Volume 1 Issue 3 2010

CSUITE INSIGHT

IN DODD-FRANK WE TRUST

HOW WILL THE NEW LEGISLATION AFFECT EXECUTIVE COMPENSATION?

MORE POWER TO YOU.

Unparalleled Support for Global Equity Compensation Plans.

- Worldwide participant support in 140 languages, from E*TRADE Securities
- Unmatched, on-demand reporting
- Choice of 3 service platforms
- Dedicated, One-to-One client service

Equity Edge Online™ The Future of Equity Compensation Management.

Visit etrade.com/equity or call us at 877-564-5068

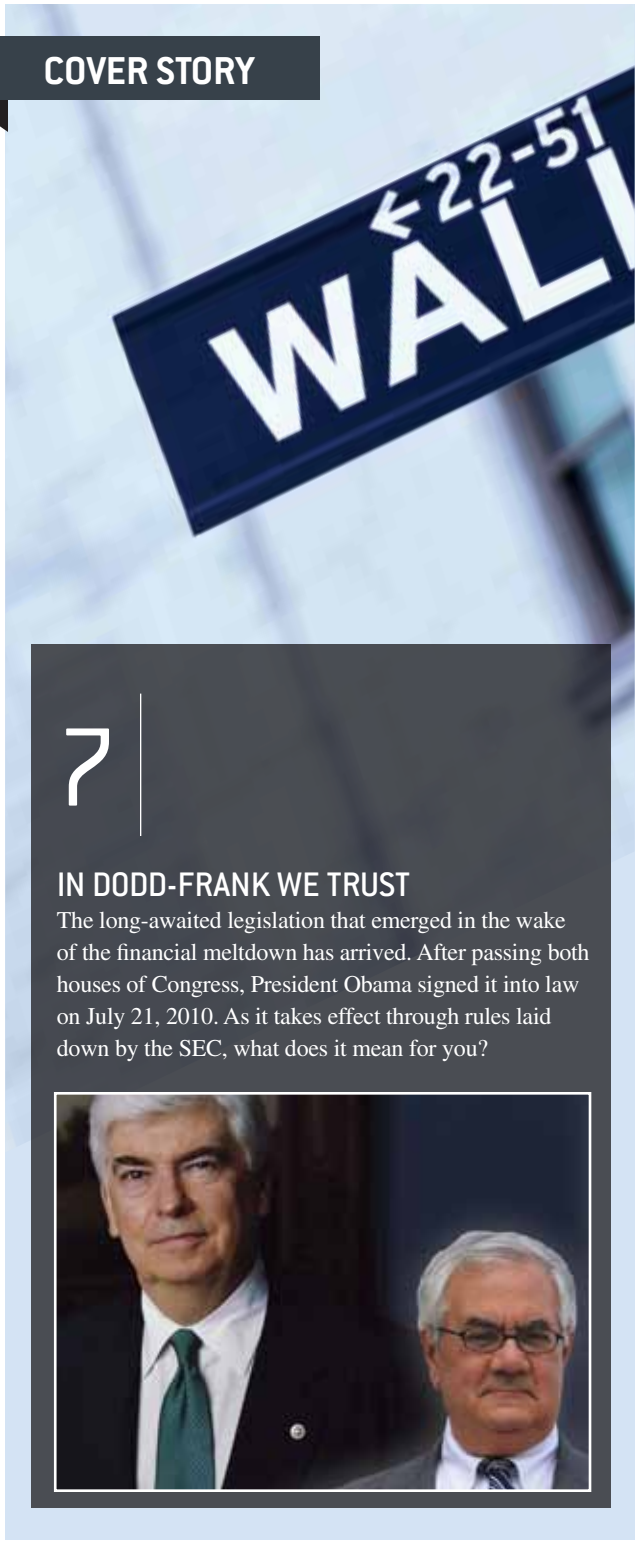
Powering 25% of the S&P 500[1]

E*TRADE® CORPORATE SERVICES

Contact us to learn how our products can meet your equity compensation needs.
The E*TRADE FINANCIAL family of companies provides financial services that include trading, investing, related banking products and services to retail investors and managing employee stock plans.
1. Data as of 9/30/09. Compiled by E*TRADE FINANCIAL Corporate Services, Inc.
Employee stock plan solutions are offered by E*TRADE FINANCIAL Corporate Services. Securities products and services offered by E*TRADE Securities LLC, Member FINRA/SIPC. E*TRADE Securities LLC and E*TRADE FINANCIAL Corporate Services are separate but affiliated companies.

Features

COVER STORY



7 IN DODD-FRANK WE TRUST

The long-awaited legislation that emerged in the wake of the financial meltdown has arrived. After passing both houses of Congress, President Obama signed it into law on July 21, 2010. As it takes effect through rules laid down by the SEC, what does it mean for you?

CONTENTS

VOLUME 1 ISSUE 3 2010

Departments

Special Report

Interviews

CSUITE INSIGHT

PUBLISHER
DAVID CHUN

EDITORIAL DIRECTOR
DAVID SASAKI

EXECUTIVE EDITOR
ROGER STRUKHOFF

PRODUCTION EDITORS
JENNIFER CHEN
ALLIE PAPE
SOFIE FREDLUND-BLOMST

EDITORIAL ASSISTANT
RODALYN VINAS

ART AND DESIGN DIRECTOR
KRIS REESE

CIRCULATION/DISTRIBUTION
LEE ANN SCHNEIDER

C-Suite Insight is published by

EQUILAR®

1100 Marshall St.
Redwood City, CA 94063
Phone: (650) 286-4512
www.equilar.com

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.

WELCOME TO *C-SUITE INSIGHT*

IN THE PROCESS of preparing our third issue of *C-Suite Insight*, I've heard a lot about trust: from panelists at our 2010 Summit in Washington, from those we interviewed for our magazine, and from conversations I've had with Equilar clients and colleagues over the past few months.

Trust is a key issue for all of us in the executive compensation field. At the end of the day, the thousands of SEC filings, statistical analyses, and legislative actions are of little value unless a strong sense of trust exists among shareholders, the public, government leaders, and public corporations.

The final passage and signing of the Dodd-Frank Act should go a long way to rebuilding trust between corporate America and these other parties. One of our interviewees in this issue, Peggy Foran, has already taken huge strides towards restoring investor trust by instituting Prudential's much-discussed say on pay efforts.

Other provisions of the Dodd-Frank Act should help consumers trust that they are being treated equitably by big financial institutions, and help boards trust the advice they receive from independent consultants. We discuss all the implications of the bill in our feature article, as well as in an interview with Robert Jackson, a Columbia Law professor and former assistant to TARP Special Master Kenneth Feinberg.

It's important to all of us at Equilar to maintain an independent, analytical perspective on all of these issues–in short, a perspective you can trust. I hope you enjoy this issue of *C-Suite Insight*, and as always, I welcome your suggestions and comments.

