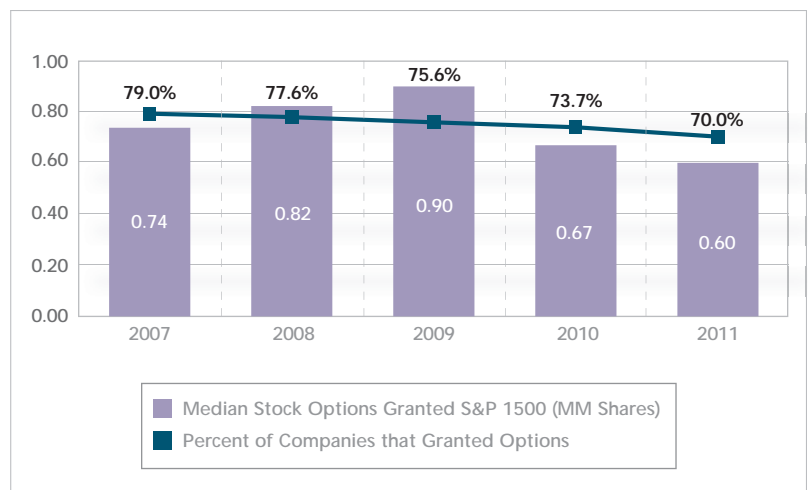


Figure 1

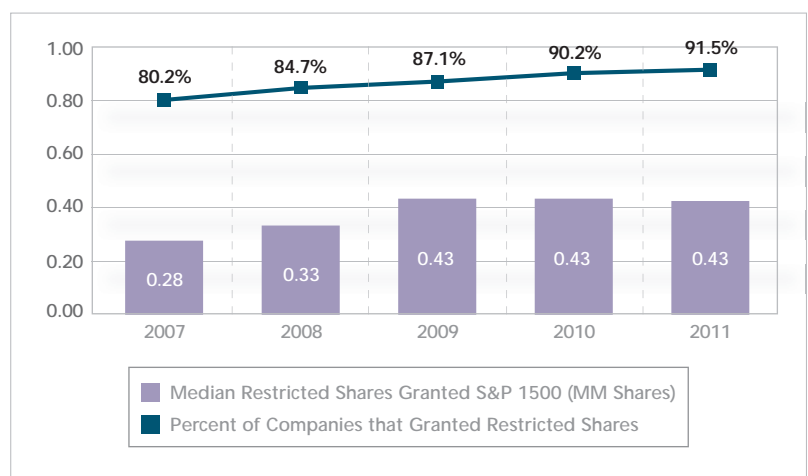


Figure 2

of companies granting both restricted stock and options fell below 2008 levels as companies moved away from granting any options to employees.

Figure 3 shows that a majority of S&P 1500 companies (63.7 percent) granted a mix of equity compensation vehicles to their employees in 2011.

PERFORMANCE-BASED EQUITY

Performance-based equity awards are becoming a popular vehicle to provide value to executives while linking pay with performance. Since disclosure surrounding performance shares on a company-wide basis is not consistent, Equilar looked at awards to chief executives at S&P 1500 companies that filed their 2011 proxy by March 23, 2012. A total of 656 companies were included in this early study of performance shares.

From 2009 to 2011, the number of companies providing performance-based equity granted to chief executives increased from 47.6 percent to 56.1 percent of companies. The majority of these shares are granted as long-term-incentive-plan stock or units.

Figure 4 illustrates the increasing number of performance shares awarded to CEOs among S&P 1500 companies.

OPTIONS-ONLY CONTRIBUTION

Options-only overhang rates at S&P 1500 companies declined steadily from 2007 to 2011, falling from a median of 5.6 percent driven by a decrease in the median number of outstanding stock options at S&P 1500 firms.

As described earlier, from 2007 to 2011, median options outstanding (the numerator in the calculation of options-only overhang) declined at an annual rate of 6.1 percent. Meanwhile, median total common shares outstanding (the denominator in the calculation) increased. From 2007 to 2011, median total common shares outstanding at S&P 1500 firms increased at an annual rate of 2.0 percent.

Another common measure of overhang incorporates outstanding restricted stock in the calculation. As the number of full-value share awards grows, this measure is becoming the standard for many companies.

Fiscal Year	Stock Options Only	Restricted Stock Only	Both Equity Vehicles	Neither Equity Vehicles
2011	6.4%	27.9%	63.7%	2.1%
2010	7.3%	23.8%	66.4%	2.5%
2009	9.9%	21.4%	65.7%	3.0%
2008	12.9%	20.0%	64.8%	2.4%
2007	16.0%	17.2%	63.0%	3.8%

Figure 3

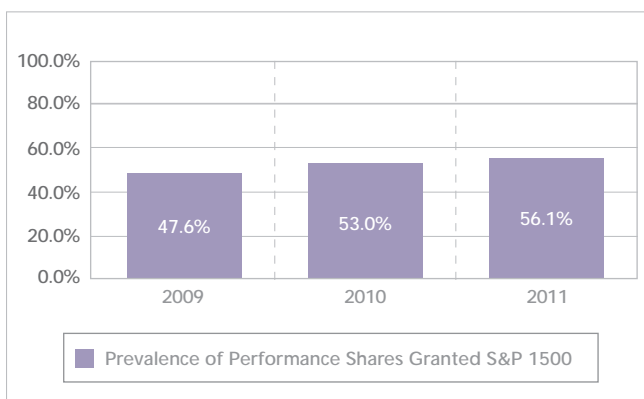


Figure 4

From 2007 to 2011, median options-plus-restricted-stock overhang at S&P 1500 companies fell from 6.2 percent in 2007 to 5.4 percent in 2011, respectively. The decline in options over the last two years has precipitated a larger decrease in overhang rates than the relatively flat changes seen from 2007 through 2009.

Figure 5 illustrates options-plus-restricted-stock overhang trends at S&P 1500 companies.

RUN RATE

Run rates (or burn rates) are another common measure of shareholder dilution. Rather than examining the potential effects of currently outstanding equity awards, run rates measure actual equity-grant activity in relation to the total number of shares outstanding at each company.

Despite an 11.3 percent annual increase in the median number of total full-value shares granted at S&P 1500 companies each year, median run rates decreased from 1.62 percent in 2007 to 1.55 percent in 2011. Partially offsetting the rise in full-value shares granted annually is the fact that the median number of stock options granted each year decreased at an annual rate of 5.0 percent over the same period.

The years 2008 and 2009 saw trends opposite those seen more recently as companies granted higher volumes of equity to keep up with the rapidly declining stock prices. These larger grants spurred run rates higher, bucking trends seen in prior years.

