

CSUITE

INSIGHT

SAY ON PAY

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by Roger Strukhoff





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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.

SAY ON PAY IN 2012

AS MANY COMPANIES FIND themselves once again in the midst of preparing for the annual rite of passage known as proxy season, we thought it would be most appropriate to focus the current issue of *C-Suite Insight* on Say on Pay. Based on voting results from last year, shareholder response to Say on Pay was overwhelmingly in the affirmative. A very small number of public companies received a majority of “withhold” votes, while many companies saw positive votes above 80 percent.

Despite what the voting results demonstrated in 2011, Say on Pay remains top-of-mind for both issuers and their shareholders. In our current issue of *C-Suite Insight*, we’ve asked a number of industry professionals for their thoughts on what issuers can do to improve the Say on Pay process. We’re fortunate to capture the thoughts of several industry leaders, including a discussion with Katherine Rabin, CEO of Glass Lewis, on the role of proxy advisory firms and her thoughts on measuring pay and performance. We also talk with Ann Yerger, Executive Director of the Council of Institutional Investors, who shares what’s on the minds of large institutional shareholders. Finally, we visit with Chip Roame, Managing Principal, Tiburon Strategic Advisors, to hear his views on the latest trends impacting the wealth management industry. We also checked in with Seymour Cash and his board on the topic of Say on Pay. It turns out that Seymour’s compensation committee accurately reflects his view on pay.

Thank you for taking the time to read our latest issue. We welcome any thoughts or suggestions you may have and we hope that this information helps you as you prepare for proxy season 2012 and what lies ahead. 



DAVID CHUN
CEO and Founder, Equilar
dchun@equilar.com



Say on Pay 2012

BY ROGER STRUKHOFF

Year Two of Say on Pay will
see continued SEC action.

Will it see more
shareholder activism?

“This landmark legislation set out to reshape the U.S. regulatory landscape, reduce systemic risk and help restore confidence in the financial system.”

SEC Chair Mary Schapiro spoke these words in July 2011, about the Dodd-Frank Wall Street Reform and Consumer Protection Act.

A key aspect of Dodd-Frank is the Say-on-Pay provisions, a rule in corporate law whereby a firm's shareholders have the right to vote on the remuneration of executives. Dodd-Frank went into effect during last year's proxy season. Now it's Year Two for Say on Pay, and a good time to look at what it has meant thus far.

WE ARE THE 2 PERCENT

The first year of Say-on-Pay did not produce earthshaking results, with fewer than 2 percent — only about 45 of approximately 3,000 corporate executive-compensation plans — receiving “no” votes through shareholders' Say on Pay.

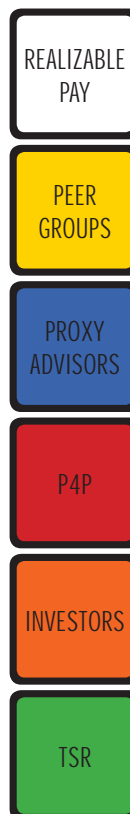
Even though Say on Pay is non-binding, about a dozen of these companies also faced Say-on-Pay related shareholder lawsuits. One company, Cincinnati Bell, recently announced a settlement clarifying the company's executive-compensation policies, according to company chairman Phillip Cox.

Cincinnati Bell had granted dramatic pay increases to top execs in a year in which profits declined equally dramatically following an acquisition. The lawsuit centered more on transparency than the compensation numbers themselves, and the company's settlement promises to “reaffirm its pay-for-performance practice and provide for an annual discussion of its philosophy related to executive compensation.”

However, research by Farient Advisors found that concerns about pay-for-performance, rather than transparency, dominated the thoughts of shareholders who voted “no” to Say-on-Pay proposals. Farient Executive Chair Robin Ferracone, (one of many industry experts featured in the accompanying story) wrote that 92 percent of these shareholders cited pay-for-performance concerns in a survey, while poor disclosure practices, including a lack of transparency, was cited by 35 percent of survey participants.

The survey also found that shareholders were also concerned about other factors, including poor pay practices (57 percent) and an “inappropriately high level of compensation...that didn't look right” (16 percent).

The poor pay practices cited included “special awards (particularly when performance was poor), targeting executive pay at the 75th percentile, a poor choice of performance measures, tax gross-ups, lack of clawbacks, and excessive termination awards,” according to Ms. Ferracone.



SO, WAS IT GOOD OR BAD?

The small number of Say-on-Pay rejections has caused some observers to declare Say on Pay as a failure, even a hoax. A previous issue of *C-Suite Insight* featured an interview with Anne Simpson of CalPERS, who referred to it as a “feather duster,” rather than the blunt instrument that many feared.

There’s a nice line in the movie *Syriana*, in which a lawyer investigating a major oil-company merger notes that “we’re looking for the illusion of due diligence” rather than the real thing. Could Say-on-Pay diligence also be an illusion?

The SEC would certainly say “no” to that question. While it has given smaller public companies with annual revenues under \$75 million until 2013 to comply with Say-on-Pay provisions, the SEC continues to pursue implementing the provisions of Dodd-Frank.

The SEC has identified about 40 sections of Dodd-Frank for which it will adopt rules in 2012, including key aspects of corporate governance related to Say on Pay that it will address by June:

- * **Section 952.** Adopt exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; and adopt disclosure rules regarding compensation consultant conflicts-of-interest.
- * **Sections 953 and 955.** Propose rules regarding company disclosure of pay-for-performance, pay ratios, and hedging by employees and directors.
- * **Section 954.** Propose rules regarding the recovery of executive compensation.



SETBACK AND COUNTERMEASURE

The SEC had a setback in July 2011, when Rule 14A-11, the “proxy-access rule,” was shot down in federal court. The regulation sought to require companies to list shareholder nominees for the board of directors in proxy statements.

The proxy-access rule would have greatly facilitated matters for shareholders, who traditionally have had to wage separate—and costly—campaigns to get their director nominees into the mix. Opponents of the rule feared its potential to advance countless special-interest agendas from all types of shareholders.

The proxy access ruling, from a three-judge panel of the United States Circuit Court of Appeals in Washington, DC, was a stern remand. The court held that the SEC had acted “arbitrarily and capriciously,” and had “failed to respond to substantial problems (about costs) raised by commentators,” but instead “inconsistently and opportunistically framed the costs and benefits of the rule.”

Furthermore, the court said, the SEC “contradicted itself” and didn’t explain how the rule would directly improve shareholder value, as the SEC had said it would.


The SEC didn’t appeal the ruling, but instead pushed ahead with a revision to Rule 14A-8 as a counter-measure, allowing shareholders to propose their own board nomination and election procedures. This Rule provided an additional way for concerned and/or activist shareholders to have their voices heard.

The major issue here is the threshold as to amount and length of stock ownership. Whereas 14A-11 set a stock ownership threshold of 3 percent (held for three years), this is an open issue with the weaker 14A-8 revisions. Informed speculation has foreseen thresholds as low as 1 percent, with holding periods as short as one year.

Boards have been advised not to act too aggressively in setting their own thresholds, lest they exacerbate what may be reasonable shareholder concerns. We should expect several entertaining jousts this season.

AND ONE FINAL NOTE

This year’s proxy season in the U.S. also marks the beginning of serious-money season for the 2012 election. Although political contributions are not covered under Dodd-Frank, corporate management now has tremendous latitude in making political donations, as granted by the Supreme Court in the *2010 Citizens United v. FEC* case.

We should expect increased shareholder scrutiny of corporate contributions to political campaigns, something that could cause unhappy shareholders to pull harder on the Say-on-Pay lever as a remedy. 

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Say on Pay – What Are Its Impacts So Far?

As many companies enter their annual proxy season, the issue of Say on Pay again presents itself. Shareholders can once more cast a vote for or against executive-compensation packages proposed by public corporations.



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.

Say on Pay is a provision of *The Dodd–Frank Wall Street Reform and Consumer Protection Act*, which was signed into law by President Obama in July 2010. Shareholder votes are non-binding, so can act as more of a nudge than something with real teeth.

It's easy enough to think of Say on Pay as something which allowed the politicians who supported it to look tough in the eyes of their constituents, while adding little to ongoing communications by major shareholders to the boards and executive teams of the companies in which they hold stock. Indeed, only about 2% of Say on Pay votes during last year's proxy season were negative.

Yet Say on Pay has had an undeniable effect on how boards set certain aspects of top-executive compensation, according to several experts whom *C-Suite Insight* recently contacted.

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

What specific impacts has Say on Pay had so far on board behavior, and what are the consequences of those impacts?

Eric Hosken Partner
Compensation Advisory Partners
New York, New York

No More Sacred Cows

Where in the past, non-performance based pay elements may have been grandfathered or slowly phased out, compensation committees are now addressing problematic pay practices head on.

With one year of Say on Pay complete, compensation committees realize there are no longer any “sacred cows” when it comes to compensation. Companies continue to move away from non-performance based pay (e.g., excise tax gross-ups, evergreen employment contracts, excessive perquisites), and the rate of change is increasing.

Eliminating elements of compensation can lead to difficult discussions between committees and management, as these changes are generally perceived as a takeaway. However, pressure from shareholders and the prospect of the Say-on-Pay vote have pushed committees to be aggressive in cleaning up compensation programs.

We expect this trend to continue in the second year of Say on Pay, as shareholders may up the ante for what they view as acceptable executive compensation practices.

CAP COMPENSATION ADVISORY PARTNERS

Eric Hosken is a partner with Compensation Advisory Partners LLC (CAP) in New York. He has over 14 years of executive compensation consulting experience working with senior management and Compensation Committees on all aspects of executive compensation, including total compensation review, annual and long-term incentive design, performance measurement and director compensation. He has worked with public and private companies across multiple industries, including consumer products, manufacturing, pharmaceutical, professional services and telecommunications.



Russell Miller Managing Director
ClearBridge Compensation Group
New York, New York

A Transparent Link

Say on Pay has renewed the focus of directors on striking the right balance between designing an effective executive compensation program that supports the company's strategic business objectives, and one that is sensitive to shareholder perspectives.

The most significant impact on board behavior has been ensuring a transparent link between pay and performance. And, as a direct consequence, compensation programs have become more performance-based.

Successfully establishing and demonstrating the pay-performance linkage is paramount to gaining majority shareholder support of the pay program. Integral to this linkage is identifying the key measures of the company's success, determining how to assess performance, and setting the payout scale.

Boards have also strengthened the pay-performance linkage by minimizing non-performance-based pay and reinforcing shareholder alignment. Directors who critically evaluate the business rationale for non-performance-based pay (such as perquisites and tax gross-ups) and use shareholder alignment tools (like stock ownership guidelines and anti-hedging policies) signal to shareholders that the company takes pay-for-performance seriously.

Ultimately, boards that succeed in having a strong and transparent link between pay and performance will achieve highly favorable Say-on-Pay outcomes.



Russell Miller is Founder and Managing Director of ClearBridge Compensation Group which specializes in executive compensation consulting. Prior to founding ClearBridge, Mr. Miller was the Managing Director of Korn/Ferry's Executive Compensation Advisors where he joined from Mercer Consulting as a

Principal in the New York office. Prior to that, he was the senior partner of the New York office of SCA Consulting, which was acquired by Mercer in 2001. Mr. Miller holds a Bachelor of Science in Economics with a concentration in Finance from The Wharton School of The University of Pennsylvania.