DAVID CHUN
CEO, Equilar
dchun@equilar.com

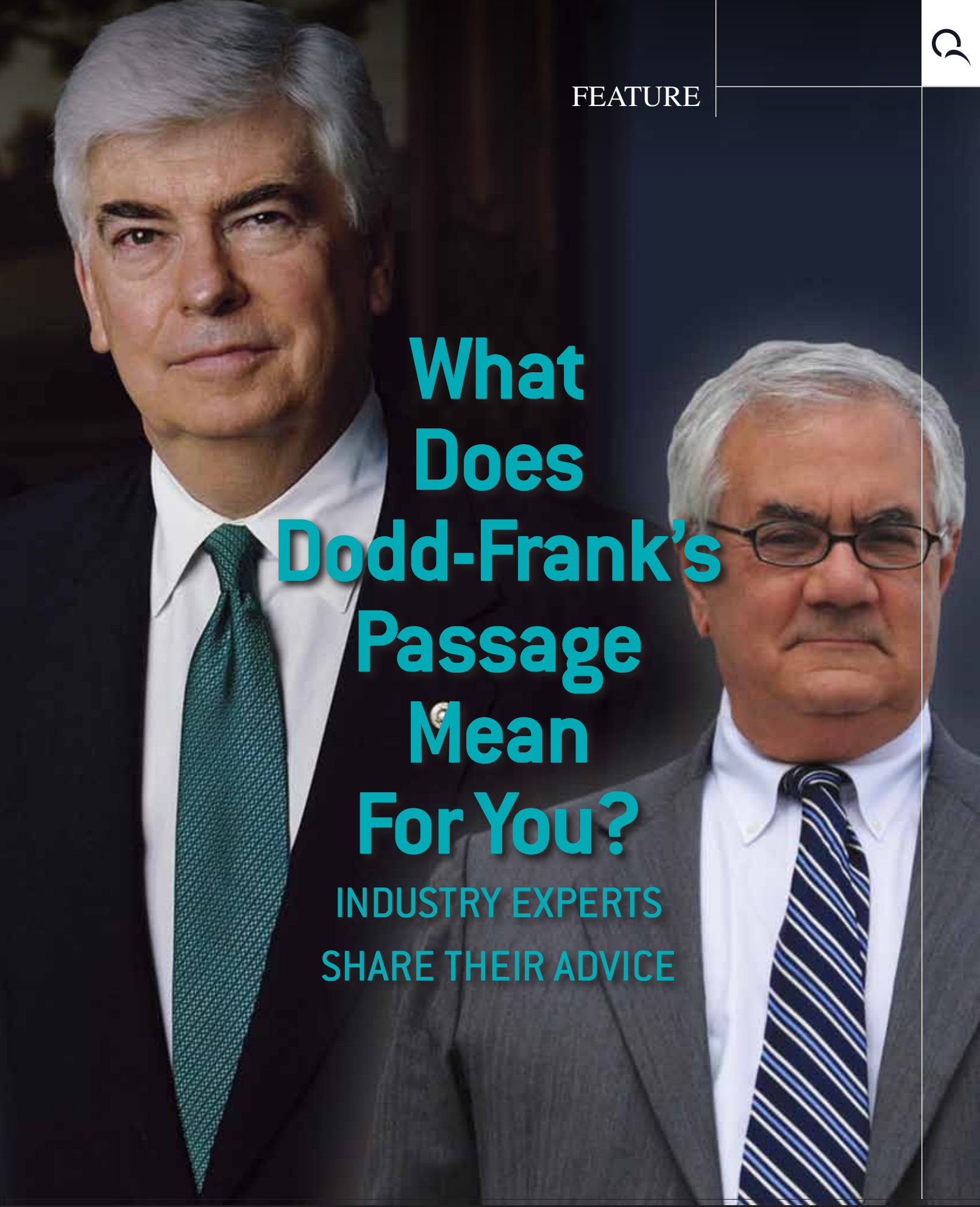
EQUILAR 2011 EXECUTIVE COMPENSATION SUMMIT

JUNE 13-15, 2011 San Diego, CA

We invite you to join Equilar and industry leaders from all facets of the executive compensation landscape to explore today's top issues and emerging best practices.

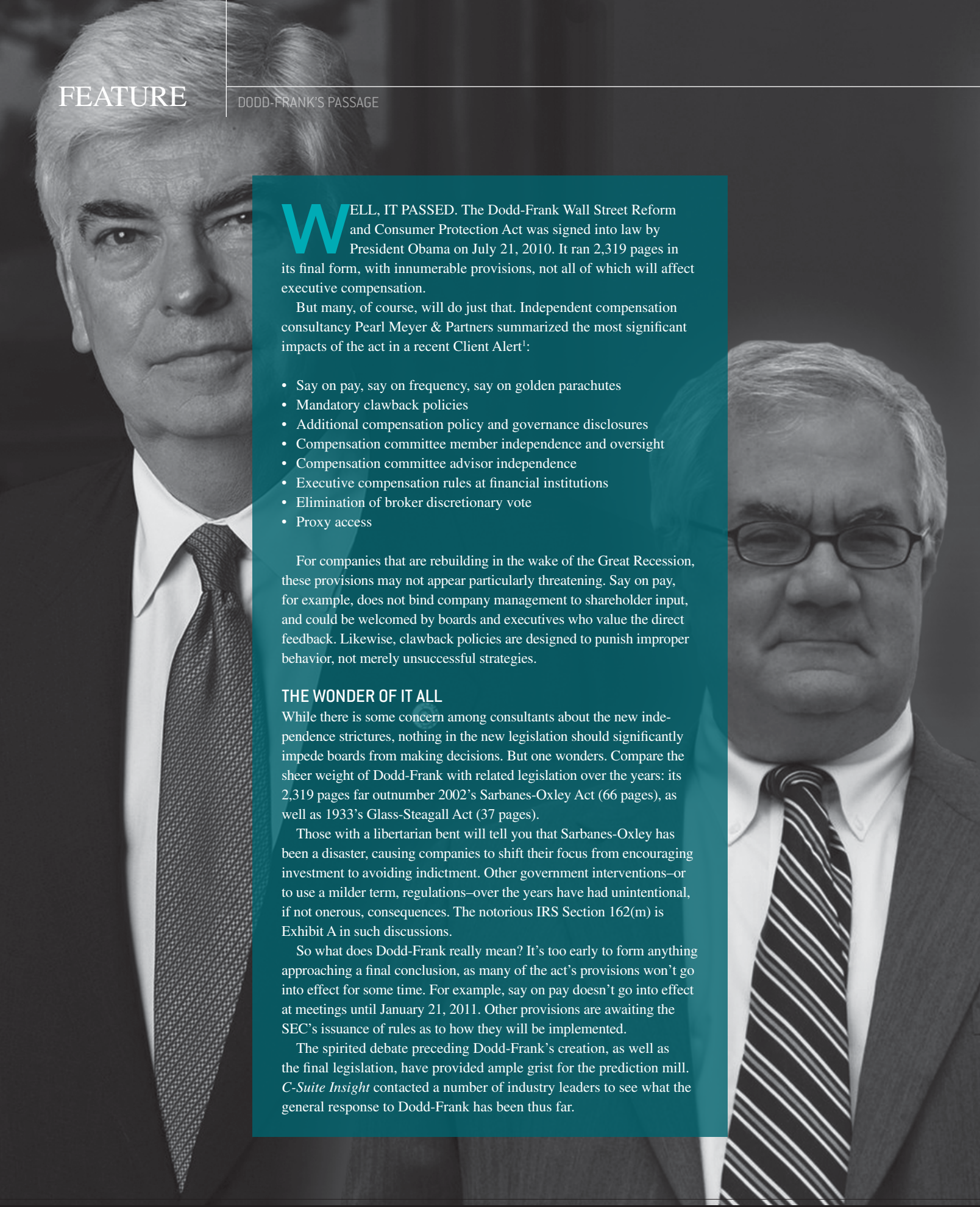
EQUILAR®

For more information, visit www.equilar.com/summit2011



What Does Dodd-Frank's Passage Mean For You?

INDUSTRY EXPERTS SHARE THEIR ADVICE



WELL, IT PASSED. The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Obama on July 21, 2010. It ran 2,319 pages in its final form, with innumerable provisions, not all of which will affect executive compensation.

But many, of course, will do just that. Independent compensation consultancy Pearl Meyer & Partners summarized the most significant impacts of the act in a recent Client Alert[1]:

- Say on pay, say on frequency, say on golden parachutes
- Mandatory clawback policies
- Additional compensation policy and governance disclosures
- Compensation committee member independence and oversight
- Compensation committee advisor independence
- Executive compensation rules at financial institutions
- Elimination of broker discretionary vote
- Proxy access

For companies that are rebuilding in the wake of the Great Recession, these provisions may not appear particularly threatening. Say on pay, for example, does not bind company management to shareholder input, and could be welcomed by boards and executives who value the direct feedback. Likewise, clawback policies are designed to punish improper behavior, not merely unsuccessful strategies.

THE WONDER OF IT ALL

While there is some concern among consultants about the new independence strictures, nothing in the new legislation should significantly impede boards from making decisions. But one wonders. Compare the sheer weight of Dodd-Frank with related legislation over the years: its 2,319 pages far outnumber 2002's Sarbanes-Oxley Act (66 pages), as well as 1933's Glass-Steagall Act (37 pages).