Figure 6 highlights run-rate trends at S&P 1500 companies from 2007 to 2011.

FAS 123R ASSUMPTIONS

Public companies are required to disclose several key assumptions used in the valuation of new stock option awards under FASB Statement of Financial Accounting Standards No. 123 Revised, also known as FAS 123R.

These assumptions, and the numerous valuation models they supply, have a large impact on the stock-based compensation expense recorded each year by corporations in their financial statements.

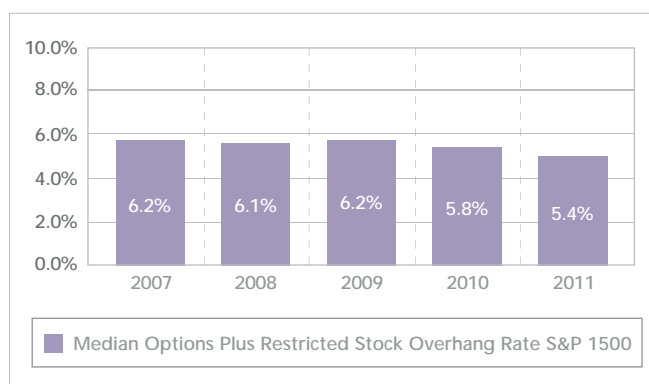


Figure 5

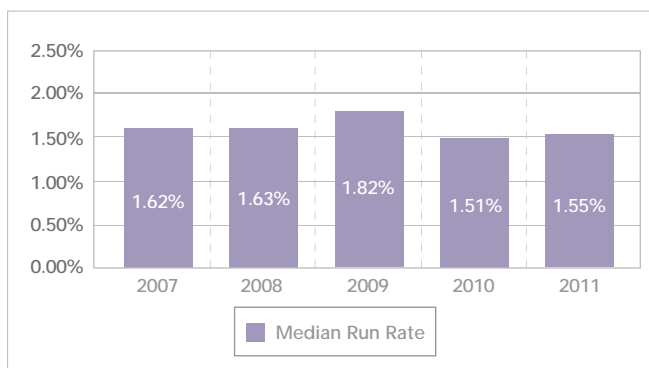


Figure 6

VOLATILITY

Over the past five fiscal years, median volatility assumptions for option valuation models at S&P 1500 companies rose, climbing from a median of 30.5 percent in 2007 to a median of 40.0 percent in 2011. The large spike in volatility was obviously due to the market turmoil during 2008 and 2009.

As the economy, and subsequently the stock market, has slowly begun to stabilize over the last several years, the volatility seen in 2008 and 2009 has also begun to fade. Since as many companies use a three year volatility measure, declines in volatility will continue to be seen in future years assuming the market continues to stabilize.

Figure 7 provides an overview of volatility assumption trends at S&P 1500 companies over the past five years.

VALUATION MODELS

Although the Black-Scholes formula is still clearly the option valuation model of choice among S&P 1500 firms that grant options, the number of companies citing the Black-Scholes formula as their methodology for valuing option awards has declined slightly, from 89.5 percent in 2007 to 88.6 percent in 2011.

Meanwhile, the number of companies indicating that they use the Binomial methodology has increased from 10.1 percent in 2007 to 10.5 percent in 2011. Figure 8 shows a breakout of valuation models. (The “Other” category includes companies using the Trinomial or Monte Carlo models.) **c**

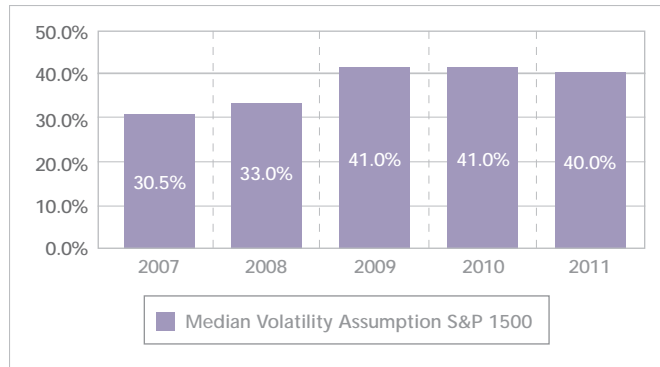


Figure 7

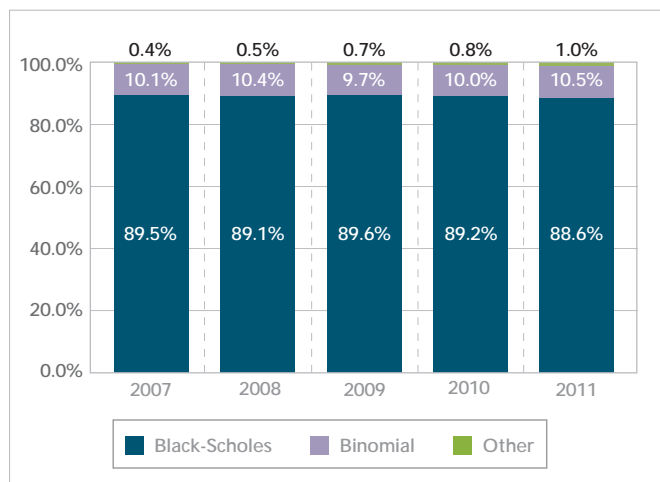


Figure 8

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REALIZABLE PAY

A NEW PERSPECTIVE VARIES FROM TRADITION

A LOOK AT S&P 1500 DATA FROM 2008-2010

THE IDEA OF aligning pay and performance has been the main topic of discussion for quite some time. Yet during this conversation, there is often a conflict about how to properly define pay.

The typical definition is that of the summary compensation table, which includes salary, cash bonus, and the grant-date value of equity. This calculation is effective in illustrating an amount of pay representing the design of the compensation policy. What this pay calculation, specifically the equity portion, fails to take into account is the effect of stock movement on the individual's pay after it is given.

For example, an option award given to an executive is typically valued using a formula that estimates the award value in the future by using historical stock price data. However, if the stock price fails to act like it has in the past; the formula does not take into account any stock price movement after the award is granted. This leaves the possibility open for large discrepancies between the listed value of the award and the amount recognized by the employee.

To accommodate the increasingly complex needs of clients, Equilar created a new pay for performance tool which allows for the incorporation of stock changes while looking at pay. It uses a calculation method termed "realizable pay," which replaces the grant-date value of equity with the amount of real value held by executives through recent equity grants. This pay calculation showcases the value an executive stands to reap factoring in the performance of the stock.