Robin Ferracone Executive Chair
Farient Advisors
Pasadena, California

Beyond the Tipping Point

Say on Pay is both the manifestation and cause of a long march towards greater conservatism in executive compensation by boards. In anticipation of Say on Pay, boards heightened their vigilance around poor pay practices that were not necessarily good for shareholders, and drove the majority toward more shareholder-friendly practices, such as 50th percentile pay positioning, clawbacks, and ownership guidelines.

While we are now past the tipping point, we expect boards to continue their vigilance in four areas:

1. Pay that is appropriately sensitive to performance, in good times and bad
2. Reasonable pay levels given the company's size, industry, and performance
3. Pay practices that withstand the test of good governance
4. More proactive, direct, and clear communications with shareholders.

Boards will continue to push for improvements in these areas. No board wants anything less than a solid majority "yes" vote on Say on Pay.



Robin Ferracone is the Executive Chair of Farient Advisors LLC, an executive compensation and performance advisory firm. She is the author of the book *Fair Pay, Fair Play, Aligning Executive Performance and Pay* and writes a weekly "Executive Pay Watch" blog for Forbes.com.

Laura Thatcher Partner
Alston + Bird
Atlanta, Georgia

The Stakes are Quite High

The proliferation of shareholder “strike” suits following on the heels of failed Say-on-Pay votes in 2011 may be more than just a nuisance to defend.

While the legal theories are tenuous under well-developed Delaware law, plaintiffs are steering clear of Delaware courts. In one instance, a Federal court applying Ohio law allowed the suit to survive a motion to dismiss, implying that the mere fact of a failed Say-on-Pay vote was sufficient, at the pleadings stage, to get past the presumptive protection of the business judgment rule.

The Say-on-Pay suits allege breaches of the duties of loyalty and good faith, which are not shielded from liability under state law. Moreover, a director found liable for disloyalty or bad faith would not be entitled to indemnification and would likely be uninsurable — all reasons why the stakes are quite high for directors in these Say-on-Pay suits, and why they should strive to achieve a positive Say-on-Pay outcome.

Christine McCarthy Partner
Orrick, Herrington & Sutcliffe
Menlo Park, California

Companies Are More Proactive

Companies have been much more proactive about reaching out to investors to discuss compensation programs and gather feedback. Directors now spend a fair amount of time focusing on how compensation programs will be “perceived” by investors.

This focus on perception will sometimes drive changes to a compensation program, or in extreme cases rejection of a compensation program.

This can happen even though directors may feel strongly that the compensation program is appropriately structured to drive maximum performance to achieve corporate objectives, and/or is fair and justifiable given the performance of the company and relevant executives. It can happen even if, additionally, directors strongly believe in the value that would be potentially delivered through the program.

Having said that, it seems that directors have generally been doing a good job striking a balance between shareholder concerns and their fiduciary duties; to act reasonably and prudently in the best interest of the company; and to craft compensation programs thoughtfully that are in the best interests of the company and shareholders.

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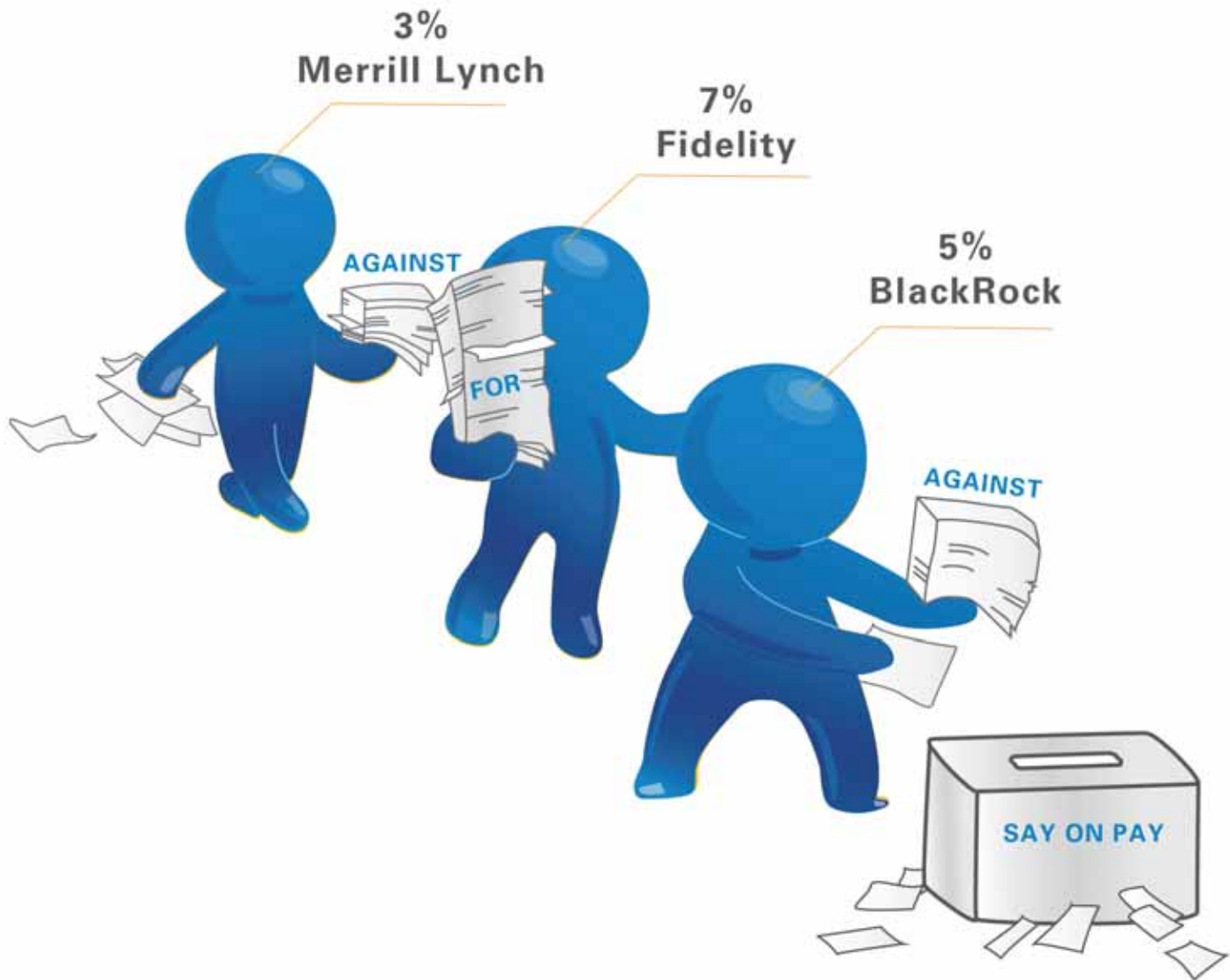
Laura Thatcher heads Alston & Bird’s executive compensation practice. She developed executive compensation as a separate specialty area of the firm’s tax practice in 1995 and now works exclusively in that area.

ORRICK



Christine McCarthy 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.

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INTERVIEW WITH **KATHERINE RABIN**

Katherine Rabin has been CEO of Glass Lewis since April 2007. Ms. Rabin joined the leading investment research and global proxy advisory firm shortly after it was founded in 2003 and became part of the original management team, overseeing various strategic initiatives during the company's key growth phases.

Prior to becoming CEO, she was Senior Vice President at Glass Lewis, responsible for Operations. Before joining Glass Lewis, Ms. Rabin was vice president of communications at supply chain management company QRS Corporation, where she helped create the company's investor relations program.

C-Suite Insight spoke with her recently about what she sees as the important issues for this proxy season.

"IF A COMPANY DOES A GOOD
JOB OF EXPLAINING — WE'RE
GOING TO LISTEN TO IT."

C-Suite Insight: Your firm has just completed a report on Say on Pay in proxy season 2011. Can you name a few companies in your opinion that did especially well?

Katherine Rabin: Sure. In doing our analysis of Say on Pay proposals, we rate the compensation disclosure and structure on a three-level scale: good, fair and poor. For the 2011 season, we rated 42 companies as good in both the disclosure and structure categories. A few spring to mind as especially good, including Entergy Corporation, PartnerRE Limited, Coca-Cola, Grainger,

Waste Management, and Newmont Mining. (Editor's Note: See the list below of all 42 companies.)

CSI: How many companies did you rate, and how many were in the other two categories?

KR: In the 2011 proxy season we rated 1,690 companies in all. However, we have been providing these ratings for S&P 500 companies for the past three years, which has helped us identify some trends.

Companies have improved plan design considerably. We found

fewer companies had poor compensation structures – just 15 percent in 2011 compared to 36 percent in 2010. On the other side of the scale, the good ratings increased, from 9 percent to 12 percent. We also saw a marked improvement in disclosure, with poor ratings dropping from 19 percent to 5 percent, and good ratings climbing from 15 percent to 22 percent year over year.

CSI: What did the 42 most highly rated companies do to merit this rating?

KR: A lot of it comes down to how well they tell their

The following 42 companies have received the highest ratings from Glass Lewis in 2011 for both executive compensation structure as well as the level of the related disclosure:

AGL Resources Inc.	Coinstar, Inc.	McDermott International, Inc.	South Jersey Industries, Inc.
ALLETE, Inc.	Colfax Corporation	Newmont Mining Corporation	Spectra Energy Corp
Amedisys, Inc.	Cypress Semiconductor Corporation	Northeast Utilities	State Street Corporation
American Axle & Manufacturing Holdings, Inc.	Deluxe Corporation	Northwest Natural Gas Company	The Coca-Cola Company
Berkshire Hathaway Inc.	Entergy Corporation	NorthWestern Corporation	The Home Depot, Inc.
Black Hills Corporation	First Financial Corporation	Owens & Minor Inc.	The Williams Companies, Inc.
C.H. Robinson Worldwide, Inc.	GrafTech International Ltd.	PartnerRe Ltd.	Triple-S Management Corporation
Calgon Carbon Corporation	Great Plains Energy Incorporated	Portland General Electric Company	W.W. Grainger, Inc.
CenterPoint Energy, Inc.	Hawaiian Electric Industries, Inc.	Provident Financial Services, Inc.	Waste Management, Inc.
Checkpoint Systems, Inc.	HealthSouth Corporation	Sauer-Danfoss Inc.	Weis Markets, Inc.
CMS Energy Corporation	Hospira, Inc.		

WE SAW A MARKED IMPROVEMENT IN DISCLOSURE, WITH POOR RATINGS DROPPING.

story in the CD&A section of the proxy. In contrast, sometimes I see companies dinged simply for having bad disclosure. If they had done a better job of telling their story, we would probably have recommended approving their say on pay proposals.

The things you see in common among the highest rated companies—even though these companies are not uniform in structure—are they all have performance-based STI and LTI plans and prevalent risk-mitigation elements. For instance, their plans feature explicit clawbacks or anti-hedging policies, minimal change-in-control issues, and a reasonable balance in internal pay equity among the named executive officers.

CSI: Even so, some companies are better at explaining all this than others, right?

KR: Yes, it's not just about the facts and the details of the comp plans, but the rationale for certain committee decisions. I think there is the perception proxy advisors sometimes just "check the boxes." But we have always wanted to look

at the companies. We look at them in the context of their own business realities, taking into consideration the size and the industry they're in.