Those with a libertarian bent will tell you that Sarbanes-Oxley has been a disaster, causing companies to shift their focus from encouraging investment to avoiding indictment. Other government interventions–or to use a milder term, regulations–over the years have had unintentional, if not onerous, consequences. The notorious IRS Section 162(m) is Exhibit A in such discussions.

So what does Dodd-Frank really mean? It's too early to form anything approaching a final conclusion, as many of the act's provisions won't go into effect for some time. For example, say on pay doesn't go into effect at meetings until January 21, 2011. Other provisions are awaiting the SEC's issuance of rules as to how they will be implemented.

The spirited debate preceding Dodd-Frank's creation, as well as the final legislation, have provided ample grist for the prediction mill. *C-Suite Insight* contacted a number of industry leaders to see what the general response to Dodd-Frank has been thus far.

The Act is Ambiguous; You Can't Be

Michael Melbinger, a partner at Winston & Strawn who serves as Chair of the firm's Employee Benefits and Executive Compensation Practice, notes that "many of the rules added by Dodd-Frank–or to be added by required SEC or stock exchange regulations–have already become best practices in recent years."

Melbinger feels that the new legislation is "riddled with ambiguity," with provisions that will lead to unintended consequences. "Executive salaries will probably continue to increase (as they did for TARP institutions) at the expense of at-risk incentive pay, as a reaction to the clawback rules," he notes. Overall, however, Melbinger believes that there will be a "gradual reduction of overall compensation to senior executives."

Melbinger sees "incidentals and protections in employment agreements and compensation plans [being] reduced when the compensation committee has independent advisors," and believes that "overall, this will be a very positive development for the executive compensation world." In his opinion, it is likely that this development will also "raise the costs of the compensation committee function."

He suggests that boards, and compensation committees in particular, "expect that most of the Dodd-Frank provisions will be effective for the 2011 proxy season." Noting that many companies are already preparing for this possibility, Melbinger adds that "boards, and compensation committees need to act fast, although the actions they take may not need to be dramatic."

Specifically, Melbinger and his firm recommend that clients take a series of steps in response to Dodd-Frank. "First, boards and compensation committees need to hear a detailed presentation on the technical provisions of Dodd-Frank. Other affected company parties should be present, including human resources, executive compensation, legal, and investor relations functions," he urges, to ensure that the response is coordinated from the get-go.

Next, "boards and compensation committees should evaluate new policies and procedures and formulate a response to each of the provisions of Dodd-Frank that apply to executive compensation," he says. "The SEC may not promulgate rules in time for a fully compliant reaction to Dodd-Frank before the 2011 proxy statement. However, we can develop a good game plan based on provisions of the statute."

"Of course, because the SEC rules may turn out differently from what we expect," Melbinger adds, "the policies, procedures, and response of the boards and compensation committee should be flexible and principles-based, rather than written in stone."

Additionally, Melbinger says that "most compensation committees [now] need to add one more factor to their consideration of each compensation issue–how will we explain this decision, payment or policy in the proxy statement CD&A, and will it increase the risk that shareholders will vote 'no' on say on pay?"

Just "one questionable action, payment, or practice could cause shareholders to vote 'no,' regardless of the reasonableness of the overall packages," he notes.

Michael Melbinger
Partner and Chair of the firm's Employee Benefits and Executive Compensation Practice at Winston & Strawn

BOARDS AND COMPENSATION COMMITTEES NEED TO ACT FAST, ALTHOUGH THE ACTIONS THEY TAKE **MAY NOT NEED TO BE DRAMATIC.**

Doug Friske
Towers Watson's Managing Principal and Executive Compensation and Rewards Global Practice Leader

Time For a Check-Up

Doug Friske, Towers Watson's Managing Principal and Executive Compensation and Rewards Global Practice Leader, also mentions unintended consequences, noting that while the "thematic underpinnings" of the bill are clear, "the practical implications [of Dodd-Frank] are much less clear, as are the long-term effects of the new rules."

"It will be years before we fully understand where this new law has taken us," Friske comments.

Friske recommends that boards "get a 'check-up' on executive pay plans, to ensure [they've] eliminated practices that don't add value but [instead] might create issues with shareholders." He notes that boards need to "make sure [they] have a good story to tell about pay for performance, alignment with business strategy, and shareholder value creation."

Friske has two other prescriptions for boards: (1) "Avoid the temptation to mechanically comply with so-called 'best practices' identified by various advisory groups," and (2) "expect it to be a while before the dust settles on how the legislation will affect your organization."

For Friske, when it comes to best practices, "one size does not fit all and can lead to bad outcomes. If a plan design feature makes sense for your organization and supports your business needs, go with it."

"The devil is in the details of these new rules," he asserts, "and even when they are final, application will likely vary from company to company."

Peter Chingos
Compensation Advisory Partners' Senior Partner

Remember the Shareholders!

Compensation Advisory Partners' Senior Partner Peter Chingos and Partner Eric Hosken also note that "much of the Dodd-Frank Act reflects where the market was [already] moving." Nonetheless, they assert that the act "will accelerate certain reforms of executive compensation and governance practices," including say on pay, pay for performance, CIC severance, clawbacks, and anti-hedging policies, among others.

Chingos and Hosken echo Melbinger in noting that "aspects of the legislation are confusing and require greater clarity for implementation," but still feel that its "main impact will be to further heighten the emphasis on responsible behavior and the relationship between pay and performance."

Their prescription for boards is simple: "Begin by validating [your] company's overall compensation strategy and program to ensure that the design represents the interests of shareholders, reflects responsible compensation practices, and provides for appropriate alignment of pay and performance." When it comes to say on pay, the two recommend that boards and management "engage with major shareholders on a regular, ongoing basis to communicate the business rationale for the compensation program and gather input from shareholders on their support for the program."

THE MAIN IMPACT OF [DODD-FRANK] WILL BE TO FURTHER HEIGHTEN THE EMPHASIS ON RESPONSIBLE BEHAVIOR AND **THE RELATIONSHIP BETWEEN PAY AND PERFORMANCE.**

Don't Just Follow the Leader

Irv Becker
National Practice Leader, Executive Compensation at Hay Group

Irv Becker, National Practice Leader, Executive Compensation at Hay Group, urges company management to understand that things "are getting tougher."

He says Hay Group "expects the impact [of Dodd-Frank] to be substantial." He also believes that "despite the fact that most companies to date have passed their advisory votes with room to spare, say on pay will shake things up."

In a new environment in which "all public companies are being subjected to this [say on pay provision], many of the more hot button pay practices will become less and less prevalent," Becker notes. This in turn, "will impact a company's ability to tell shareholders that everybody in the industry is doing it."

He expects "shareholders will have to get tougher on these votes [because] there's now a provision that requires the votes of investment managers to be made public." The net result will be that companies will have to take these "votes much more seriously."

Becker also cautions companies from simply "replicating what others are doing," Claiming that "every company seeking out a new middle ground isn't the right outcome." Therefore, he says, "we are telling all of our compensation committees that there is no security in what others are doing. The only safety in this process is in maintaining–and communicating–an ironclad linkage to business strategy."

"Even when your program looks different than your peers', if your shareholders understand how the program supports what you're trying to do with your business, then the program can be justified," Becker says. But "companies need to help their shareholders become savvier about evaluating their executive pay programs, and the best way to do that is to take pains to ensure that the program directly links to helping the company make money and create value," he concludes.

How to Avoid Backlash

Robert McCormick
Chief Policy Officer at Glass Lewis & Co.

In response to *C-Suite*'s questions regarding Dodd-Frank, Robert McCormick, Chief Policy Officer at Glass Lewis & Co. commented that not only will Dodd-Frank "further encourage companies to examine their compensation programs to ensure the programs enjoy widespread support among shareholders," but the Act will also "further the oft-stated goal of say on pay proponents to encourage companies to engage with shareholders about compensation."

McCormick predicts that "companies may simplify their compensation programs in order to enable clearer explanation of how these programs work," but cautions that they should "provide clear disclosure of how and why the performance metrics they have selected foster the performance they seek to encourage." This is particularly true, he notes, "since Dodd-Frank bans the use of broker votes for [say on pay] proposals."