(This article is based on a report from Equilar Inc. entitled, "Introduction to Realizable Pay." For the full report, including breakdowns by market sector, please email info@equilar.com.)

This article introduces the idea of realizable pay and showcases how it differs from more traditional calculations. Figures come from S&P 1500 companies, and focus on an aggregate three-year amount from 2008 to 2010.

KEY FINDINGS

- Target and Realizable Pay closely align in overall trends: Only three sectors, Basic Materials, Consumer Goods, and Utilities saw a difference of greater than 10 percent between target and realizable pay with a change of 17 percent, 23 percent, and 12 percent, respectively.
- Realizable Pay reveals CEOs earned more than target pay over a three-year period. The median three-year realizable pay of all companies was \$12.1 million, 4 percent higher than the median three-year target pay figure of \$11.6 million. Basic Materials and Consumer Goods companies led the way with \$16.9 million and \$16.0 million in realizable pay.
- Realizable Pay provides greater distinction between CEO pay. Despite producing similar median pay figures, realizable pay produced greater variation among CEO pay with a standard deviation of \$22.4 million compared to the \$18.6 million for target pay.
- Most CEOs receive less value from performance equity than disclosed target: Only 44 percent of CEOs received target levels or above for payouts on performance-based equity.

TARGET VERSUS REALIZABLE PAY

The point of using multiple calculations for pay is to better understand how pay can change from its original target values to what someone actually receives.

The use of realizable pay provides a different look at compensation over multiple years with its alignment of the company's stock performance. Target pay provides a look at compensation at the point it is communicated to the employee. Yet, do these pay calculations actually provide a different story about the overall state of CEO pay?

To answer the question above, we compared the median target pay with the median realizable pay in each sector. The resulting figures show, from an overall perspective, the discrepancies that exist between the two calculations are relatively small, with most of the sectors showing a difference between the two numbers of less than 10 percent. Without doing a historical analysis of both calculations, we cannot determine if they conflict when it comes to trends. What we can determine is the median of both calculations provide a good sense of which sectors pay the most and which pay the least.

Only three sectors, Basic Materials, Consumer Goods, and Utilities saw a greater difference with a change of 17 percent, 23 percent, and 12 percent, respectively.

Most sectors saw a higher pay figure represented in realizable pay than through target pay. This is due to companies over-achieving relative to target in the past three years. A slowed economy has caused many companies to conservatively set growth goals and as firms have rebounded, in many cases rebound has been stronger than the projection. If the economy takes another dip, we would expect the realizable pay figure would find itself below the target pay figures.

Figure 1 shows the comparison between these two pay calculations for the companies in the S&P 1500 index, broken out into eight major sector classifications. In general, realizable pay exceeds the value of target pay, due to share price appreciation between the grant date of equity awards and the end of the last fiscal year.

SECTOR ANALYSIS

If we look at the three-year median pay by sector, we can compare the results of the target pay with that of the realizable pay. We can look at the pay levels discussed above in the context of three-year TSR return, providing a picture into how the pay levels align relative to the performance of the different industries. By focusing only on sectors, this allows a broader context to the numbers. We can focus on the standard deviation to showcase the differences between target and realizable pay on an individual company level.

Each of the companies we analyzed from the S&P 1500 index were categorized into eight major sector classifications. For the companies that comprise the sector groups, we determined the median CEO three-year target pay and the median three-year TSR. In aggregate, the median three-year target pay of all companies was \$11,586,856 and the total shareholder return was 1.84%. Figure 2 shows the relative position of each industry on the TSR versus Target Pay plot.

The standard deviation for all companies for target pay was \$18,604,268. Financial companies paid their CEOs the least, at \$8,614,680, but had a similarly low stock price performance with a -1.7 percent shareholder return. Companies that produce energy and other raw materials performed comparably with a -2.0 percent return, but the targeted value provided to their CEOs was 67 percent higher compared with financial companies, at a median level of \$14,424,847.

Now if we look at the standard deviation within each sector, we see the Technology and Basic Materials group typically had the largest swings in pay figures with standard deviations of \$29.2 million and \$25.3 million, respectively. The smallest difference belonged to the Healthcare sector, with a standard deviation of \$4.5 million. Figure 3 below showcases the standard deviation among the sectors.

	Target Pay	Realizable Pay	Difference (Target-Realizable)
Basic Materials	\$ 14,424,847	\$ 16,928,032	\$ 2,503,185
Consumer Goods	\$ 13,007,974	\$ 16,032,230	\$ 3,024,256
Financial	\$ 8,614,680	\$ 8,499,752	\$ (114,928)
Healthcare	\$ 12,744,836	\$ 12,526,979	\$ (217,857)
Industrial Goods	\$ 11,432,490	\$ 12,412,941	\$ 980,451
Services	\$ 11,089,676	\$ 11,821,357	\$ 731,681
Technology	\$ 10,017,491	\$ 10,363,524	\$ 346,033
Utilities	\$ 11,109,089	\$ 12,395,422	\$ 1,286,333
All Companies	\$ 11,586,856	\$ 12,075,768	\$ 488,912

Figure 1

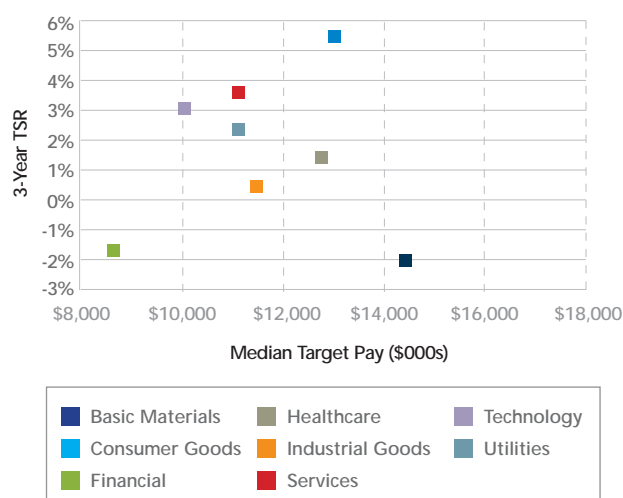


Figure 2

	Target Pay	Standard Deviation
Basic Materials	\$ 14,424,847	\$ 25,255,659
Consumer Goods	\$ 13,007,974	\$ 12,913,699
Financial	\$ 8,614,680	\$ 13,719,215
Healthcare	\$ 12,744,836	\$ 4,462,534
Industrial Goods	\$ 11,432,490	\$ 13,534,401
Services	\$ 11,089,676	\$ 14,686,879
Technology	\$ 10,017,491	\$ 29,248,480
Utilities	\$ 11,109,089	\$ 8,811,083
All Companies	\$11,586,856	\$18,604,268

Figure 3

PAY FOR PERFORMANCE

How do the sectors fare when we view pay for performance in terms of realizable pay? The median three-year realizable pay of all companies was \$12.1 million compared to the \$11.6 million found through target pay. Figure 4 shows the median realizable pay figures in place of the target pay for each sector.