When it comes to Say on Pay, if a company does a good job of explaining why, for example, a discretionary award was needed, a retention grant was given to an executive, or even why or how certain performance metrics were chosen to align with the company's business strategy—we're going to listen to it.

CSI: Doesn't sound like "check the box" at all.

KR: Right. It's not as if everyone on the list of 42 had exactly what fits the Glass Lewis guidelines. It has to do more with how they told their story, how they made us feel comfortable in what was being paid was in fact earned.

CSI: What issues other than Say on Pay are of high importance to you right now?

KR: Proxy access. You know, after the SEC lost its legal case on 14A-11, we won't know whether there will be many proxy access proposals, or whether the institutional and investor community is going to focus on putting proposals at a smaller group of companies and hoping they get support for them. So it's something we're closely watching. Seventeen have been filed so far and it is unlikely the SEC will allow them to be excluded.

There's also the issue of corporate political donations because of *Citizens United v. FEC*. I think you're going to see a number of shareholder proposals in this area.

A third issue, albeit to a lesser extent, involves board leadership issues, such as, the separation of the chairman and CEO, and succession planning. The latter is

especially topical in light of issues raised over the past 12 months at HP, Apple, and News Corp.

CSI: How about independent board members? Is this an issue?

KR: Yes, in an interesting way. I don't want to suggest the focus on independence is going away, but there is definitely a greater focus on diversity. By this, I don't particularly mean gender and ethnic diversity, but also diversity of experience. How do you balance it? CalPERS and CalSTRS, with their new Diversity Director Data-Source, is a great example of this trend.

CSI: When we launched this publication a couple of years ago, we started by looking at risk, because

we were right in the midst of the Great Recession. Looking at things today, what role do you think Say on Pay could play to mitigate what we might call unwarranted risk?

KR: In a nutshell, I think you can incentivize any type of behavior and very easily tie it into the risks you're taking. Thus, mitigating risk through the prudent selection of targets and timeframes for compensation is a good thing.

For example, many boards come to realize discretionary bonuses shouldn't be the primary vehicle for linking short-term pay with performance. We've seen more than 75 percent of the companies we analyzed that had a performance-based short-term incentive plan. This was encouraging.

CSI: Good news there.

KR: However, we also found the adoption of performance-based, long-term incentives was not as prevalent. Only 56 of the companies granted LTI awards subject to vesting for even a portion of the award on the basis of performance criteria during the past fiscal year. This practice was more common among S&P 500 companies than smaller companies.

CSI: How did "The Group of 42" do?


KR: They had good structure and good disclosure. Among those companies you'll find there are incentive plans based on multiple measures, which provide a better picture for the company than a single metric.

MITIGATING RISK THROUGH THE PRUDENT SELECTION OF TARGETS AND TIMEFRAMES FOR COMPENSATION IS A GOOD THING.

CSI: How so?

KR: Having just a single metric can focus management on a single target which may encourage excessive risk taking. Without multiple metrics for measuring performance, you have the ability to incentivize—if unintentionally—bad behavior, behavior that presents risk. Think of Home Depot, where the single target was revenue. The company hit it, but the stock price went nowhere.

CSI: So you're seeing stronger ties between performance and compensation. But in a 24-hour global market where companies live and die by quarterly results, isn't it still difficult to get LTI as significant a factor as you want to see?

KR: This is the reason given, but they need to do better. 

A Brief History of Glass Lewis

[Note: The following comments were made by Glass Lewis CEO Katherine Rabin during our interview with her.]

Greg Taxis and Kevin Cameron had the idea for the company, and are both from the San Francisco Bay Area. Although much of our North American market is on the East Coast, there were some advantages to being different, and we were definitely looking to be different.

We weren't originally going to be a proxy advisory firm. Greg and Kevin envisioned doing proxy analysis, but this was going to be an element of a larger independent investment research service focused on issues of corporate integrity, including governance, accounting risk, legal risk, political risk, etc.

They put together a team with lawyers, accountants, and people with Wall Street or finance backgrounds, which was definitely a different mix than what historically had been applied by other proxy advisors.

We don't believe you can apply one policy to all companies in a market irrespective of size and industry. I spent a lot of time as a journalist prior to coming to Glass Lewis, and I don't see how you can look at the corporate governance of a large-cap consumer-products company the same way you would look at a small-cap information-technology company. No portfolio manager would look at those companies the same way.

When Glass Lewis was launched, activism was no longer just for activists. Our launch coincided with the emergence of what we call "the governance enthusiast." Within companies, the job of voting proxies was moving from the back office to the front office, involving portfolio management and client services, among other departments. The people within investor organizations responsible for proxy voting were changing and were becoming more sophisticated. They were increasingly looking to vote according to their own policy rather than someone else's.

So we think we came in at the right time with a new business model. We hit the sweet spot with institutions looking for a qualified advisor who would help them implement their custom policies and support their custom engagement programs.



Who Are Your Real Peers?

New Equilar Peer Group
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Make the Call

The Dodd-Frank Act, which became effective in late 2010, has already had a pronounced impact on executive compensation by increasing public scrutiny and awareness of the details of executive pay packages. Because of this increased public attention, public companies must now justify executive compensation practices to shareholders, regulators, the media, and the general public.



One of the most widely accepted methods of determining compensation packages is by benchmarking pay levels against a predefined peer group. In using benchmarking, a company's choice of peers can have a significant impact on the ultimate scope and scale of executive compensation.

The SEC requires companies to disclose all peer companies used as part of the pay-determination process. In addition, the SEC requests that information about the process of determining peers be included in the proxy statement. With this increased SEC scrutiny, firms must have a clear understanding and explanation of who their benchmarking peers are, why they're considered peers, and the process by which they have been selected.

To examine the mechanics of how companies choose their peers, Equilar used its Peer Group Dashboard product to study the peer groups of S&P 1500 companies. The analysis compared the percentile rankings of companies against those of their disclosed peers. This Equilar report offers information on peer group size, revenue, total shareholder return, CEO compensation, and more.

WHAT DOES A PEER GROUP LOOK LIKE?

For fiscal 2010, 83.4 percent of companies in the S&P 1500 disclosed the firms comprising their peer group.

S&P 500 companies were most likely to disclose peers, with 90.0 percent reporting, while 84.1 percent of the S&P MidCap 400 and 77.2 percent of the S&P SmallCap 600 disclosed peers.

Of the companies that disclosed peers, 55.8 percent of the S&P 1500 made at least one change in their peer group from the previous year. The percentages of other company groups modifying their peer groups were: S&P 500, 57.3 percent; S&P MidCap 400, 57.6 percent; and, S&P SmallCap 600, 52.8 percent.

Tables 1 lists the ten most frequently referenced firms and the number of companies that use these firms as benchmarks, arranged by index.

Company Name	No. of References
--------------	-------------------

S&P 1500

3M	58
Johnson & Johnson	55
Pepsico	52
Honeywell International	48
General Mills	47
United Technologies	47
Kellogg	46
Colgate Palmolive	45
Eaton	44
Procter & Gamble	44

S&P LargeCap 500

3M	56
Johnson & Johnson	53
Pepsico	50
Honeywell International	45
United Technologies Corp	45
General Mills	44
Procter & Gamble	44
Colgate Palmolive	43
Kellogg	41
Emerson Electric	40

S&P MidCap 400

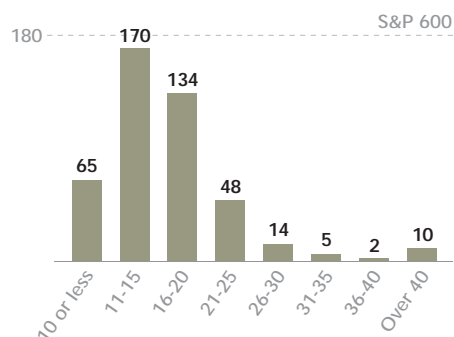
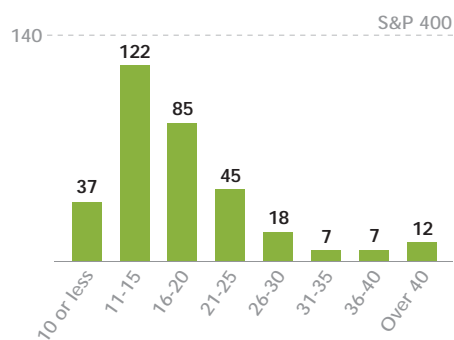
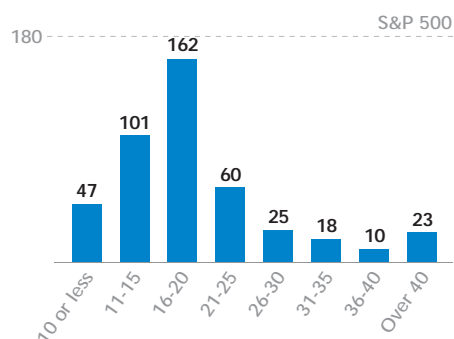
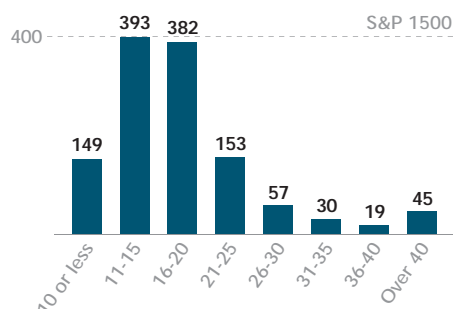
Flowserve	19
Donaldson	17
Dover	17
Abercrombie & Fitch	16
Ametek	16
Cullen Frost Bankers	16
American Eagle Outfitters	15
Commerce Bancshares	15
Limited Brands	15
Roper Industries	15

S&P SmallCap 600

Graco	19
Cymer	18
Mks Instruments	17
Coherent	16
Firstmerit Corp	16
Ilex	16
Brooks Automation	15
Fuller H B	15
Chico's FAS	14
Esco Technologies	14
Veeco Instruments	14

Table 1

Peer Group Size Prevalence



Tables 2-5

HOW DO PEER GROUPS BREAK DOWN BY SIZE?

For the entire S&P 1500, the average number of firms disclosed in a company's peer group was 19, while the median was 16. Also in the S&P 1500, 32.0 percent of companies disclosed 11 to 15 peers, and 63.1 percent disclosed 11 to 20 firms.

Only 12.1 percent of companies disclosed peer groups that have 10 peers or less, while 3.7 percent of companies featured peer groups with more than 40 peers.

Separating the S&P 1500 into the S&P 500, S&P MidCap 400 and S&P SmallCap 600 reveals that peer groups of companies in the S&P 500 generally contain more peers than those in the other indices.

The average size of peer groups was: in the S&P 500, 21.2 firms; S&P 400, 19.0 firms; and for the S&P 600, 17.4 firms. The median number of firms per peer group was: S&P 500, 18 firms; S&P 400, 16 firms; and S&P 600, 15 firms.

For the S&P 500, the most common number of peer groups considered was 16 to 20 peers. Comparatively, the most common range for the S&P 400 and S&P 600 was 11 to 15 peers.

For the S&P 600, 82.4 percent of companies had 20 or fewer firms in their peer groups, compared to 73.4 percent for the S&P 400, and 69.5 percent for the S&P 500.

Tables 2 through 5 show peer group sizes, arranged by index.