Looking at the big picture, McCormick says that "shareholders are less concerned with actual compensation amounts than knowing that a company's compensation programs result from thoughtful deliberations by the compensation committee, and are clearly linked to sustainable performance criteria."

He also stresses the commonsensical tactic of "thoroughly explain[ing] any aspects of their compensation programs that could be interpreted as outside the norm to avoid shareholder backlash."

Michael Powers
Managing Partner with Meridian Compensation Partners

Say on Pay Looms

Michael Powers, Managing Partner with Meridian Compensation Partners, is inclined to think that "the absolute and primary forms of executive pay are not likely to be immediately impacted by the Dodd-Frank Act. However, over time, the compensation landscape may be significantly affected by say on pay voting patterns, proxy access, and the rising influence of shareholder advisory firms."

"Boards are not under significant pressure to take immediate action prior to the SEC issuing rules on the Dodd-Frank Act's executive pay and corporate governance provisions," Powers adds. "There is one pressing item, though: the thousands of say on pay votes that will occur during the 2011 proxy season."

"In advance of these votes," Powers advises, "boards should take the time to critically evaluate executive pay programs to identify possible areas for improvement and exposure, surface any issues regarding executive pay programs among institutional investors, and make a compelling case on the merits of their executive pay programs."

THE PRESSING ITEM IS THE THOUSANDS OF SAY ON PAY VOTES THAT WILL OCCUR DURING THE **2011 PROXY SEASON.**

David Swinford
Pearl Meyer's President and CEO

"Selling" the CD&A

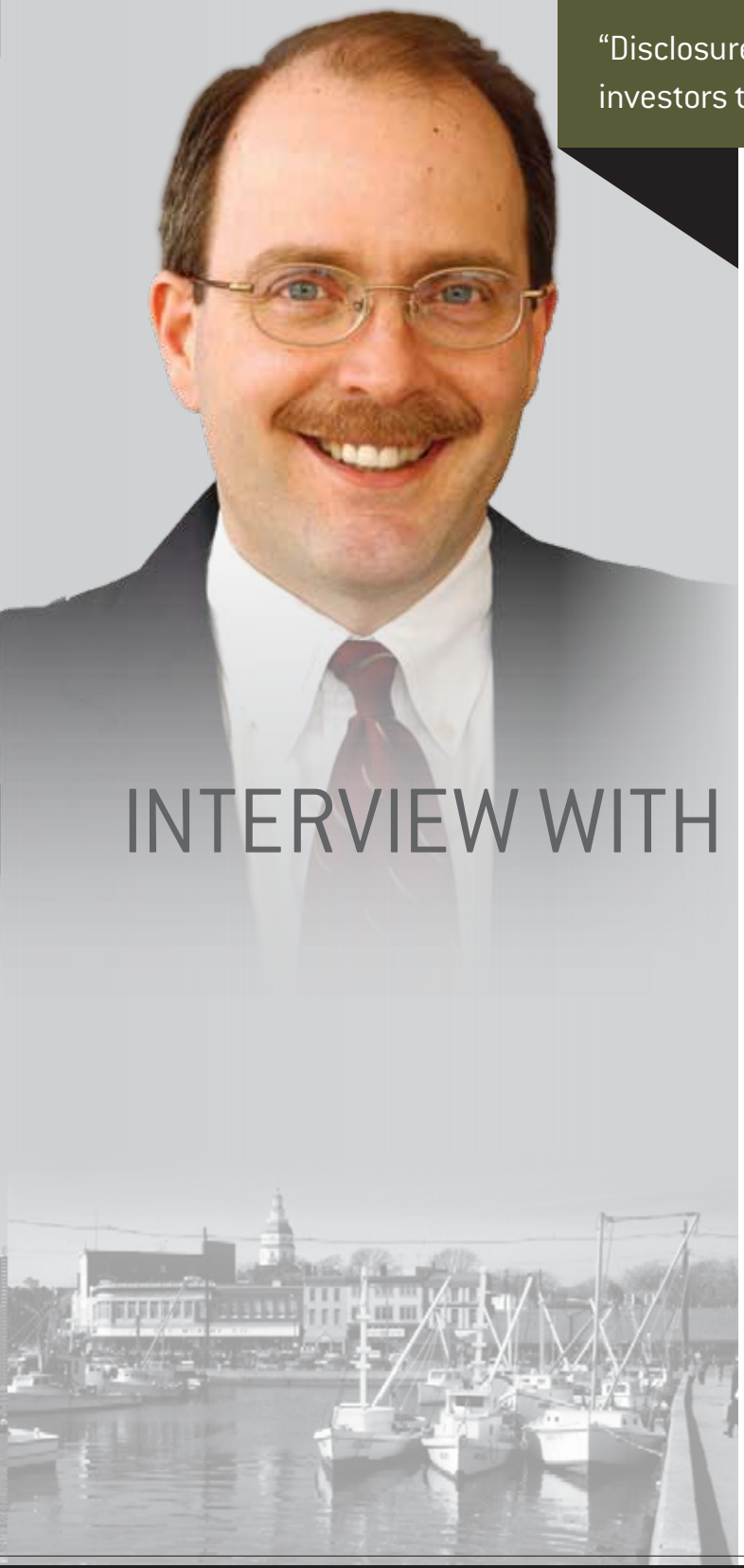
Pearl Meyer's President and CEO, David Swinford, believes that "companies are going to have to think more about how to define and communicate, in the CD&A, the link between pay and performance. "

Swinford advises board members to approach their proxy "as a campaign tool [used] to 'sell' their compensation programs to investors." The proxy should explain exactly how an organization measures performance under its incentive programs, avoiding "obvious lightning rods, like huge or unusual perquisites that people don't understand, or gross-ups."

"With say on pay votes and pending changes in proxy access rules, some directors may feel pressured to opt for non-controversial performance measures and plan designs that won't attract outside criticism," Swinford notes. "It's unclear what value is provided by certain of the newly required disclosures," he adds, citing the ratio of CEO pay to median pay as an example.

Swinford is concerned that the new requirements "will generate a great deal of new data, but no useful information" and suggests that companies should focus on the question of "what compensation approaches enable [them] to attract, retain and appropriately reward the executive talent necessary to create superior returns for shareholders." Without this focus, Swinford worries that "the pay discussion becomes almost a Tower of Babel." C

1 "Dodd-Frank Wall Street Reform and Consumer Protection Act Signed Into Law: New Requirements for Say on Pay, Executive Pay Disclosure, and Director Independence Will Affect All Public Companies." Pearl Meyer & Partners. http://www.pearlmeyer.com/newexecpayrules/PMP-CA-DoddFrankBill-7-21-10.pdf



"Disclosure about process is critical since it allows investors to assess the rigor of the pay risk analysis."

PATRICK S. MCGURN SERVES as Special Counsel at ISS, the world's leading provider of proxy voting services and corporate governance research. ISS recommends votes on ballot issues for more than 40,000 shareholder meetings across 115 markets around the globe.

Prior to joining RMG/ISS in 1996, Pat was director of the Corporate Governance Service at the Investor Responsibility Research Center (IRRC), a not-for-profit firm that provided governance research to investors. He also served as a private attorney, a congressional staff member and a department head at the Republican National Committee. He is a graduate of Duke University and the Georgetown University Law Center. He is a member of the bar in California, the District of Columbia, Maryland and the U.S. Virgin Islands. Pat serves on the Advisory Board of the National Association of Corporate Directors.

Pat is frequently cited by business publications such as the *Wall Street Journal* and *BusinessWeek*. He has appeared on ABC's *World News Tonight*, Bloomberg Radio and TV, BBC Radio, *CBS Evening News,* CNBC, CNN, *Marketplace, NBC Nightly News, Nightly Business Report, National Public Radio, Tech TV* and ABC's *This Week*. He is a frequent presenter at conferences.

INTERVIEW WITH PATRICK MCGURN

C-Suite Insight: You've mentioned that you'd give a C+ average grade to companies that simply walked through the new pay risk disclosure process mandated by the SEC. Why so low?