CASE STUDY

Perhaps no better way to demonstrate the difference between the two pay calculations is through the use of an actual example. As we already pointed out, the overall differences between the two calculations are somewhat muted when looking at groups. Where realizable pay becomes useful is in looking at a company's specific situation to identify when failure to meet target numbers produces a different narrative about the executive's pay.

Consider the two pay calculations for Air Products & Chemicals. The company's pay design puts a large emphasis on tying the amount received by its CEO to long-term performance with over 85 percent of total pay being variable. This is accomplished through the use of an annual incentive plan, stock, options, and performance units. Looking at pay through the target lens reveals a three-year amount of over \$30 million, an average of approximately \$10 million per year.

However, since much of that \$30 million is valued on the day of grant, the actual amount received by the CEO could prove to be quite different. In fact, upon examination of the realizable pay figure, it is revealed the CEO received less than \$20 million over the three-year period, an average of approximately \$7 million. This showcases that the design of the Air Products' pay plan effectively limited the amount of compensation received by its top executive when performance does not meet expectations. Figures 5 and 6 tell this story.

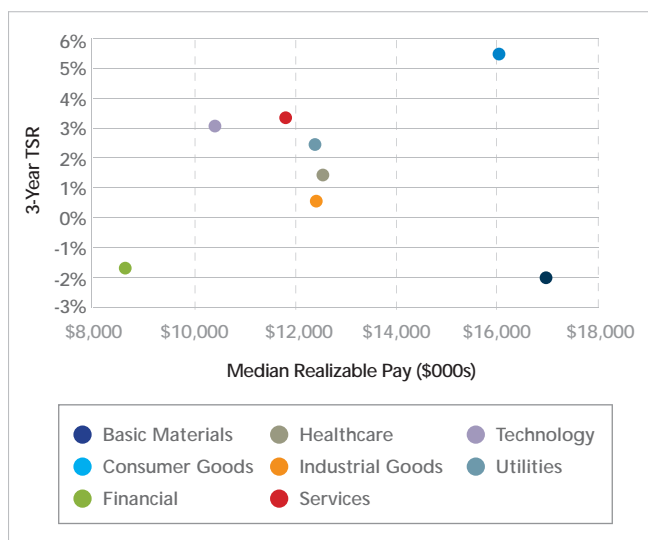


Figure 4

Fiscal Year	Salary	Bonus	Performance Units	Stock	Options	All Other Comp	Total Pay
2011	1,300,000	1,250,000	2,587,398	1,437,443	3,457,048	142,910	\$10,174,799
2010	1,300,000	1,320,000	2,474,945	1,374,969	3,653,323	162,688	\$10,285,925
2009	1,170,000	1,320,000	1,826,751	1,315,598	5,634,846	123,012	\$11,390,207

Total 3-Year Target Pay: \$31,870,931

Figure 5


Fiscal Year	Salary	Bonus	Performance Units	Stock	Options	All Other Comp	Total Pay
2011	1,200,000	2,546,000	1,569,633	1,569,633	2,417,852	142,910	\$9,446,028
2010	1,200,000	2,746,000	1,256,057	1,256,057	0 (underwater)	162,688	\$6,620,802
2009	1,200,000	0	1,270,720	1,270,720	0 (underwater)	123,012	\$3,864,452

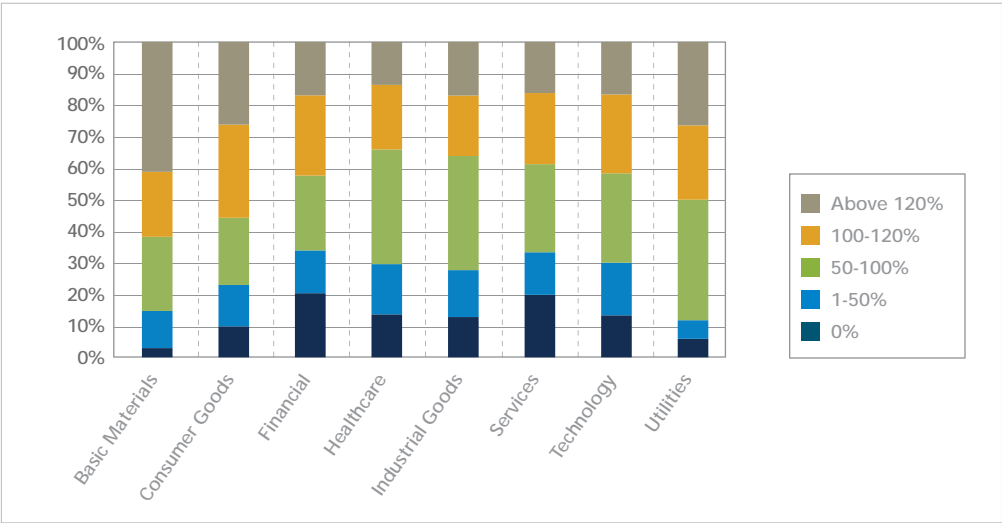
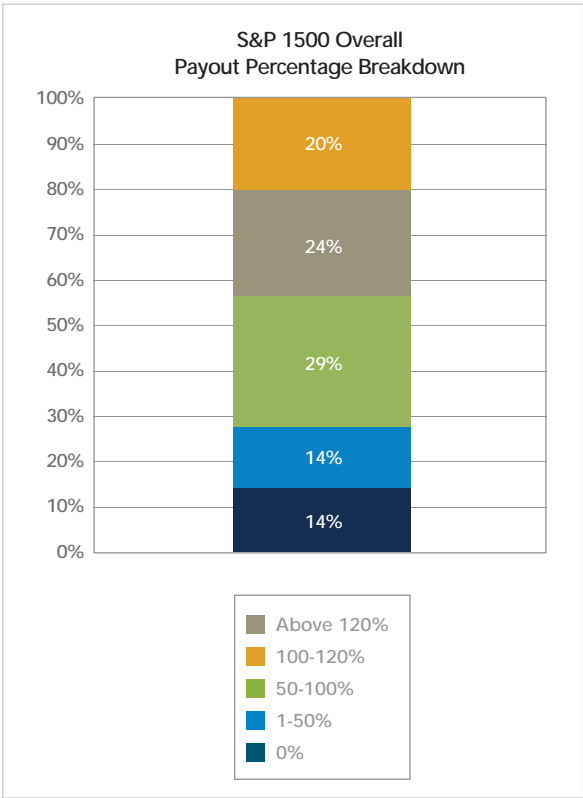
Total 3-Year Target Pay: \$31,870,931

Figure 6

PERFORMANCE SHARE PAYOUTS

As discussed previously, the value realized by an executive can differ significantly from the target values required by disclosure rules. While the realizable pay calculation used here adds a level of nuance and sophistication by including the value realized from the cash incentive plans and reflects movements in stock price, even this figure fails to report the real outcomes from performance stock, unit and option plans. Therefore, additional data is needed to accurately represent the final payout levels from these performance share awards.