WHO ARE A COMPANY'S PEERS, REALLY?

When selecting a peer group, companies often select peers within the same industry as their own.

In fiscal year 2010, an average of 75.3 percent of all peers selected belonged to the same industry as the benchmarking company. The median percentage of peers selected in the same industry was 85.7 percent, and within the S&P 1500 companies, 57.0 percent of companies selected 80 to 100 percent of their peers within their own industry.

Table 6 shows the percentage of S&P 1500 companies that use peers in the same industry. For this analysis, the first digit in the company's SIC code was compared to those of its peers'. The y-axis represents the number of companies in each percentage range.

Revenue is also a major factor in the peer determination process. To identify how companies use revenue as a metric for selecting peers, Equilar compared each company's revenue to that of its peers.

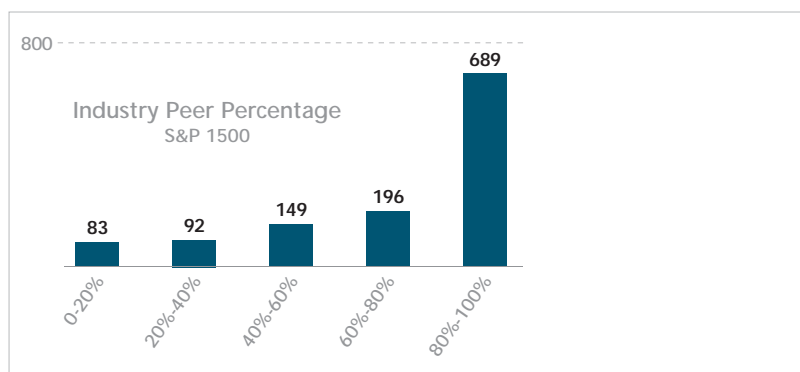


Table 6

The percentile rank represents the relative position of the company within its peer group. For example, a company at the 50th percentile revenue rank has a peer group in which half of its peers have lower revenue and half of its peers have higher revenue.

Considering peer groups this way, 62.1 percent of selected peers had revenues that were 0.5 to 2.0 times the company's revenue, a common rule of thumb for determining relevant peers. In addition, 80 percent of peers had 0.6 to 3.6 times a company's revenue, and 90 percent had 0.5 times to 5.8 times.

Table 7 shows the distribution of revenue percentile rankings among the S&P 1500. The y-axis shows the number of companies that fall into each percentile range. The "Above" and "Below" categories depicted in the chart capture companies that have revenues that fall outside of the peer-group revenue range.

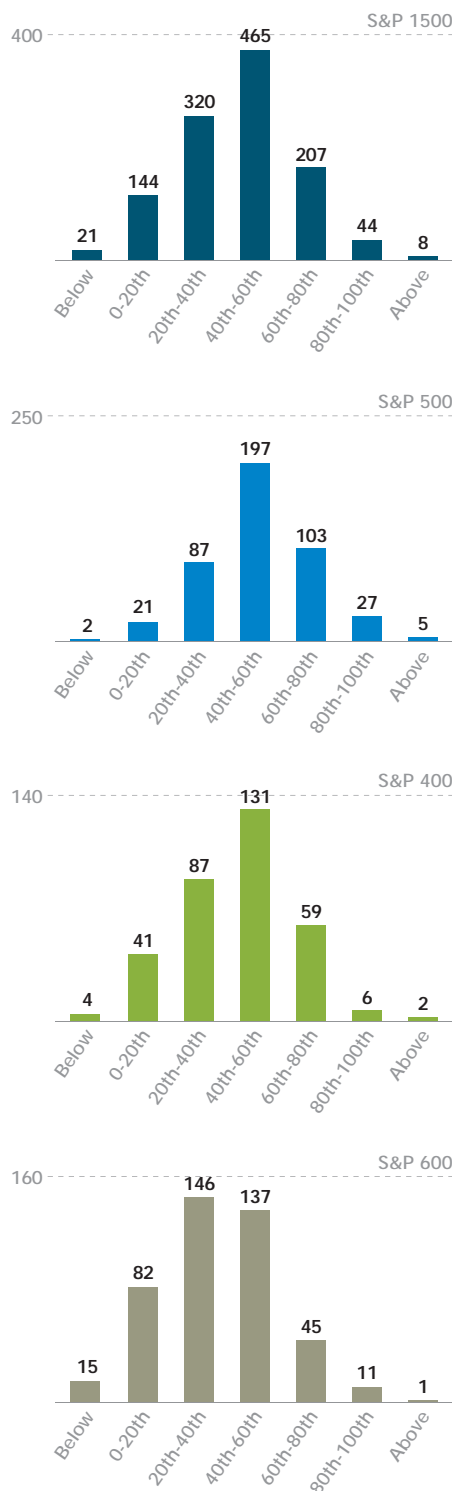
Analyzing the data for the S&P 500, S&P MidCap 400 and S&P SmallCap 600 groups reveals that S&P 400 and S&P 600 companies tend to benchmark against firms with more revenue, while companies in the S&P 500 typically benchmark against companies with less revenue.

These revenue figures are not surprising, given that the S&P 500 is composed of the largest public companies in the United States. The most common revenue percentile range for the S&P 500 and S&P MidCap 400 was the 40th to 60th percentile. In comparison, the most common percentile range for companies in the S&P SmallCap 600 was the 20th to 40th percentile.

Looking at the medians and averages for each S&P index reveals that the smaller the market capitalization, the lower the company's revenue percentile rank. The median percentile rank for the S&P 500 was 52nd; S&P 400, 45th and S&P 600, 37th, respectively. The corresponding average percentile ranks were the 51st, 44th, and 38th percentiles.

Tables 8 through 10 present the distribution of revenue percentile rankings among the S&P 500, S&P MidCap 400 and the S&P SmallCap 600. The y-axis of each chart shows the number of companies that fall into the percentile ranges on the x-axis.

Revenue Percentile Rank vs. Peer Group



Tables 7-10



S&P 1500 COMPANIES GENERALLY TARGET THE MIDDLE OF THEIR PEER GROUP AS THE DESIRED LEVEL OF CASH COMPENSATION.

CEO TDC & TCC

One of the primary purposes of peer groups is to provide a benchmark against which to determine total direct compensation (TDC).

Analyzing how companies in the S&P 1500 pay their CEOs in comparison to their peers reveals that companies generally target the middle of their peer group as the desired level of compensation.

The most common percentile range was from the 40th to 60th percentile, which accounts for 25.7 percent of companies. The higher prevalence of companies in the 0 to 40th percentiles (39.0 percent of companies) compared to the 60th to 100th percentiles (28.9 percent of companies) indicates that a majority of companies had smaller pay packages than the firms they determined to be peers.

In fact, the median and average CEO TDC percentile rank were both in the 47th percentile (for companies whose TDC fell within that of its peer group). Table 10 illustrates these findings.

Similar to TDC, peer groups are used to provide a benchmark to establish total cash compensation (TCC).

The distribution of TCC percentile rankings indicate that companies in the S&P 1500 generally target the middle of their peer group as the desired level of cash compensation.

The most common percentile range was the 40th to 60th percentile, which accounts for 23.9 percent of companies. The slightly higher prevalence of companies in the 0 to 40th percentiles (35.6 percent of companies), compared to the 60th to 100th percentiles (32.7 percent of companies), indicates that more companies had smaller cash compensation packages than their peer firms.

Moreover, the median and average CEO TCC rank were both in the 49th percentile. Table 11 illustrates these findings.

TDC Percentile Rank vs. Peer Group

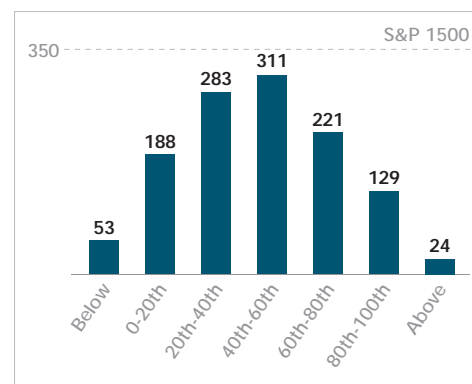


Table 10

TCC Percentile Rank vs. Peer Group

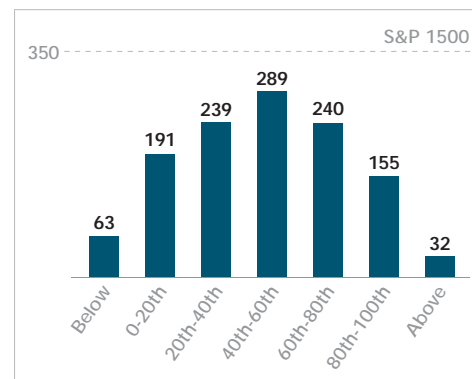


Table 11

A Market-Based Approach to Peer Groups

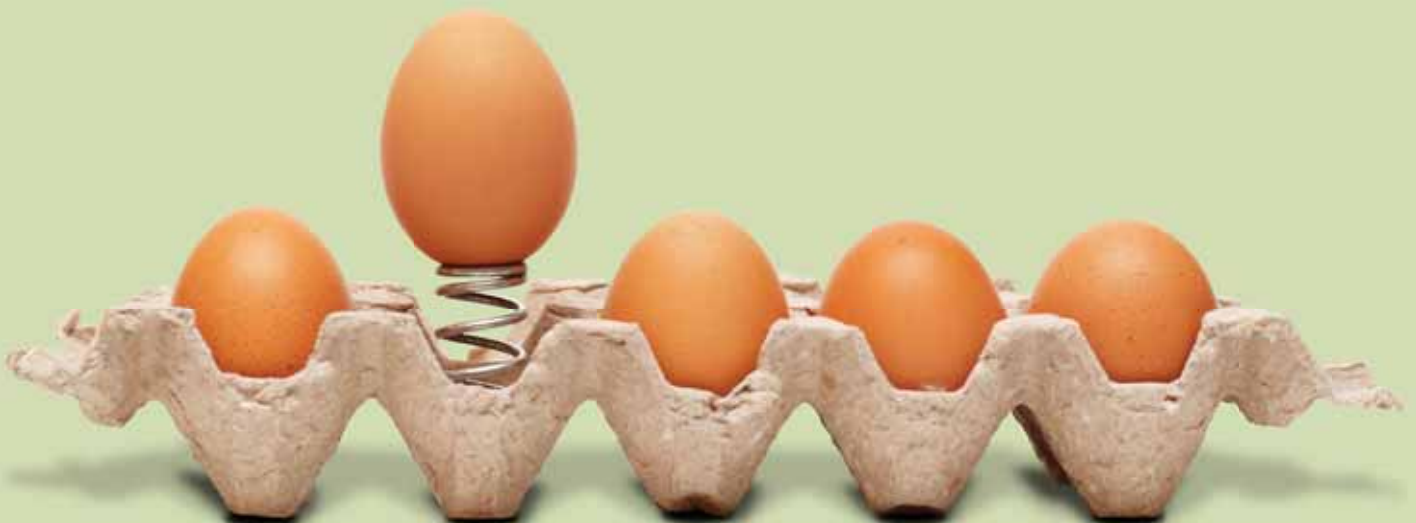
The challenges of peer group selection for executive compensation benchmarking are widely understood. It's hard enough to identify the right set of companies—who to include, who to exclude? But now the traditional ways of identifying peer groups are facing significant scrutiny from institutional investors and their advisors. With the inherent difficulties and increasing scrutiny of peer group selection, how should executive compensation professionals think about, develop, and justify a peer group?