Patrick McGurn: Yes, C+ still sounds about right for the 2010 disclosures. It's actually a blended grade that takes into account the full range of efforts–the good, the bad and the ugly–that we saw during the 2010 proxy season. The overall average was pulled down by companies that provided no disclosure whatsoever. That's not ugly disclosure, it's invisible.

CSI: Why would companies provide no disclosure in this environment?

PM: It's hard to imagine that these companies were thinking at all, especially in light of the around-the-clock attention being paid at the time to the risky pay issue by regulators and lawmakers in Washington, D.C. My best guess is that these companies were advised to take a very short-term, compliance-driven approach to pay riskiness. At the outset of the proxy season, numerous outside legal counsels and compensation consultants told their clients to say nothing unless

they identified specific materially adverse risks that had to be reported.

This type of a "say nothing" approach is highly problematic and in the end, it's counterproductive. Sadly, it is somewhat emblematic of a larger problem involving executive compensation disclosures –a focus on the wrong audience.

CSI: They are speaking to the wrong audience?

PM: Yes. All too often, executives and board members assume that the audience for their disclosures is a SEC staffer sitting inside a cubicle over at 100 F Street rather than their owners. They view the process as a pure compliance exercise. In an age of say on pay, the proxy statement is the front-line communications document that issuers must use to sell investors on the quality of compensation programs.

CSI: So what should all companies do to get their grades up?

PM: At the outset of the 2010 proxy season, we said that we hoped for three things in the pay riskiness area: process, mitigation and, when appropriate, the all-clear signal.

From a governance standpoint, disclosure about process is critical since it allows investors to assess the rigor of the pay risk analysis and the level of boardroom engagement and oversight. This section should provide the meat and potatoes: who was involved in that process? What sort of issues did they look at?

Listing possible mitigators demonstrates the company's commitment to managing the identified risks–materially adverse or otherwise. Even if an identified risk is not a bet-the-company issue, investors want to know whether the directors have put countermeasures in place. Does the company, for example, balance long- and short-term compensation? Is it balancing equity and non-equity compensation?

CSI: Did anyone get an A last year?

PM: Citigroup was one that I liked. The company was clearly under the gun to provide profound pay risk disclosure, given that it was a TARP recipient and one of the firms overseen by Paymaster Kenneth Feinberg and his team.

Citi had to go through a very thorough and thoughtful process of looking at pay riskiness, and the company's narrative disclosure really reflects this effort. The disclosure includes a graphic presentation that illustrates both process and mitigation. One column shows how particular pay provisions might encourage risk. An adjacent column shows the potential mitigators for each

BOARDS AND ISSUERS HAVE TO PROVIDE MUCH MORE EXPANSIVE DESCRIPTIONS OF THEIR PAY FOR PERFORMANCE PHILOSOPHIES AND HOW THEIR **ONGOING PRACTICES REFLECT THEM.**

pay factor. Another column shows the outcomes, that is, the potential impact of the risks to the company's financial reporting. It's simple and elegant.

Although I don't expect other companies to replicate this exercise, I think Citi provides a model of how to look at compensation risk issues and how to present this information in an investor-friendly format.

CSI: Were a lot of companies just asleep at the switch?
PM: No, I don't think so. I've discovered that many companies simply made the mistake of not showing their work. Management teams and directors had often conducted very robust risk-review processes. These efforts were not reflected in the disclosures that made it into the proxy statement.

CSI: Why do you think this happened?
PM: I think the SEC set the bar fairly low as to what had to be disclosed and most issuers jumped just high enough to clear it. As a result, many firms missed out on their only opportunity to make a good first impression by discussing the thorough jobs they did in examining pay-risk issues.

But, that's the beauty of an annual disclosure, rather than, say, a quarterly one. Companies have the opportunity to be expansive. We hope that companies don't treat this as a compliance exercise. Instead, they should treat it as a communications exercise, one in which they can point out to shareholders the processes their management team and boards went through when architecting their executive compensation program to avoid creating significant risks.

CSI: Is there a chance that companies might be overly focused on risk mitigation, even as they become more expansive in outlining their processes and reasoning?
PM: If companies don't take risks, investors don't make money. It's as simple as that.

So when we talk about mitigating risk, we're really talking about trying to find ways to avoid incentivizing bad behaviors. Boards should not be risk-averse, but they must make sure they're incentivizing the right things.

For example, we constantly run into companies that use earnings for both their long- and short-term plans. So we would ask them: "what have you done to make sure that you don't focus people just on managing earnings–or managing expectations at least–which can lead to other problems?"

CSI: This reinforces the point you made earlier about disclosure being a communications exercise.
PM: Yes. You'll notice I haven't said that investors will balk if they don't see a punch line, that is, where the company states that it didn't find any pay provisions that would lead to materially adverse risks.

I think those negative disclosures are less important than providing shareholders with adequate information to reach such conclusions on their own. The objective should be to bolster investors confidence that the board has pay risk issues under control and that the directors have set the right kind of incentives for company employees.

The SEC focused on forcing boards to disclose information about life-threatening events. Shareholders want to have confidence that boards are looking at all potential risks when they're designing and administering compensation programs.

CSI: Now that Dodd-Frank has been signed into law, how do you think it will affect executive compensation?
PM: From the investor perspective, the most important compensation provision is say on pay. Next year, the vast majority of U.S. corporations will have such advisory votes on their ballots.

Say on pay isn't a referendum on how much CEOs are paid. With a couple of years of say on pay under our belts in the U.S.—and after observing a half dozen years of such votes in the U.K. and other global markets—we can say for certain that

executive pay won't go down as a result of this legislation. But CEO pay at companies with say on pay votes will be more closely related to financial performance. That's been the finding of the studies that have looked at the long-term impact of advisory votes on remuneration reports in the U.K. And I think it's also what we've found to date in the U.S. Companies with advisory votes on their ballots typically eliminate some of the more potentially abusive provisions of their compensation programs in order to win a high level of support on their say on pay votes.

CSI: We also wanted to talk a little bit about discretion. You've noted that if we look at one year of discretion, we see a snapshot, but that we really need to see a movie. How can boards achieve this continuum, and properly place discretion within it?

PM: One of the changes we made in our proxy reports for 2010 was providing a chart that tracked five years of CEO compensation against five years of company performance, measured by shareholder returns. Our clients really liked this presentation. They said it focused their attention on the boards' long-term stewardship of compensation, not just the annual numbers.

By taking a multi-year view, institutional investors are able to step back a bit and grade out the stewardship of boards over the long haul. The new Dodd-Frank legislation will eventually require companies to place similar CEO pay vs. performance graphs in their annual proxy statements.

My hope is now that say on pay has arrived, and with these new disclosures likely in proxy statements, that companies will be more long-term oriented in the narrative disclosures that they provide.

Companies should provide a more holistic picture of their compensation philosophy and how it is operationalized through the programs they've put into place. With this context, it should be much easier for directors to explain anomalous pay practices.

Say on pay should also encourage greater engagement. In the past, engagement only occurred when companies got into trouble. Now, there should be much more of an ongoing dialog, and a bolstering of investor confidence. In this environment, investors will be much less likely to react to a single number that jumps out of a proxy statement.

It's going to take change on all players' parts to make say on pay work. Investors have to take more of a long-term view. Proxy advisors have to be able to provide a broader picture of compensation practices over a longer period of time. Boards and issuers have to provide much more expansive descriptions of their pay for performance philosophies and how their ongoing practices reflect them.

CSI: And what are the two or three topmost priorities that you want to ensure boards don't overlook in 2011?

PM: Boiling it down, I would say "long-term" and "communication."

Say on pay must become something more than a rote exercise. All parties —executives, board members and investors—must embrace it. The way you do this is through engagement and communication.

If we subtract heat from the executive compensation debate, we need to add light. More engagement and better communication are the keys to decreasing the amount of confrontation we currently see during proxy season over compensation issues.