Approximately 64 percent of companies in the S&P 1500 have awarded stock, units or options within the past five years that only vest when certain performance metrics are achieved. Of these companies, available payout data was compiled for awards granted to CEOs and have a performance period that ended within the last three fiscal years. This dataset represents 450 unique companies and over 1,100 separate awards. For each company analyzed, the sum of the number of paid out shares was divided by the sum of the target number of performance shares, resulting in a payout percentage relative to target. Figures 7 and 8 show the breakdown of payout percentages among all companies and among the different sectors. 




Equilar On YouTube™

Equilar, the leading provider of executive compensation data, has recently launched Behind The Numbers, a weekly series of brief, online videos exploring the latest developments in executive compensation. The weekly series airs on Equilar's YouTube channel (www.youtube.com/equilarvideo).

In the coming weeks, Behind The Numbers will feature segments outlining a wide variety of issues of interest to the executive compensation community, including:

- CEO & CFO Pay Analyses
- Compensation Differentials between Male and Female CEOs
- CEO Pay by Industry

"Behind The Numbers extends our executive compensation research to a wider audience in an easy-to-understand format," said David Chun, Equilar CEO and Founder. "Alongside our in-depth compensation reports and our C-SUITE Insight magazine, Internet video is an effective way to rapidly share our findings and to elevate the conversation around corporate governance." 

INTERVIEW WITH **AMY LYMAN**

Amy Lyman co-founded the Great Place to Work® Institute, a San Francisco based research and consulting firm with over 40 affiliate offices around the world. While best known for its selection of the 100 Best Companies to Work For that appear annually in Fortune magazine, the Institute provides consulting, coaching and educational services to leaders and organizations interested in creating great workplaces.

Amy has spent close to thirty years studying organizations and groups, seeking to understand what helps some groups to thrive while others stall and fall apart. Her current focus is on Trustworthy Leaders and their key contributions to the creation and sustenance of successful groups and organizations. Great leaders are the key to organizational growth and success, and trustworthy behavior is needed to become a great leader.

Amy provides advisory services to leaders and organizations interested in understanding and enhancing the trustworthy practices of leaders and managers. She has been a featured speaker at management workshops and conferences and also develops custom presentations and workshops for organizations and associations.

Amy received her Ph.D. from the University of Pennsylvania and her B.S. from the University of California, Davis. She began her consulting work while a research fellow at the Wharton Center for Applied Research at Penn.

“GREAT LEADERS ALSO
CONVEY A COMMITMENT
TO A HIGHER PURPOSE.”

Great Place to Work Institute is a global human resources consulting, research and training firm specializing in organizational trust. The firm's model is built on 25 years of research and data collected through its Trust Index Employee Survey, which is taken by over 10 million employees annually worldwide.

In the United States, Great Place to Work produces the annual Fortune 100 Best Companies to Work For list, as well as the Great Place to Work Best Small & Medium Workplaces list published by Entrepreneur.com.

C-Suite Insight recently interviewed Amy Lyman, the Institute's co-founder, on what makes a place a great place to work and how that affects company performance.

C-Suite Insight: How did you get the idea for Great Place to Work Institute, and how did you get it off the ground?

Amy Lyman: The idea of Great Place to Work came about 25 or so years ago. (Co-founder) Robert Levering and I were having conversations about how to help more companies understand the importance of being one of the best places to work, of focusing on the idea of the work-

place culture and having employees say, "I want to work here. I love my workplace."

Milton Moskowitz and Robert had written, "The 100 Best Companies to Work For," (1984) and Robert had followed up with the book, *A Great Place to Work* (1988). I came into the picture in 1989 having done research and teaching on workplace culture and leadership, and a lot of consulting work on a variety of topics. I also recognized early on the contribution of workplace culture to organizational success.

We started out with a small consulting practice, created an employee survey and began helping companies to become better places to work.

CSI: How did you expand?

AL: We started working with companies that were interested in our stance, which has always been to look at an organization from an employee's perspective. After all, everyone is an employee in an organization. We found leaders who believed that trust was the key intuitively or experientially, and they wanted help to implement strategies to create a great workplace.

We developed our consulting work for a number

of years, Robert and Milt produced a second book of the 100 Best Companies to Work For (1993) and then an editor from Fortune Magazine called and asked us to develop the 100 Best Companies concept into an annual magazine article. This turned out to be a massive undertaking, but as those things often are, with a great idea, and a real commitment to a sense of purpose and a higher value, you just go for it, which is what we did. The first Fortune article came out in 1998, and the annual article is still going.

CSI: How did you determine which companies make the cut?

AL: We used our employee survey as a measurement tool since it had been designed and tested to assess the level of trust between employees and management. We also developed a company survey that we used to assess the policies and practices in the workplace that both influenced and reflected the culture. Both survey tools are still used today to determine which companies are the Best Companies to Work For. When we started our consulting work in 1990 we were one of the first groups to talk about the importance of trust that's felt by employ-

ees, and that the relationship between employees and management needs to be based on trust. That's common language today.

CSI: Are there companies that have been on the list since the beginning?

AL: Yes, and some of those companies are more than 100 years old as well. The great places to work today are similar to the great places to work that we highlighted on the first list. A great example is Wegmans, a chain of grocery stores in the Northeast. It's an amazing, great place to work.

CSI: And some of the newer companies?

AL: Google is one of the 'newer' companies on the list. Certainly they show up on all kinds of lists for their flash and tools, yet that's not what gets them on the Best Companies list. The Google culture is quite stunning and their approach to developing trust is innovative. I've visited the campus a couple of times, and there is such a refreshing sense among people there of, "We're all valuable. We're all expected to participate. We all need to participate."

Google employees also realize that nothing's perfect, and are encour-

aged to speak up and try to make things better. It's an excellent place to work in a completely new industry.