Traditionally, peer-group development methods have focused on two factors: size indicators such as revenue, and strictly-defined industry designations such as GICS. However, these methods oversimplify the complex and overlapping competitive dynamics that exist in the marketplace.

As such, corporate professionals and industry consultants pour significant effort into determining peers based on their insider knowledge of industries and businesses within those industries. They generally begin with broad screening techniques using revenue or industry, but finalizing a peer group requires individual knowledge and judgment that cannot be captured in any directly-quantifiable financial metric. As a result, formulaic peer groups determined by these metrics can lead to strange (and arguable) selections.

In response to these challenges, Equilar has developed a new method of executive compensation peer group development, based directly on market data. This new approach brings together in an objective and quantifiable way (1) peer group disclosure for thousands of public companies, and (2) proven analytics from the social networking industry.

Since 2007, SEC regulations have required companies to list firms used in executive compensation benchmarking. In 2011, more than 80% of the S&P 1500 provided such disclosure. Information from this peer disclosure is the initial raw data input into Equilar's new market-based peer network algorithm.



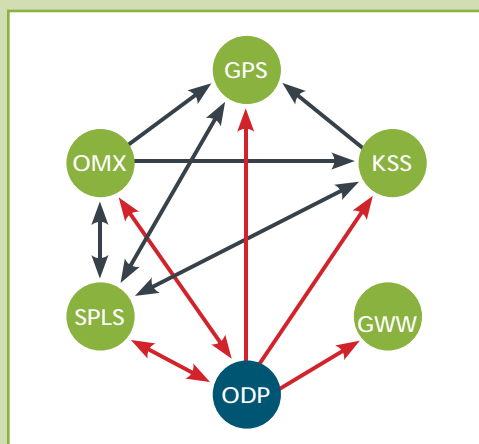


Figure 1

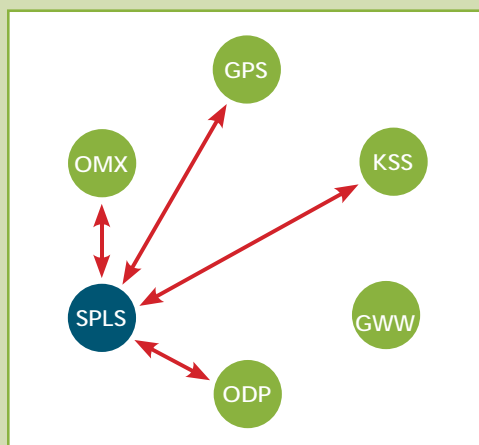


Figure 2

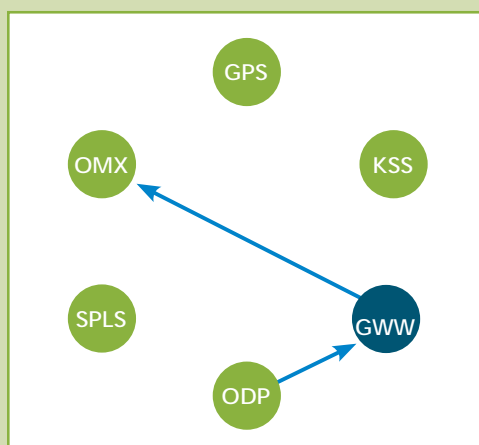


Figure 3

Equilar's algorithm then mines peer network data between companies to identify the best peer connections for any given company, similar to the way that the professional networking site LinkedIn analyzes professional connections to identify opportunities in your network, and in your connections' networks.

Connection strength between two companies in the peer network can be determined on the basis of how many connections, both distinct and mutual, the two companies make. Two companies strongly correlate if there are many connections between them, including many other companies that validate their connection. This is similar to the idea that two people are likely to know one another if they have a large percentage of their individual professional networks in common.

This market-based solution can be best understood with an example. Figure 1 shows a part of Office Depot's (ODP) actual peer network.

From this network, we can identify the companies with the strongest connections to ODP by looking for those companies that have the most connections in total within the network. Interpreted another way, these are the companies that have the most evidence of being related to ODP because the most companies in the market agree they are connected to ODP.

Figures 2 and 3 compare the respective connections for Staples (SPLS) and W.W. Grainger (GWW) in ODP's peer group. Clearly, the peer network indicates that Staples is a stronger peer for Office Depot than W.W. Grainger—a conclusion most would agree with.

Applying this algorithm across the Russell 3000, one can generate more useful peer groups that best reflect market reality. Despite ignoring arbitrary financial cut-offs and industry designations, the algorithm also generates valid peer groups according to these traditional metrics.

For example, the generated peer groups tend to place the focus company near the median by revenue (44th percentile is the average). This new, innovative approach addresses industry concerns about formulaic peers, and investor concerns about hand-picked peers, by applying an objective methodology based on market insight. **C**

TWO COMPANIES STRONGLY CORRELATE IF THERE ARE MANY CONNECTIONS BETWEEN THEM.

INTERVIEW WITH **CHIP ROAME**

Charles ("Chip") Roame is the managing principal of Tiburon Strategic Advisors, and a leading strategic consultant to CEOs and boards of directors in the brokerage, investments, wealth management, banking, and insurance markets.

Prior to forming Tiburon in 1998, Mr. Roame served in similar capacities, first as a management consultant at McKinsey & Company, and later as a business strategist at The Charles Schwab Corporation.

"THE ECONOMY WILL
IMPROVE, BUT CONSUMERS
WON'T RUSH BACK."

C-Suite Insight: We'd like to talk about the post-financial-crisis meltdown and what resulted, increased merger-and-acquisition activity, and new regulations, including Dodd-Frank. To begin, let's talk about the biggest winners, the biggest losers, and the future of mergers and acquisitions at the big wirehouses.

Chip Roame: The broad market environment has recently been driven by the economy and the markets. The economy is self-explanatory. By markets, I mean both the stock market and the housing market, because the majority of consumers' money is in their homes, not the stock market.

The housing market is down, depressing consumer wealth over the past few years, and the stock market has been down and volatile, impacting consumer sentiment and confidence.

Investment professionals say "The stock market's back, everyone's rich again." Maybe that's true for rich people, but not for Middle America. For Middle America, housing is the biggest asset. So trend number 1 is to better understand what drives consumer sentiment and consumer confidence.

The financial-services industry's recent stumbles have impacted consumer sentiment and confidence. MF Global's controversy was the most recent, but many other firms have done bone-headed things. So the broad

market is driven by consumer confidence and sentiment, and by the fact that consumers think all financial-services companies are evil.

Those two drivers have led to Occupy Wall Street, and to even more depressed consumer confidence and sentiment. Consumers are skeptical. They don't like government and they don't like financial-services companies.

CSI: So how does that relate to wealth management?

Chip: We have to look at the trends in wealth management, without considering the channel. Product polarization is a major trend, and the opposite ends of the spectrum are growing. Low-cost, indexed, exchange-traded fund products are booming, as are high-cost alternative investments packaged as limited partnerships.

For the past decade, traditional mutual funds have stagnated. More money is invested in mutual funds than in all other financial-services products combined: \$10 to \$12 trillion. And 401(k)s dominate the mutual funds. Mutual funds have stagnated in favor of indexed funds: ETFs on one end, and hedge-fund products on the other. Again, product polarization—the greatest growth is occurring in both low-cost and high-cost products.

The second trend is the breakaway broker, or the growth of independent-advisor channels. Part of that

growth is brokers leaving the wirehouses. The other part is RIAs outgrowing the wirehouses. In short, the RIAs are booming.

If I combine product polarization, independent-advisor growth, and crummy consumer confidence, I see the trends speeding up. Low consumer confidence and sentiment will cause continued growth of low-cost indexing products. Consumers won't pay high fees, driving the ETF trend, and the RIA trend will continue because it's perceived as the channel doing the right thing for customers' needs.

Again, I believe recent trends will continue and accelerate: low-cost products, indexing, and in distribution, continued movement to independents.

A third trend is the acceleration of self-serve, as people take more control of their own money. You're going to see continued growth in things like the Schwab Discount Brokerage offerings: not just the custody business for RIAs, but discount brokerage offerings as well.

I think Schwab's Independent Branch Operator (IBO) initiative, where entrepreneurs can have a franchise Schwab office, will do extremely well, because of consumers thinking "This industry is a bunch of crooks" and "I'm taking back control."

We have a bit of an outlandish ten-year prediction that says that discount brokers and banks will



exchange where they are. There are five or six thousand bank branches, but bank branches are dinosaurs. I haven't been inside a bank branch in twenty years. If you need credit, you go online. If you want low-cost savings products, you go somewhere like ING Direct.

While branch banking doesn't make sense, walking into a discount brokerage office makes a lot of sense—you have money there, and you want advice. Today, discount brokers have a handful of branches, while banks have a plethora of branches. Our belief is that in a decade you'll see Schwab and Fidelity branches all over the country, delivering investment products and advice, while banks move to the Web. Credit's credit—you don't need to go talk to a person in a bank branch to pick the lowest mortgage.

CSI: The Occupy movement drew a lot of attention to "the 1 percent" of people with substantial wealth. Who's been successful in going after the people with high net worth?

Chip: Analysts, consultants, and journalists can get this wrong very easily. Population and wealth is not 99/1—it's closer to 80/20. About 20 percent of Americans have \$1 million or more, and everyone's going after that 20 percent, or some minority of that market. There are 125 million households in

America, but to wealth managers, there are really only 20 million households that have any money.

If you look at assets alone, you would say the winners are the big banks: Northern Trust, Bessemer Trust, and even U.S. Trust. These guys have billions of dollars, but it's legacy money. It's been there a long time.

But if you measure flows and look at where the guy who got rich recently is putting his money, you conclude that the RIA market is winning. These are very narrowly the upscale RIAs, the Convergent Wealth Advisors. They've gone from nothing 10 or 20 years ago, to having \$10 billion or \$20 billion of assets today—and there's no bank!

CSI: The growth of RIAs is somewhat due to a decrease in technology costs, and somewhat due to the tarnishing of wirehouses' brands. So there are a lot of reasons to go to the RIA. Now companies are providing technology that allows RIAs to compete for the upscale market. Since you were recently on the board of Envestnet, can you talk about the technology companies?

Chip: For many years, the independent-advisor channel was a disorganized set of people doing business in a bunch of different ways. But over the last 15 to 20 years, custodians have emerged,

THERE'S BEEN A BIG CHANGE IN WHO'S BENEFITING FROM NEW TECHNOLOGY.

the independent broker-dealers have grown up, and players like Envestnet have jumped in to fill the need for technology.

There are lots of good technology companies providing single-point solutions. But the objective of companies like Envestnet is to be the whole platform. They may be partnering on some of the pieces of technology, but primarily, they're doing it all.

Over the past 15 years, there's been a big change in who's benefiting from new technology. Captive channels—the wirehouse brokers, insurance agents, and private banks—once had proprietary technology. Their technology was better, and they had marketing budgets and brand names—stuff the independent channels didn't have. But recently, it's become almost the exact opposite.