We hope that investors, boards, and executives will use say on pay votes as a non-confrontational forum. These are advisory votes, after all. They provide a way to resolve compensation issues quickly, rather than allowing them to fester into something that could have an impact on the election or re-election of the board members, especially members of compensation committees. C

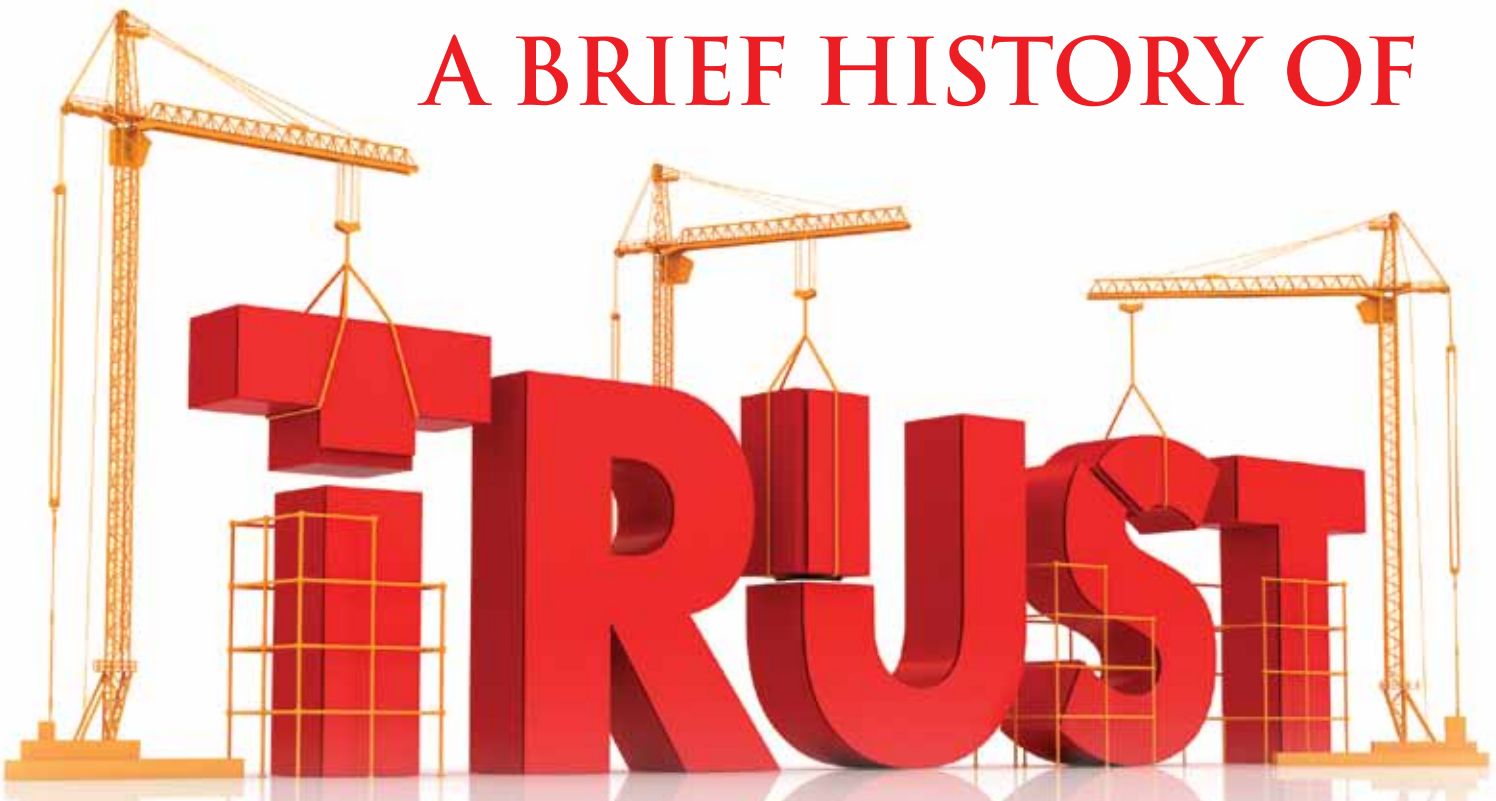
Read by Executives and Board Members Across America

IF YOU ARE AN EXECUTIVE OFFICER OR BOARD MEMBER, REQUEST A COMPLIMENTARY SUBSCRIPTION TO C-SUITE INSIGHT AT WWW.C-SUITEINSIGHT.COM.

CSUITE INSIGHT

BROUGHT TO YOU BY THE LEADER IN EXECUTIVE COMPENSATION RESEARCH EQUILAR®

A BRIEF HISTORY OF



COMPANIES NEED TO REBUILD TRUST AMONG INVESTORS. BUT TRUST IN WHOM?

BY ROGER STRUKHOFF

THERE ARE MANY issues facing those who determine compensation: aligning pay with performance, working with new regulations, retaining top talent. One word, however, came up repeatedly among experts at Equilar's 2010 Executive Compensation Summit in Washington, D.C. That word was "trust." Many panelists contended that restoring trust is the fundamental task facing executives and boards in the aftermath of the Great Recession.

As Robert Jackson, put it: "Investor trust is the source of liquid capital markets that has been driving our economy for generations."

Jackson (whose full interview with *C-Suite Insight* appears on page 27) served in the TARP Special Master's office, headed by Kenneth Feinberg, during the most intense days of the all-out effort by the United States government to restore enough short-term trust in investors to keep financial markets from seizing up entirely. After leaving the Treasury Department earlier this year, Jackson now serves as a professor at Columbia Law School.

Panelists and attendees at Equilar conferences, along with readers of this magazine, are familiar with the complexities of executive compensation. They study the latest trends and development, the latest laws and regulatory updates, the latest statistics, and the latest gossip with an eye for detail and a finely tuned sense of what matters and what is relevant.

Jackson's comment, on the other hand, cuts through all the detail. His assertion that trust has been the driving force of the U.S. economy for many generations signifies the inherent importance of trust to ensuring sustained economic growth.

THE BACKDROP: AS THE PRICE OF OIL SET ONE NEW RECORD AFTER ANOTHER IN THE SUMMER OF 2008, TROUBLING MESSAGES APPEARED IN REAL ESTATE MARKETS ACROSS THE COUNTRY. NOBODY WAS UNAWARE THAT HOUSING PRICES HAD BEEN BUBBLING UP FOR SEVERAL YEARS.

TIME TO SELL

It's been said that John D. Rockefeller knew to sell his stock in the Roaring 20s when a shoeshine boy offered him a stock tip. Similar surrealism emerged during the height of the dot-com madness, when a Super Bowl ad featured a man visiting an emergency room because he had money up the wazoo. Emblematic of the general ethos of the time, the ad seemed to suggest that companies that were careful enough with their money to make a profit simply weren't thinking big enough.

And it all came tumbling down–as it had many times before.

IN SEARCH OF LOST TRUST

There have been several major economic meltdowns in the United States over the past 125 years. As the country emerged from its disastrous Civil War, manufacturing and industrial progress became the economic engines of the United States, giving the young country immense new power.

The Panic of 1873 was the first serious economic crisis to hit the U.S. after the Civil War. This event started in Europe, where its effects were even more severe. Among other precursors, it was blamed on too much faith in the newly united Kingdom of Germany and too many new industrial competitors (including the U.S.) challenging Britain's former dominance.

The Panic of 1873 was followed by what many people at the time termed the Great Depression. In the U.K., the era is known as The Long Depression. By either name, it took many years before robust economic growth returned.

In the U.K., the good times never fully returned; the Long Depression permanently cost the country its position at the top of the pyramid. Increasingly, the United States was seen as the most vibrant, trusted economy in the world.

THE PANIC OF 1893

Then came the Panic of 1893. Over-investment in American railroads was a major precipitating factor. The nation's first struggle with deflation came during this period as well: indebted farmers and laborers advocated a "Free Silver" policy that would compete with the existing gold standard and thereby flood the market with new dollars. The policy would have sparked significant inflation, to the advantage of its debt-laden proponents throughout the country but to the disadvantage of the big credit holders in the Northeast.

For the first time, a large percentage of Americans were putting their full faith and trust in large investment schemes and macroeconomic policy over which they had little individual control. Although a halfway measure (the Sherman Silver Purchase Act of 1890) did pass during this era, a railroad failure in the Northeast sparked bank runs, bank failures, and general economic panic.

Investors large and small had lost their trust in the economic ideals of the age.