Wegmans, on the other hand, is an older company, with 41,000 employees. Profit margins are low in the grocery business, which can place stress on relations between employees and management if employees are not treated well. Yet Wegmans is a wonderful place to work and their culture contributes greatly to their success.

One thing I remember from going to Wegmans is that everyone there had the expectation that they could be a nice person throughout the day, and that every other employee there as well would be committed to being a nice person. There wasn't competition. There wasn't any one-upsmanship. Everyone was working toward the common good, and toward the benefit of the company.

CSI: What other surprises have you found?

AL: One company that I love is Radio Flyer.

CSI: The company that makes the red wagons?

AL: Yes, and Radio Flyer is another fascinating company. It has a hiring strategy

that is really quite sophisticated. It's a small company, with about 70 employees, but the screening, the number of interviews conducted, and the seriousness of the hiring process would work just fine at Google.

CSI: That sounds like it speaks to leadership.

AL: Absolutely. When the leaders are onboard, understand the importance of trust and being trustworthy, and of supporting that kind of a culture, then the achievements are astronomical.

CSI: You mean financial performance?

AL: Yes, that is one measurement. The best companies are significantly better financial performers than their peers on the S&P 500. If you look at the publicly traded 100 Best over time, their annualized return now, including the 2012 list, is about 10.4%. Companies dream about getting that kind of return and yet, here it is.

CSI: What sort of leadership tends to create this sort of performance? Is it a charismatic founder type or a more humble type, more of a listener type? Or is there an archetype?

LEADERS MUST ALSO BE VERY CONCRETE, THEY NEED TO ANSWER THE QUESTIONS THAT ARE ASKED, MAKE THEIR EXPECTATIONS CLEAR AND BE APPROACHABLE.

AL: There isn't one archetype—there is always a commitment to being trustworthy, and there are certain things in terms of how you lead that convey your trustworthiness.

CSI: How important is instilling a sense of equitable compensation?

AL: Equitable compensation is one of the big issues. The greatest difference on the employee survey used to select the 100 Best—between the companies that are the Best versus the companies that are good but not great—is the employee response to the statement, “I feel I receive a fair share of the profits made by this organization.” Many more employees at the 100 Best Companies (compared with those that do not make the list) believe that they receive a fair share of the profits, and that they are paid fairly for the work they do.

CSI: Intel is on your list, a company that springs to mind in the area of equitable treatment.

AL: Yes, Intel is known to be very egalitarian. It's a company that's done a tremendous amount to provide mechanisms for fair profit-sharing and the fair distribution of benefits

through stock ownership. Intel is also going a step further by developing educational programs to help people understand the importance of participating in stock purchase plans.

CSI: Starbucks is on your list as well...

AL: Starbucks has been exemplary in trying to ensure that all of their benefit programs reach as many employees as possible. It was one of the first companies with a large number of part-time employees to offer health insurance to everyone—all the baristas, for example. REI—Recreational Equipment Inc.—is another company that did the same thing.


CSI: Can you define a Great Place to Work in three words or fewer?

AL: Sure. It's a company with trust, pride, and camaraderie.

To earn trust, management needs to be credible, needs to convey respect to employees, and needs

to create an atmosphere and practice of fairness. Trustworthy leaders are what enable great companies to be so successful.

Leaders must also be very concrete, they need to answer the questions that are asked, make their expectations clear and be approachable. It's important to practice two-way communication, because you want people to be able to participate in and influence the life of the business. Great leaders develop others through interaction, mentoring and direct teaching.

Great leaders also convey a commitment to a higher purpose. This leads to a deeper sense of meaning for people, instills pride and a camaraderie that extends up and throughout management and leadership. In great workplaces you will find leaders and managers who genuinely care about the people who work in the organization. They are able to say “hello” to all of the employees. And they're able to talk with people and it's sincere. 

INTERVIEW WITH **KEN BERTSCH**

Ken Bertsch is CEO and President of the Society of Corporate Secretaries and Governance Professionals. Previously, he was head of corporate governance for Morgan Stanley Investment Management (MSIM), where he provided support for equity portfolio managers in New York, Houston, London, Singapore, Tokyo, Mumbai and other locations.

From 2002 to 2006, Mr. Bertsch headed the corporate governance analytical team for fundamental ratings groups at Moody's Investors Service. Ken received a J.D. from Fordham University School of Law in 2004 and a B.A. from Williams College in 1978.

C-Suite Insight interviewed him lately, to get his thoughts on the issues facing the members of the Society.

"BOARDS NOW ARE VERY IMPORTANT IN THE LIFE OF COMPANIES AND THEY NEED TO BE FUNCTIONING WELL."

C-Suite Insight: What are the top two or three specific issues that you're hearing in conversations today and where does Say on Pay rank?

Ken Bertsch: Say on Pay probably ranks at the top. Our members do work that supports boards, and they tend to be very focused on practical matters. At the moment, shareholder interactions and communications—how they are conducted and how they can improve—are at the center of many discussions, and right now that's mostly because of Say on Pay.

The second issue is the use of technology in the boardroom. This area is changing very rapidly. In particular there is an increasing use of board portals and electronic materials driven in large part by the rise of tablets like the Apple iPad.

The third area concerns how the classic corporate secretary runs the board, making sure the board is run as efficiently as possible, using best practices in pulling and presenting materials.

CSI: Regarding Say on Pay, what are you hearing? Is it triggering more interactions?

Ken: Absolutely. It's somewhat time-consuming for

everybody involved, but there are a lot of interactions and some interesting things coming out of that. We're in the midst of what I think may be a five-year process of adjusting to Say on Pay. I believe that some of the conversations include back and forth on why particular pay structures were set, and/or about peer comparisons and other matters. Many feature a focus on pay for performance, but concerning appropriate benchmarks to encourage long-term performance.

CSI: What are some of the other specific conversations you're hearing?

Ken: Issues concerning the election of directors are very high on the list, including the issue of proxy access. While defeat in court of the SEC's proxy-access rule means this is not an immediate issue for most companies, there is considerable interest in developments at companies that do face shareholder proposals to implement access. More generally, proxy access is one of a series of developments (including majority vote standards) that potentially make re-election of directors less certain than in the past.

This whole series of issues is central to what a corporate secretary does. There's been a lot of change, and

there is the prospect of more change.

Litigation issues are always close to the surface as well. For example, there's been alarm at the lawsuits seemingly generated out of Say on Pay votes, although I personally tend to think this won't be terribly significant (the plaintiff's bar can always find targets).

Another less-publicized issue: some companies have moved to adjust their bylaw provisions for exclusive jurisdiction, so that cases can be brought in Delaware or in their state of incorporation, rather than in multiple jurisdictions.