Today, products are everywhere. If you want to buy a Dreyfus fund or a T.R. Price Fund, or if you want separate account-manager access to Brandes or to the Highbridge hedge fund, you can get it in any channel. Because of this freedom, no one has any leverage over customers or advisors merely because of their channel.

INTERVIEW

CHIP ROAME, TIBURON STRATEGIC ADVISORS

Secondly, the technology is actually now better in the independent channel. Envestnet is a good example. An amazing number of the largest independent BDs are using their technology, as are insurance companies. They have become a cutting-edge, industry-utility technology.

Third, the reputations of the wirehouses have fallen. Once, their phones would ring just because they were Merrill Lynch, or Morgan Stanley. If you gave someone your business card, they knew Merrill Lynch. But that has reversed itself completely. Consumers have read about those firms' stumbles, and they're turned off.

CSI: Among independent advisors, who is doing well, and why?


Chip: Independent advisors are easy to profile because they file an ADV, they have a brochure, they have their own website. It's more difficult to profile the successful wirehouses, because an advisor's website is part of the company's website, or their brochure has to include the firm's attributes.

First of all, the independents today all have a sales and marketing strategy. It doesn't matter what the strategy is, but they have one. So if I'm an aspiring advisor, I've got to pick a sales and marketing strategy and execute it. Why?

Because the successful advisors have one.

Similarly, the big advisors all have technology strategies. An amazing number of them outsource tech now, while 10 or 15 years ago, it was all inside. Large firms like Edelman Financial Services are outsourcing their back office because they understand that's not their core capability.

Third, the successful independents have a thoughtfully developed staffing and organizational strategy. They have equity-compensation plans and thoughtful bonus plans. They're more likely to have Chief Operating Officers who run the business, and Chief Investment Officers who only manage the money.



Recruiting a board member?



CSI: What do you see as the big-picture trends for 2012?

Chip: For 2012, there are two wild cards. Number one is the regulatory environment, as related to the election, and number two is M&A activity.

On the regulatory front, you have to decide what you think is going to happen with Dodd-Frank and the election. The more conservative the Republican nominee, or the more Republicans elected to Congress, the more likely Dodd-Frank is to come under attack.

The other wild card is the M&A environment. Right now, a lot of financial-services companies have cash they need to spend, and a

whole lot of companies lack cash right now and are probably for sale. This will cause a rebound in M&A activity, including financial-services companies.

Barring the wild cards, my prediction is "more of the same." The market and economy will likely just bumble along and do fine. The economy will improve, but consumers won't rush back. Consumers are permanently scarred—maybe scarred and scared at the same time. They're more skeptical. You'll continue to see product polarization, where people want low-cost indexing products.

In addition to polarization, the growth of the indepen-

dent-advisor channel will continue. I expect one or two of the wirehouses to create some kind of halfway house where advisors are partly independent, so they can hang onto their advisors.

And number three, self-serve channels will continue to grow. Online banking is booming, discount brokerages are booming. I'm a big fan of the Schwab IBO franchisee strategy. And Fidelity or T.R. Price might do something similar.

Consumer skepticism will continue to drive those three trends: the indexing trend, the independent advisor trend and the self-serve trend. **C**

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A NEW LOOK AT VOTING ANALYTICS

ANALYSIS OF VOTING RESULTS AND PERFORMANCE IN THE RUSSELL 3000

SINCE THE PASSAGE of the Dodd-Frank Act—the set of new SEC regulations includes a provision requiring companies to provide shareholders with an advisory vote on executive compensation, more commonly known as Say on Pay—the results of annual meetings have drawn increased interest. For the first time, shareholders have the opportunity to indicate their specific approval of (or dissatisfaction with) a company's pay practices.

With additional pressure from proxy-advisory firm recommendations, the new law has led many companies to increase their communication with shareholders and re-evaluate their compensation and corporate-governance practices.

Companies have mostly won approval from shareholders for their pay packages. As of June 30, 2011, only 38 companies in the Russell 3000 had failed their Say-on-Pay votes and almost 75 percent of firms not only won their votes, but did so with 90 percent or higher approval.

To gain a better understanding of the factors behind voting outcomes, Equilar compared voting results to a handful of key performance metrics. A new Proxy Voting Analytics tool created by Equilar also enabled the analysis of voting results for equity incentive plans, offering a broader look at shareholder responses to compensation-related votes.

(This article is based on a report from Equilar Inc. entitled, "Voting Analytics." For information about the new Proxy Voting Analytics tool, please email info@equilar.com.)

PERFORMANCE, VOTING RESULTS, AND TSR

The analysis examined voting results at 2,252 companies from the Russell 3000 that held their annual meetings between January 21 and June 30, 2011. Table 1 shows the distribution of companies according to their Say-on-Pay approval rates.

As companies work to align pay with performance, they have increased their focus on performance-based incentives. In a recent study of CEO performance metrics at S&P 1500 companies, for example, Equilar found the most prevalent metric in short-term incentive plans was earnings (including both net income and earnings per share). The most prevalent metric in long-term incentive plans was total shareholder return (TSR), followed by the aforementioned earnings measurement.

Comparing these performance metrics, as well as CEO pay growth to approval rates for Say on Pay; defined performance quartiles as shown in Table 2.

The prevalence of companies using TSR as a performance metric has continued to increase over the past several years. It is now one of the most widely used metrics for determining the overall success of a company and the performance of its executives.

As one might expect, the number of companies with bottom-quartile performance in one-year TSR decreased as approval votes increased. It is interesting to note among those companies receiving greater than 90 percent approval, over 20 percent still had a bottom-quartile TSR ranking.

Table 3 shows the distribution of companies by performance that fall into each voting bracket for one-year total shareholder return.

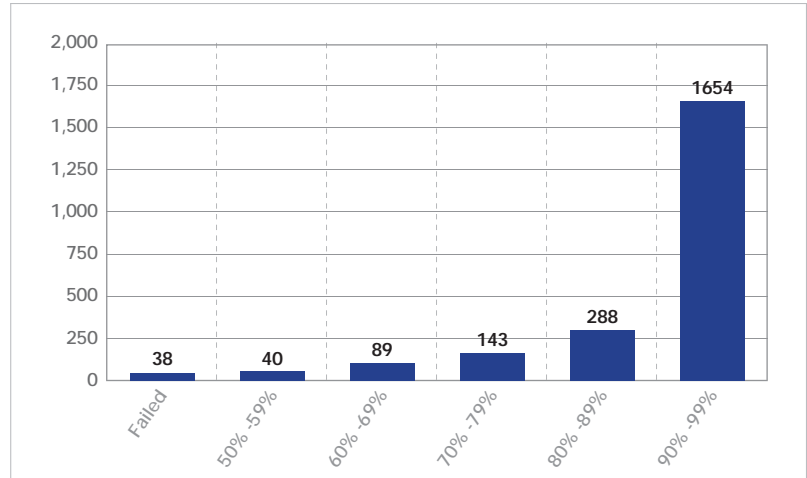


Table 1

Performance	1-Year TSR	3-Year TSR	3-Year Net Income Growth	2010 CEO Pay Growth
25th Percentile	4.6%	(11.5%)	(48.7%)	(4.7%)
Median	21.0%	(0.1%)	4.4%	20.2%
75th Percentile	45.7%	8.6%	74.2%	67.8%

Table 2

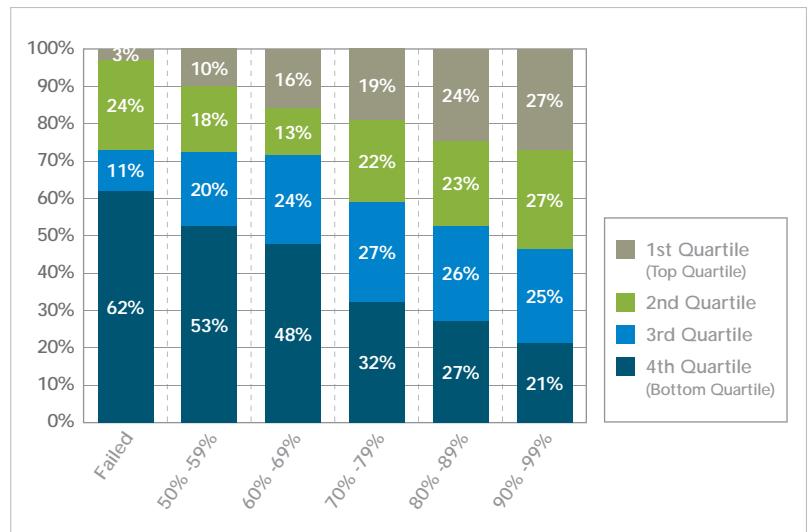


Table 3

THE LONGER TERM

Shareholders are considering more than just one-year returns. There is a steady decline in lower quartile companies (by voting bracket) when looking at three-year total return. The number of companies achieving above-median returns over the previous three years increased from 14 percent among those that failed their votes to 60 percent among companies receiving at least 90 percent of the vote.

Contrasted with the one-year chart, the approval votes more consistently align with the three-year returns. Table 4 shows the distribution of companies that fall into each voting bracket for three-year TSR.

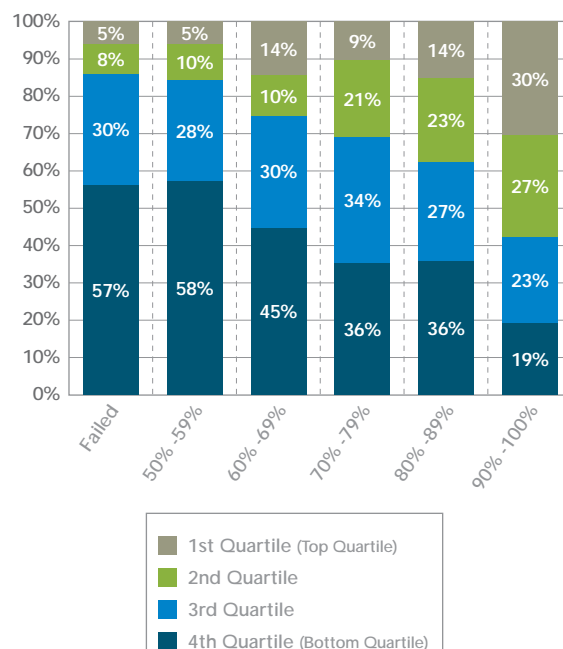


Table 4

NET INCOME GROWTH

Earnings have historically been the most prevalent metric in incentive plans for S&P 1500 CEOs for all performance periods, driving many of the changes in pay. In line with the TSR results, there was a decline in lower-quartile companies as the approval percentages increased.

The findings also showed a greater focus on long-term results. The percentage of companies with below-median performance decreased from 71 percent to 46 percent when measured against three-year net income growth. When measured against one-year net income growth, the percentage of below-median companies decreased from 58 percent to 50 percent. Table 5 shows the distribution of companies by performance that fall into each voting bracket by three-year net income growth.