The Panic of 1893 may be best known as the episode in American history when financier J.P. Morgan saved the day by loaning tens of millions of dollars to the United States Treasury, at the behest of President Grover Cleveland. During those days, a single person could restore trust overnight.

THE PANIC OF 1907: MAIN STREET MEETS WALL STREET

The Panic of 1907 is a lesser-known episode, but represented the first enormous Wall Street crash. J.P. Morgan again intervened to restore investors' trust, with the help of his fellow bankers. It's difficult to calculate what his contributions would be worth today. Suffice it to say that the combined forces of Warren Buffett, Bill Gates, and all their friends would still fall short of providing similar assistance to the U.S. economy today.

Other panics, recessions, and slowdowns are found in the history of the late 19th and early 20th centuries. The frequent use of the word "panic" adequately describes the loss of trust that ensued each time. But America was a growing nation then. It was unburdened by the weight of history that Europeans carried, and trust was easily restored.

To instill investor trust, the U.S. government created the Federal Reserve Bank in 1913, under President Woodrow Wilson. The bank's creation was seen as a way to free the U.S. from its previous dependence on gold and silver, creating flexibility in an economy that had become characteristic of a populace ever-enthusiastic for the latest new thing.

THEN THE BIG ONE HIT: THE GREAT DEPRESSION

But government action and investor enthusiasm was no match for what was to come. The earlier panics were all warm-up acts for the Great Depression of the 1930s, which started with the Crash of 1929. Although the market recovered somewhat early on, it crashed again in 1930-32, terrifying in its ferocity.

There are very few people left in the U.S. who remember those days, but perhaps still enough who remember the stories their parents and grandparents told them. Trust–in institutions, in the government, in the future–was lost, and never fully regained in the eyes of those who were there.

The trust of the common man and woman may have first been broken in 1893, as people ran to their banks, only to find that their money wasn't there. But it was shattered and destroyed by the Great Depression, when banks not only failed, but factories, too, and dust storms obliterated thousands of square miles of overused Western farmland.

This time, the contagion passed from the U.S. to a weakened Europe, which had already lost a generation of men to The Great War of 1914-1918. It's widely agreed that the Great Depression was only halted by the massive armament efforts undertaken by several nations prior to and during World War II.

A BRIEF RESPITE AND THE COMPANY MAN

The post-WWII era is remembered fondly for its steady economic progress, even as underlying social tensions began to surface in the U.S.

Mild recessions in the late 1950s and very early 1960s are often said to have been alleviated by the famous tax cuts instituted by President John F. Kennedy. Meanwhile, economic stability came from institutional investors in the form of pension funds and mutual funds. Tasked with maintaining a steady rate of return, rather than pursuing get-rich-quick strategies, the funds exercised a moderating influence on markets.

Institutional investors also became increasingly systematic in rewarding companies that performed well (by buying their stock) and punishing those that didn't (by dumping it). Armies of advisors, trackers, analysts, hedgers, and other financial wizards were deployed.

They had the effect of simultaneously making markets more inclusive (most families depended on the pension plan and gold watch at the end of the rainbow in those days), while increasing the distance between individual investors and the companies in which they were now indirectly investing. Trust was now something investors put in their advisors, rather than in the market itself.

THEN OIL ENTERS THE PICTURE

What a generation or two of Americans remember as the glory days, economically speaking, came to a rude halt with the advent of the 1973 Oil Crisis.

Within a few year period, Saudi Arabia's leaders and their OPEC brethren quadrupled oil prices from about $3 to $12 a barrel. (Inflation-adjusted to today's dollars, the rise would have been from about $15 to $50; current oil prices hover around $70 per barrel.) There was talk in the air of $50 oil, $60 oil, even $100 oil. The U.S. exit from Vietnam during the same period no doubt exacerbated the situation.

The crisis and all that went with it triggered a long era of stagnant employment and high inflation, or "stagflation." President Nixon couldn't stop it in the last days of his term, and it subsequently stymied President Gerald Ford (along with chief economic advisor Alan Greenspan) and President Jimmy Carter.

The 1973 Oil Crisis brought serious economic dysfunction to a society that was already socially fraught.

Another oil shock in 1979, brought on by the Iranian Revolution, ratcheted prices up to $38 a barrel (approaching $100 in 2010 dollars). The nation was in "malaise," in the words of President Carter.

MORNING IN AMERICA RE-DAWNS

Ronald Reagan's election as President of the United States in 1980 was due, in no small part, to the candidate's sunny optimism in the face of such grim times. The old actor expressed his belief and trust that "America's greatest days [lay] ahead."

President Reagan's espousal of supply-side economics (based on the theories of Milton Friedman and other University of Chicago economists) reversed a decades-long belief in the power of government stimulation that was advocated by British economist John Maynard Keynes.

Keynesian tinkering had been a cornerstone of U.S. government policy from the time of F.D.R.; it was central to his efforts to restore trust as he grappled with the Great Depression.

President Reagan set out to change all that. A new recession was triggered in the early 80s, causing a spike in unemployment, but also crushing inflation for good.

President Reagan's belief in personal initiative launched an Era of Entrepreneurialism in the U.S. that continues today. His advocacy of a "Star Wars" defense system and his efforts against what he termed the Soviet Union's "Evil Empire" continued America's long commitment to burying its fellow superpower, technologically and economically.

RECOVERY

THERE YOU GO AGAIN

Along the way came the Crash of 1987, something that remains rather mystifying to this day. It was thought then, and now, that this was the first crash caused by computers. A great deal of paper wealth was being manipulated by program trading rather than on-the-spot human decisions. The program trading seems to have been exacerbated by a large variety of derivatives, creating a house of cards where there was once a solid foundation.

We were a long way from the gold standard by then–who knew that derivatives could be so dangerous?

Meanwhile, the technological revolution in Silicon Valley ushered in a new era of economic growth for the country. The IT revolution led to spectacular productivity increases in businesses across the board.

In the end, the entrepreneurial 80s saw enormous new wealth created and "Masters of the Universe" emerge. Greed was good. The Crash of 1987 wiped out more than 22% of Wall Street's wealth in a single day, yet didn't significantly impede economic growth during the era.

President Reagan helped to restore trust in U.S. markets, and in the future of the U.S. economy, even as the country's social divide widened.

THEN HISTORY REPEATS ITSELF

Even so, the fate of the U.S. economy remained inextricably linked to oil, and little has changed since that first shock in 1973. As a result of this shift, the U.S. automobile industry embarked on a downward slide that may only now be reaching equilibrium. The domestic steel industry foundered as well. The U.S. remains one of the world's top oil producers, but it is also the world's top oil consumer.

Another strenuous recession in 1990 and 1991 foreshadowed future contractions of the media and advertising industries, but didn't seem to destroy investor trust in a serious way. A second oil shock followed the Iraqi invasion of Kuwait, and inflation fears continued to haunt Washington policymakers who had not forgotten the 1970s.

That recession was followed by the huge economic boom of the 1990s, primarily under President Bill Clinton's administration. The creation of the World Wide Web, and the ensuing dot-com madness, was the centerpiece of the boom; it helped drive the U.S. stock market to levels unseen by all and unimagined by most.

If there was ever a time that investors large and small trusted the markets, this was it. But the bursting of this particularly frothy bubble, and the events of 9/11, brought about a sudden end to investor optimism and trust in markets.

ENTER THE 21ST CENTURY

It's commonly observed that the Depression-era stock market took 22 years to recover from its low tide in 1932. As a contrast, the NASDAQ (admittedly only 15% of the overall market) has already taken a decade to recover about 25 percent of the losses it sustained from its year 2000 peak.

On a positive note, the Dow Jones and S&P 500 recovered well in the first decade of the 21st century. A new generation of college graduates emerged, as comfortable with the Web, social networking, and computing as their parents' generation was with television.

Another generation, confronting middle age for the first time, drew on their dot-com experience "back in the day" to avoid new bouts of irrational exuberance while maintaining the dream of end-game wealth creation.

But the world was still round–and increasingly connected; economic crises became instantly global. The Crash of 1987 started in Hong Kong, after all. The Asian Financial Crisis in 1997 rattled markets and caused consternation in governments throughout the world.