The exclusive jurisdiction issue has received what is to me a surprising degree of opposition from mainstream investors, which to me does not really make sense. Multiple suits in multiple jurisdictions really do seem wasteful of shareholder assets. This issue is of concern to the corporate secretaries, and the shareholder interaction piece comes into it because we need to better inform shareholders what the present costs are, and why they are at their current level.

CSI: Is there a concern among your members that certain activist shareholders may disrupt annual meetings?

Ken: Yes, although there are different types of activists. I think there is respect for long-term holders who are raising issues, and who are doing so in constructive ways. Shareholders who buy one share of stock just before record day in order to get in the hall and disrupt the meeting are very different from long-term holders.

This latter type of shareholder and disruption have not been very common until this spring. But this is a bit alarming and does upset our members, because their job is, among other things, to make sure the annual meeting happens. They have to make sure the legal formalities that are supposed to happen at an annual meeting, do happen.

CSI: How do your members help board members balance their need to keep a big-picture view, but also handle the level of detail they see today?

Ken: Board members need to have confidence in the executive team, and in their own ability as directors to know what questions to ask. Our organization's members have as their central role enabling board effectiveness. Corporate secretaries and governance professionals need to see to it that boards get the timely information they need and

the detail they demand, but also that they not be overwhelmed by minutiae. This can involve a gatekeeper role. Our members tend to be empathetic, and it is particularly important they be empathetic with board members and what they need to do their job.

CSI: What can board members do to optimize this relationship?

KB: First, board members should be clear with corporate secretaries on what they need and where they may need help. This will vary by industry, company and director. Boards need to have a good understanding of their industry, of course, and they need to have a long-term perspective. In some cases, that involves a fair amount of technical knowledge, at least among some board members, so that they can ask probing questions and really understand the directions the company is going.

A footnote: when I was on the investor side and talking with directors on a regular basis, I was surprised at the number of conversations in which directors seemed too focused on the current quarter or year, and not really on the longer term. I think that both corporate directors and those helping them within the corporation

need to balance getting sufficient detail on near-term developments while keeping a view on the long-term.

CSI: Do you have a position on how important compensation is for board members?

Ken: Board members should be paid, of course, but I personally don't think how much they get paid is that important. Most companies try to go right down the middle with board compensation—paying very close to what peers pay.

CSI: So why serve on a board then?

Ken: Number one, serving on a board of directors is a really interesting thing to do. I think that's what motivates a lot of directors. It is intrinsically interesting, and in a particular industry it can provide a vantage point that's unique.

Secondly, there's a civic-responsibility aspect. Board members are acting as stewards for an important asset in the community. I think that motivates people, and I think it's an honor.

CSI: So it's not about the money?

Ken: I don't think people are on boards to get rich.

People become executives partly to get rich, but I don't think that's why you serve on a board of directors.

CSI: The theme of your organization's conference in July is, "The Shape of Things to Come." What do you expect to hear at that event about the shape of things to come?

Ken: Our members have been focused, as others have been, on Dodd-Frank and all the rules that came out of the financial crisis. What we need to do is take a step back at this point. There is still more work to do at the SEC and among companies in implementing Dodd-Frank requirements and the new rules implementing the JOBS Act, but we want to step back and ask, "Where are we going in the next five years? What we would like to see? What would be useful reform, now that we've got a little bit of distance from the financial crisis?"

So, for example, we'll have a panel on the future of disclosure. There's a lot of change happening in disclosure with technological development, with the way information is presented on the web, and with concerns about information overload for investors. A number of groups, including the Society, would like to get ahead of the train and push

consideration as to how to present information optimally given current technology and current ways of using information. Is there a way to streamline that and make it more effective communication? How will things look five years down the road and how should they look?

CSI: What's your view of the recently-passed JOBS Act?

Ken: The JOBS Act went through Congress very fast, and the Society did not take a position on the Act or most elements within it. Some elements that should be helpful for emerging-growth companies, but I do not see the Act as leading to a huge amount of change, and there are some problem areas, as is typical with legislation like this that moves through Congress quickly for reasons only partly related to the underlying issues. The SEC faces some challenges on implementation, particularly as Congress has given the Commission a short timeline for acting on implementation.

CSI: Let's finish by talking about the last two words in your organization's name — "governance professionals." What sort of correlation do you see between good

governance and corporate performance?

Ken: A lot of people argue that governance is really about risk more than it is about opportunity. Many of the governance mechanisms that companies and regulators put in place are really about making sure that risk is paid attention to.

Often when people ask this question, they are referring to certain indicia of good governance and corporate performance, such as the annual election of directors or board independence. If you want to measure correction of such check-the-box good-governance indicators to performance, I think the academic research is mixed, at least on many such indicia. Substantively, there is no question that bad governance, such as mishandling of executive succession, does harm companies. It is almost irrefutable that Boards doing their jobs well will be better for the company than Boards fumbling their job, and that more broadly effective governance is important. The problem is that it can be difficult to understand good governance from the outside and before events happen. Bottom line though: boards now are very important in the life of companies and they need to be functioning well. ■

INTERVIEW WITH **CHRISTINE MCCARTHY**



Christine McCarthy is a partner in the Silicon Valley office of Orrick, Herrington & Sutcliffe, member of Orrick's Compensation & Benefits Group and serves as the General Counsel of the American Coalition of Stock Plan Administrators.

She has extensive experience advising on all aspects of equity compensation plans and arrangements for multinational private and public emerging companies, as well as large Fortune 500 public companies. Such advice covers the design, administration, and implementation of such plans and arrangements, as well as compliance with applicable federal and state laws, including corporate, securities and tax laws, NASDAQ/NYSE rules, and accounting rules.

"ANYTIME A RULE IS PASSED WITH TERMS THAT ARE NOT 100% CLEAR, IT CREATES CHALLENGES FOR STOCK PLAN ADMINISTRATORS."

C-Suite Insight: Let's start by letting our readers know about the organization that you helped form last year, the American Coalition of Stock Plan Administrators, what it is and what it does.

Christine McCarthy: The American Coalition of Stock Plan Administrators, also referred to as ACSPA, is a newly-formed trade association serving the U.S. equity compensation plan administration industry. It's specifically focused on the administration of stock plans and, for the time being, on U.S. issues facing the industry.

Currently, Bank of America Merrill Lynch, Charles Schwab, EASI, E*Trade Corporate Services, Fidelity Investments, FRS Equity Strategies, Global Shares, Morgan Stanley Smith Barney, Norse Solutions, OptionEase, Solium Capital, and UBS are all members of ACSPA. These ACSPA members collectively represent thousands of companies that maintain stock plans, who in turn provide stock plan benefits to millions of participants.