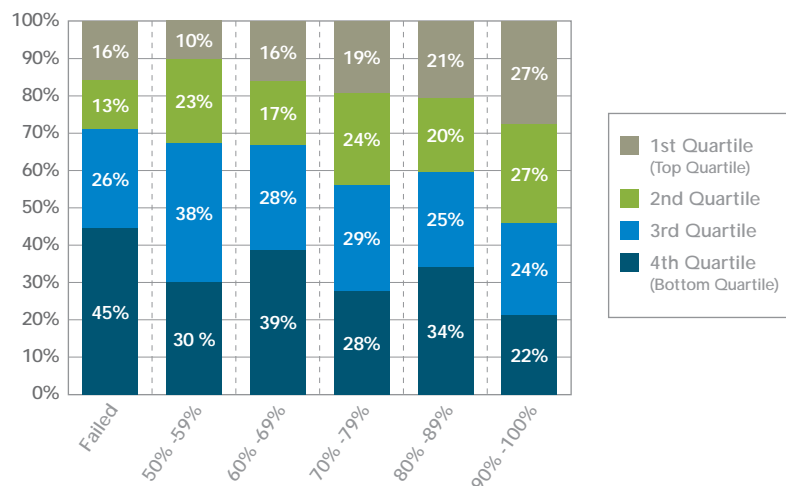


Table 5

COMPANIES WITH THE BIGGEST JUMPS IN PAY OVER THE PAST YEAR WERE MORE SUSCEPTIBLE TO NEGATIVE VOTES.


CEO PAY GROWTH

A major concern for companies undergoing Say on Pay was the recommendation practices of proxy advisory firms. Equilar utilized a scope of analysis similar to many advisory firms, which focus heavily on one-year growth in pay. We found one-year growth for failed companies far outpaced the pay for CEOs at companies receiving 90 percent or higher approval of their compensation.

Based on this analysis, it appears the companies with the biggest jumps in pay over the past year were more susceptible to negative votes than those with smaller changes. Table 6 shows the median CEO pay growth by voting bracket.

EQUITY INCENTIVE PLANS

Say on Pay is not the only compensation-related matter on which shareholders are asked to weigh in. Shareholders are also regularly asked to approve new or amended equity incentive plans. These plans are used to grant shares to executives, key employees, and directors.

Through use of the new Proxy Voting Analytics tool, it was found that among the 2,252 companies included in this analysis, 686 presented equity incentive plans subject to shareholder approval. Over half of these plans were passed with 86 percent or more of the vote, while only six plans failed. As they did for Say on Pay, shareholders showed strong support for companies' requests for new or additional shares. Table 6 illustrates these results. 

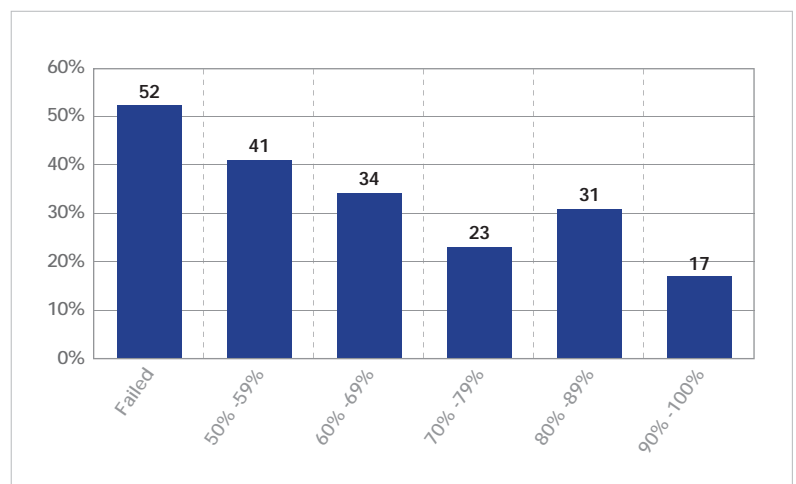


Table 6

INTERVIEW WITH ANN YERGER



Ann Yerger has served as executive director of the Council of Institutional Investors since 2005. She joined the Council in 1996 as director of the research service.

Previously, she was deputy director of the Investor Responsibility Research Center's corporate governance service. Prior to that, she spent five years in the domestic corporate banking division of Wachovia Bank.

Ann is a member of the Investor Advisory Group of the Public Company Accounting Oversight Board, the Investor Advisory Committee of the Securities and Exchange Commission and the NASDAQ Listing and Hearing Review Council. She also serves on the board of directors of the National Institute on Retirement Security.

C-Suite Insight spoke with her recently about executive compensation, shareholder rights, and related issues.

"ANY TIME SOMEONE IS
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OUR MEMBERS ARE INVESTING IN THE LONG TERM, AND THEY CAN'T SIMPLY PICK UP AND MOVE.

C-Suite Insight: Looking at Congressional testimony you gave in 2010, you noted 14 percent of public corporations made political contributions in a total amount of about \$100 million. With a Presidential campaign coming up, how large does this issue loom?

Ann Yerger: We're in this era after the *Citizens United v. FEC* decision, so this is a huge issue for investors. The council for many, many years has had a policy supporting disclosure of corporate political and charitable contributions.

The thinking is that any time someone is donating shareholders' money, it's important to look at board oversight and shareholders' ability to review what is happening. Certainly Target is an example of a company that has learned the lesson of how those contributions can backfire and indeed hurt the company's reputation.

So with the election coming up, it's going to be interesting to see what happens this proxy season with proposals related to this issue. There are going to be a lot of them.

CSI: Really.

Ann: We're also going to see some pretty high vote totals, with some of these proposals passing. That is my bold prediction.

CSI: But do you think most shareholders are okay with companies donating politically per se, but do they really want to know where it's going?

Ann: Yes, I think so. The council doesn't have a policy of endorsing or requiring approval of them, but we think there needs to be oversight by the board and disclosure. It's a simple way of making sure corporate resources are being used carefully.

CSI: While we're on the topic, it's not political donations alone that have the potential to cause trouble.

Ann: Right. The council's view is this kind of disclosure should extend to charitable

donations too. We certainly learned in the wake of Enron and WorldCom sometimes donations made in the name of an executive actually have been paid for with shareholders' money.

CSI: Why do you think institutional investors need such a strong presence, such as yours, in Washington, DC? Can't they vote with their feet and sell stocks of companies with which they have problems?

Ann: You can't apply this idea to members of the council. They are so large, they essentially are investing in everything, and they all use passive strategies. They are investing in the long term, and they can't simply pick up and move.

I mean, they are the market. The issues of shareholder rights and good corporate governance are critically important because our members are with these

companies through thick and thin.

CSI: What other issues are on your members' front burner as we go into 2012?

Ann: I think the idea of majority voting for directors would be at the top of our list. We will continue to push to set majority voting as the default standard in the *Model Business Corporation Act* and in the Delaware Code.

THIS IS A HUGE ISSUE, BECAUSE EVERYONE WANTS TO BE PAID AT THE 75TH PERCENTILE OF THEIR PEER GROUPS.

CSI: Do you believe that strongly in this issue?

Ann: Yes, we think it is a core structural principle. It's such a basic right we think it should be in place at all companies and not something that is implemented through private-ordering.

If I could wave a magic wand and have Congress approve one more change in the governance world, it would be to require majority voting for all directors of U.S. companies.

I might add this is a right or structure in many nations around the globe. The United States really lags in this area.

CSI: How much headway has the issue made recently?

Ann: In the largest companies, somewhere north of 70 percent of the S&P 500 now has majority voting for directors. This is a strong number, but it's still not 100 percent, which is sort of shocking.

Then, when you look at the small and mid-cap companies, overwhelmingly they do not have majority voting for directors. If you look at companies newly listed, overwhelmingly they have plurality voting.

Therefore, I'd say the success rate is pretty poor when you consider how many years we've worked on it and pushed for it.

CSI: What are your current thoughts on C-level executive compensation, and how peer groups affect it?

Ann: This is a huge issue, because everyone wants to be paid at the 75th percentile of their peer groups. Figuring out or setting who's in the peer group is profoundly important.

Companies clearly want shareholders to defer to their judgment about who the peer groups are. Moreover, I think shareholders in many cases are very skeptical about how companies are picking the companies in their peer groups. As a result, I think it's fair to say there is a lot of cynicism about how those groups are being structured and used.

CSI: It's the Lake Wobegon Effect, where everyone's CEO is above average which creates this ratcheting effect.

Ann: Absolutely. This is the reality that contributed to the escalation of compensa-

GENERAL ELECTRIC WAS A GREAT EXAMPLE OF A COMPANY THAT PUSHED BACK WHEN ITS SHAREHOLDERS WERE DISAPPOINTED.

tion. It's aggravated further when companies select peers receiving higher pay or peers who have different structures or much larger businesses.

CSI: How is this issue, as well as concerns about pay-for-performance, going to affect Say-on-Pay votes this proxy season?

Ann: It's a mixed bag. Not many companies lost their Say-on-Pay votes last year, which suggests shareholders are saying everything is fine with compensation. That suggestion probably is a little simplistic.

I think 2011 was a learning year and the markets were a bit stronger during proxy season. Maybe folks were feeling more generous. We're going to be in a different place in the 2012 proxy season. Shareholders will be taking a much more critical look this time.

CSI: What companies stand out as doing either a really

good job, or not so good a job of weighing pay-for-performance?

Ann: I'll start by saying I think most companies try to do it right, but not all companies seem able to do it right. Plus, shareholders are now paying a lot more attention to how awards are structured.

General Electric was a great example of a company that pushed back when its shareholders were disappointed with the structure of its equity awards to the CEO.


CSI: Now let's take a look at the long-term. How do your members define this and incorporate it into their thinking?

Ann: Our policy is the long term is five-plus years. This is to a certain extent the business cycle for a company. For some companies, it might be a little shorter. But as I mentioned, if they are indexed, our members are in these companies as long as they are around. And they're in broadly, more

along the lines of the Russell 3,000 than just the S&P 500.

CSI: How do you account for the special cases where you've got a company and maybe it needs a turnaround, or is replacing a charismatic founder, or going through a big merger?

Ann: Well, the largest institutional investors are pretty thorough and have their own guidelines and methodology for looking at companies. I think they're flexible enough to take into account unique company circumstances, be it a major turnaround or executive search.

I don't think we've seen any irrational votes in that space, because there is leeway when you are talking about companies in unique circumstances. Yet, it is important that companies do a good job of disclosing unique circumstances in board meetings, in their required filings and through discussions with investors. 

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COMPENSATION

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PUBLIC COMPANIES AREN'T the only ones facing increased scrutiny in the current economic climate. Potential donors are curious about executive compensation practices at their favorite nonprofit organizations, and at educational institutions as well.

As with public companies, an outsized compensation package can draw unwanted attention.

Educational institutions are required to disclose details of compensation packages greater than \$150,000 annually, including base salary, bonus, other compensation, deferred compensation and nontaxable benefits. New research from Equilar examined IRS Form 990s for 197 educational institutions—each of which have an asset size greater than \$200 million—for the fiscal years 2009 and 2010.

(This article is based on a report from Equilar Inc. entitled, "2011 Nonprofit Educational Institutions Report.")

CEO PAY ELEMENTS

Equilar looked at the Chief Executive Officer (CEO) at each institution, analyzing the different pay components and comparing pay by institutional location and size.

The median pay for CEOs at educational institutions was \$480,357. This is a minimal increase from the 2009 median of \$479,236. Base salaries for CEOs increased 5.3 percent from 2009 to 2010. However, the median bonus and incentive compensation for CEOs in both 2009 and 2010 was zero, indicating that a majority of institutions do not award bonuses.

There was a slight year-over-year decline in other compensation, deferred compensation, and non-taxable benefits for CEOs. In both 2009 and 2010, base salary made up the majority of total pay for CEOs, representing over 60 percent of their total compensation. Table 1 shows the year-over-year changes in the median value pay components from 2009 to 2010.

GEOGRAPHIC BREAKDOWN

Illustration 1 features a map of the United States broken into four primary regions: West, Midwest, South and Northeast. In 2010, the region with the highest median CEO pay was the Northeast, at \$579,000. This area is home to some of the largest and most prestigious Universities in the country, with median revenue topping \$190 million for the most recent year. Northeastern schools make up over one-third of all institutions included in this study.

The South was the second-highest-paying region, with a median total pay of \$465,537. With the most states of the four groups, the South had the second highest number of schools in the study and boasted median school revenue of \$140 million.

The Midwest came in third, with a median total pay of \$446,417. With schools similar in size and number to Southern institutions, the Midwest had median revenues of \$137 million. More than half of the Midwestern schools reside in Great Lakes states, with Illinois boasting the most schools in the region.

The West was the lowest-paying of the four regions, with a median CEO compensation of \$384,830. The West region covers the largest area in the study, but has the lowest median revenue, with \$110 million. This could account for the region's lower pay. More than half of the institutions in the Western region can be found in California.

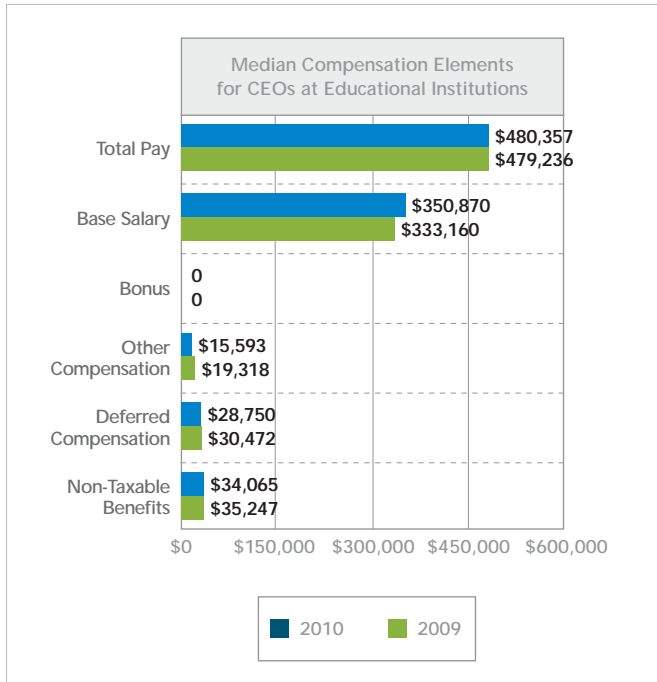


Table 1

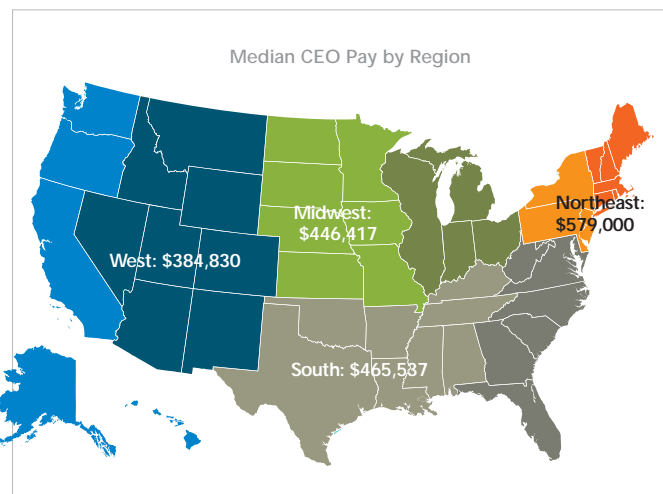


Illustration 1

CEO REVENUE COMPARISON

The research also focused on the link between CEO compensation and institutional revenue. As one would expect, median pay levels increase as an institution's revenue grows.

The highest median CEO pay came from institutions with revenues greater than \$1 billion. The median pay for this segment was \$911,272. Institutions with \$501 million to \$1 billion in revenue also had a high median pay level, at \$747,620.

The largest grouping of companies was the \$100 million to \$500 million revenue range, with over half of the organizations studied falling into this category. Only 12 percent of institutions had over \$1 billion in revenues. These are the most well-known and prestigious private universities in the country, and frequently compete for the top talent in education leadership.

OFFICER COMPENSATION

Table 2 examines the prevalence of the top ten most common roles for employees marked as Officers by the educational institutions surveyed. The most common role in this group was Vice President, at 35.6 percent of the total group. The next most prevalent role in our study is that of Chief, representing 17.2 percent of individuals. The Other category is made up of less common roles, including Chancellor, Controller, and Managing Director.

Table 3 lists the median total pay for the ten most prevalent roles designated as Officers. Of these employees, the highest-paying position is that of President, with a median total compensation of \$480,924. The next highest-paid office is that of Executive Vice President, with a median total compensation of \$450,733. The third-highest-paid position is Chief, at \$436,762. This category includes chief executives, chief financial officers, and other C-level positions.

At large institutions, the need for individuals to oversee many different aspects of a university's operation is reflected in the heavy concentration of roles that cover multiple areas of responsibility, such as Vice President and Chief. Multiple officers at each institution carry these titles. Roles focused on specific areas, such as technology and fiduciary compliance, demonstrate the many talents needed to advance a university and its goals.

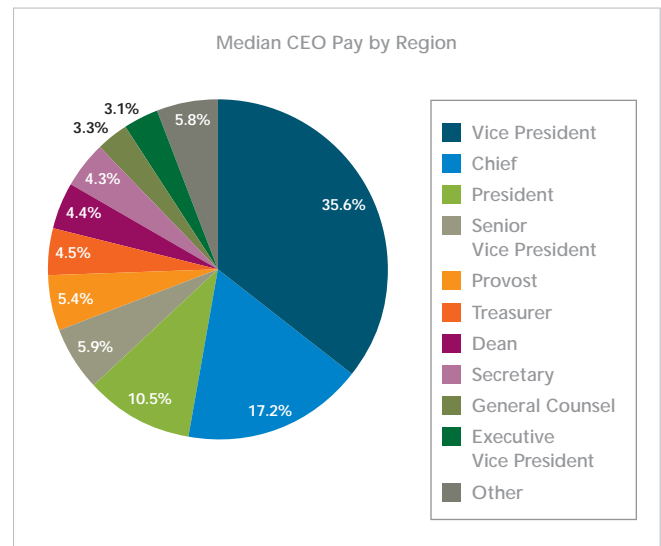


Table 2

Role	Median Pay
President	\$480,924
Executive Vice President	\$450,733
Chief	\$436,762
Senior Vice President	\$329,585
Provost	\$310,545
General Counsel	\$289,606
Treasurer	\$274,755
Vice President	\$258,667
Dean	\$253,984
Secretary	\$244,511

Table 3

PERQUISITE POLICIES

In 2010, 91.9 percent of the educational institutions studied either granted some kind of perquisite to or offered a reimbursement policy for their officers, highest-paid employees, trustees, and directors. The value of these perquisites and benefits are included in the Other Compensation and Non-Taxable Benefits fields in the 990 forms.

Table 4 lists the most prevalent benefits provided to these employees, topped by housing at 74.6 percent and club dues at 60.9 percent. Housing is a typical perk at educational institutions, giving top officers close proximity to the university and the ability to host events associated with the school. Although the practice of granting club dues is on the decline for most public corporations, the majority of institutions still grant club access, as many clubs are associated with a given school.

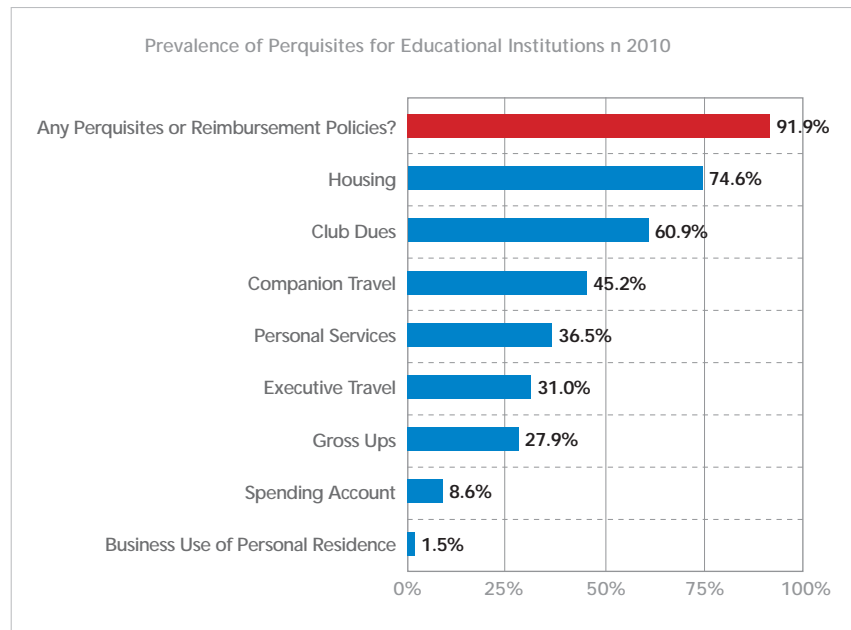


Table 4

COMPENSATION DETERMINATION

Of the educational institutions included in the analysis, 82.2 percent utilized a compensation committee to determine the pay levels of their officers, directors, and highest-compensated employees. That percentage is a slight increase from 2009, when 80.7 percent of these institutions had compensation committees in place.

More than 84 percent of these institutions used compensation consulting services or surveys to help determine pay levels over the past two years. 85.8 percent of institutions utilized surveys or studies, while 45.2 percent engaged compensation consultants.

Both methods of compensation determination were more prevalent than in 2009, when 84.3 percent of institutions used surveys or studies and 44.7 percent hired compensation consultants. ©



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KEY FINDINGS

- **CEO compensation.** Median pay for CEOs at educational institutions with over \$200 million in assets remained relatively flat in 2010, at \$480,357. This was a slight increase over the 2009 median of \$479,236.
- **Compensation elements.** In 2009 and 2010, compensation paid to the CEO primarily consisted of a base salary. The median base salary for CEOs increased 5.3 percent from 2009 to 2010, rising from \$333,160 to \$350,870.
- **Compensation by role.** The highest-paid position at educational nonprofit institutions was that of President, with a median total compensation of \$480,924 in 2010. Total compensation includes salary, bonus, deferred compensation, non-taxable benefits, and other compensation.
- **Role distribution.** In 2010, 35.6 percent of the individuals marked as an institution's officers were Vice Presidents, making this the most common role.
- **Prevalence of perquisites.** In 2010, 91.9 percent of the educational institutions in this study provided perquisites or had reimbursement policies in place for their employees. The most common perquisite granted to employees was housing, with over 74 percent of organizations providing this benefit.
- **How educational institutions determine compensation.** In 2010, 85.8 percent of institutions utilized surveys or studies, while 45.2 percent engaged compensation consultants. Both methods of compensation determination were more prevalent than in 2009, when 84.3 percent of institutions used surveys or studies and 44.7 percent hired compensation consultants.

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