There are a few primary purposes of the organization. One is to create awareness among regulators,

lawmakers, and key industry constituencies to the needs and challenges that stock plan administrators, and their customers, the companies that maintain stock plans, experience when facing potential changes in policies, laws, and regulations affecting the stock plan industry.

Our members are also focused on industry standardization to promote efficiency, educational standards that support a common set of industry knowledge, and the efficient administration of stock plans through open dialogue with key industry constituencies including industry groups, plan designers, and consultants.

CSI: You mention that it's a new organization. Why was it formed? What was the perceived need?

Christine: Some of the current members started to get together about two years ago. Even though they were often competitors, they recognized that they were all experiencing common issues and challenges, that they had a collective interest in coming together to discuss and address issues

that they all face in an effort to better serve their clients, and that there wasn't a trade organization specifically focused on their challenges.

CSI: No organizations focusing on stock plans?

Christine: No. There are several associations that focus on stock plans. The Global Equity Organization and the National Association of Stock Plan Professionals are two of the leading organizations, but neither of them spends a lot of time focusing on the stock plan administration side of the business.

One of the primary drivers for ACSPA was a concern that rules and regulations that affect stock plans and stock plan administration are drafted by lawmakers and regulators who may not have a clear understanding of how stock plans work, the administration that goes into stock plans, and the impact that those rules and regulations can have on that administration. In many cases, when a new rule is passed, there is a trickle-down effect that can lead to a lot of unanticipated cost and complexity on the administration side.

CSI: How so?

Christine: Some rules cause stock plan sponsors to change their plan design. In some cases, this is a direct response to the rule and, in other cases, an unanticipated side effect. Each time stock plan sponsors change their plan design or come up with new plan designs, there is an impact on administration which, in some cases, can be very difficult and costly to address. A good example of this was the adoption of FAS 123R. One of the things that FAS 123R did was make it easier for companies to grant equity awards with performance vesting features. This (combined with other influences) led to a tremendous increase in the use of equity awards with performance vesting features which, from an administrative perspective, can be very complicated to deal with.

Another issue is ambiguous rules. Anytime a rule is passed with terms that are not 100% clear, it creates challenges for stock plan administrators to try to determine how to adjust their systems to address the new rules, particularly because the companies who maintain the stock plans (and their advisors, like me, and accounting firms) may take different interpretations of the rules, which forces

the administration firms to come up with multiple solutions to address the same rule. This, of course, is inefficient and costly for all of the administration firms.

CSI: It seems like a lot of times Congress will pass laws that are broadly written, and let regulators such as the IRS or SEC interpret them. It also seems that, in some cases, the regulators will issue rules and/or guidance that are very broad and, as a result, somewhat vague. Is this what you are referring to?

Christine: Yes, that's exactly right. I understand that this is often intentional as the rules often need to be written to address many different situations and rules that are too narrowly drafted can cause issues of their own. However, in some cases, the rules are vague where there doesn't seem to be a great reason to be vague and this can lead to a lot of inefficiency and non-compliance. I also believe that the rules are sometimes vague because there is not a good understanding of how stock plans work and the administration of stock plans.

Last year ACSPA met with the SEC, the IRS, and FASB to introduce the association to the agencies and to talk to them about some of these

concerns and challenges and let them know that ACSPA and its members are available to assist the agencies where helpful.

The discussions were all very interesting. As I noted previously, it was clear that the agencies are often asked to write rules in a broad manner by issuers and other constituencies because people often have a lot of concern that rules that are too narrowly tailored won't make sense for different subsets of the market, which I think is true and a fair concern. It was also clear that it was a little unusual for them to hear from an organization like ACSPA, which is looking for more clarity and precision in the way that some of the rules are written.

Ultimately, ACSPA's message to the regulators was that there has to be some balance to account for the fact that in some ways more clarity would be appropriate and very helpful to the stock plan administration industry, without sacrificing too much in terms of being too narrowly constructed.

CSI: How has your world changed since the onset of the Great Recession and all of the legislation and regulatory stuff that's followed?

Christine: I think things have

evolved and changed quite a bit. Before Dodd-Frank and Say on Pay there was always a discussion about shareholders and how they may react to certain things, primarily stock plan proxy proposals. Today, those discussions have intensified exponentially and the focus has become much broader where all aspects of executive compensation are under the microscope.

Also, from a stock plan design perspective, we've seen a real shift toward performance-based compensation and an increased focus on the specific performance measures that are used and whether they make sense, or not from an overall business perspective, as well as from the perspective of what incentives they will provide and behavior they will elicit. Really, everything is driving toward the use of performance-based compensation—Say on Pay, institutional investors and proxy advisory firms like ISS and Glass Lewis—all increase the focus on performance-based compensation. The dialogue in the boardroom has gotten much more focused and intense when it comes to discussing performance compensation and specific performance measures, whether programs make

sense and then, of course, how they may be perceived by shareholders.

CSI: Is there a single issue that's particularly difficult to deal with today?

Christine: One issue that came up with multiple clients this proxy season concerned the disclosure of performance goals, and the timing of that disclosure. No one wants to disclose their goals in real time to the market, because competitors are looking at those along with everyone else. There are some pretty easy solutions to the real time disclosure issue but, ultimately, the SEC does require you to disclose your goals and your targets in your CD&A to the extent that those goals and targets are part of the formula that determines the executive's compensation.

CSI: Reasons other than letting the competition know?

Christine: Yes. In addition to worrying about your competitors having insight into the company's strategy, you may also not want to tell the market that you were driving to a particular "stretch goal" that you may or may not meet. These "stretch goals" are real goals, but if you don't meet them, it shouldn't always be perceived as

poor performance. It can be difficult because you don't always want to disclose that stretch target, but you do want it to be part of the program that your executives are driving toward.

CSI: You're based in Silicon Valley, but travel to Washington and handle clients from other regions. Do you think that your location influences your perspective? Do you find that different locations mean different points of view?

Christine: Yes, I absolutely see differences regarding how people view the world of compensation, no matter where I go. There are differences between the east coast and west coast. There are differences between the U.S. and outside of the U.S.

I think we have to remind ourselves that those differences exist. Many of our clients are based in Silicon Valley but have operations all around the world. It's very important to ensure that you understand how your programs will be implemented and how they'll be perceived in every location where you're rolling them out. As an advisor, it's very important to have an appreciation for that, and to not have tunnel vision in the way that you think about and do things. **C**

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