AN OCTOBER SURPRISE FOR THE AGES

Economists and politicians had a fresh opportunity to debate the root causes of the Great Depression, as the nation seemingly teetered on the precipice of another one in late 2008.

Even as they debated, the infusion of several hundred billion dollars to rescue the most seriously wounded companies, with hundreds of billions more waiting in the wings, has so far kept the U.S. and global economies from plunging over the edge.

One thing not up for debate in this scenario is the role of trust. The most sophisticated economic models can never account for the role that investor confidence plays in sustaining economic growth.

It's as if the entire global economy often operates on the moviemaking principle of "the willful suspension of disbelief." People must believe that the paper money they hold in their hand has intrinsic value. They must believe that the statements they receive in the mail, or online, are not just numbers on a page, but represent true wealth.

They must believe that the people in charge–whether in industry, finance, or government–know what they're doing.

WHERE'S THE RECOVERY?

Once everyone was able to look away from the precipice, they looked around–and so far, they haven't really liked what they've seen. Today, there's continued talk of a recovery, but there's also talk of a double-dip recession or something worse.

The harsh reality is that large parts of the U.S. economy remain shattered and shuttered. In fact, the U.S. has lost about a quarter of its manufacturing jobs since 2000–approximately 6 million jobs. Some states have lost 40% of their manufacturing base since 2001.

It's becoming apparent that losses of this magnitude, even in a supposed Post-Industrial Era, drag down numerous other industry sectors. A jobless recovery may not be a recovery at all.

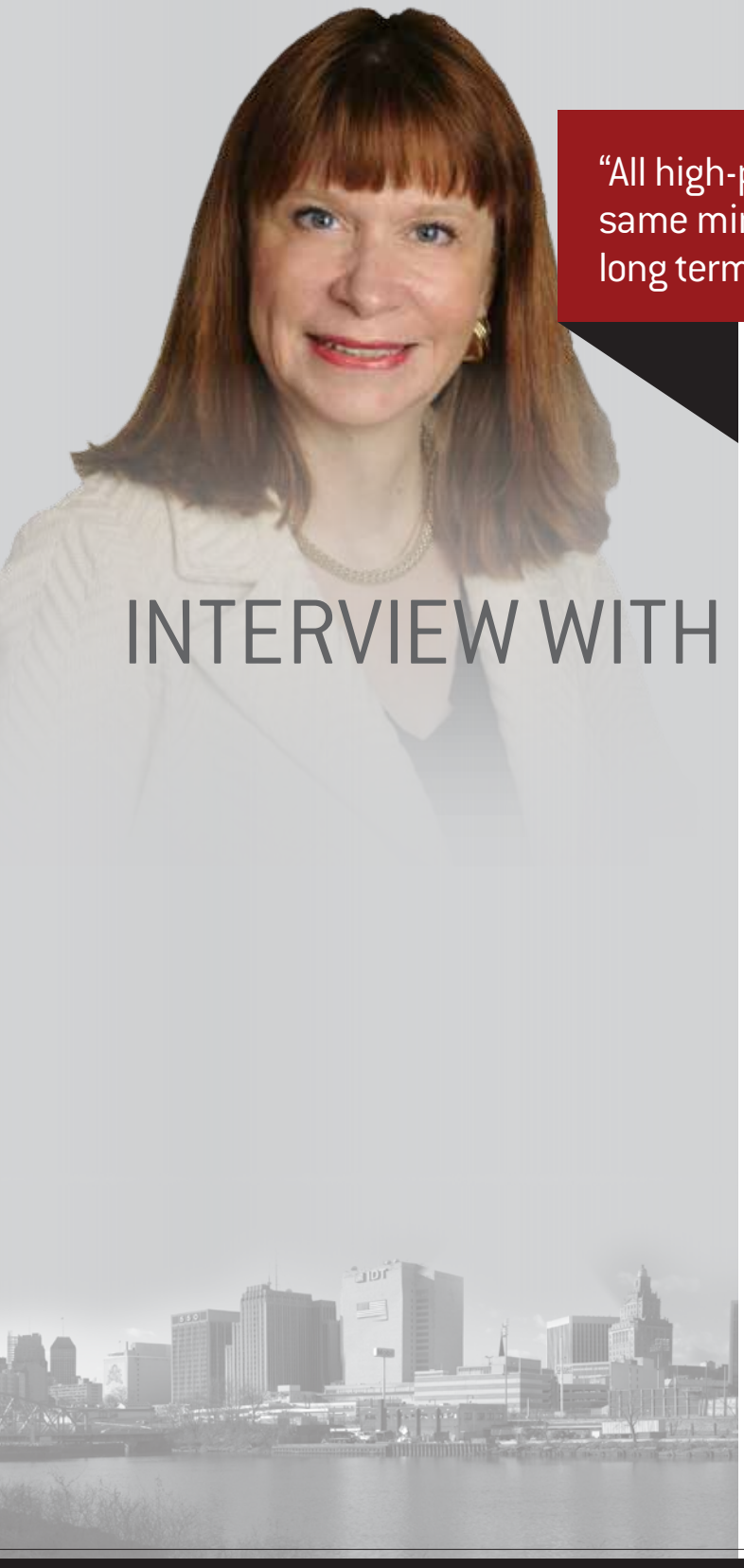
ONE THING NOT UP FOR DEBATE IN THIS SCENARIO IS THE ROLE OF TRUST. THE MOST SOPHISTICATED ECONOMIC MODELS CAN NEVER ACCOUNT FOR **THE ROLE THAT INVESTOR CONFIDENCE PLAYS IN SUSTAINING ECONOMIC GROWTH.**

TRUST IN WHOM AND IN WHAT?

The economic history of the U.S. displays several major shocks to the system. It could recover from its early shake-ups because the country was growing, and a small number of powerful investors could alter things on their own. But it had a terrible time trying to recover from the greatest shock so far, the Great Depression, a time when massive government intervention was first deployed.

The country's mood was also dire in the 1970s, when it looked as if "the good times [were] gone for good," in the words of a popular song of that era. In the final analysis, an initial wave of IT productivity, then a second one driven by the World Wide Web, saved the day.

What about today? Dodd-Frank seems likely to restore trust in the ability of management and boards to be more open and inclusive; but it isn't something that is meant to address the bigger picture. It seems something else is needed. Who else, or what else, will save the day this time? C



"All high-performing, effective boards have the same mindset and are really focused on the long term."

MARGARET (PEGGY) FORAN IS Chief Governance Officer, Vice President and Corporate Secretary of Prudential Financial, Inc., responsible for Shareholder Services, and the Mergers & Acquisitions, Disclosures, Capital Markets, and Derivatives divisions within the Law, Compliance and Business Ethics Department. Foran has a B.A. and a J.D. from the University of Notre Dame.

INTERVIEW WITH MARGARET FORAN

C-Suite Insight: You've mentioned that you have a passion for corporate governance. How did that develop, and how does this passion translate to your role at Prudential?

Peggy Foran: I love what I do, and maybe that has to do with fairness and respect for people. We're dealing with board members, executive officers, and share owners, so fairness and respect are critical. This means making sure that all are heard, and that things are done in the right and ethical way.

CSI: What similarities and/or differences have you seen between the two great industries with which you've most recently been involved (i.e., pharmaceuticals and financial services) as related to governance? Do you find that there are any underlying governance principles that apply generally?

PF: I see more similiarities than differences. I look at boards and executives often dealing with different specific issues, to be sure, but they deal with the policies and procedures in the same way, no matter what industry you're talking about. They always have to get the job done right, in an effective, efficient and ethical manner, and stay focused on long-term growth. So if, like me, you are a student of corporate governance, you will find many similarities among companies that have good corporate governance.

CSI: And the same goes for boards?

PF: Yes, I really believe that all good boards operate similarly. Taking a quote from Tolstoy, happy boards—that is, high-performing and effective boards—are all alike, whereas unhappy, dysfunctional boards are each dysfunctional in their own way. All high-performing, effective boards have the same mindset and are really focused on the long term.

CSI: While focusing on the long term appears to be a central objective of good governance principles, this is often easier said than done. How you are you able to maintain a long-term focus?

PF: As a board member, you have to look at the company's long-term strategy. The board also has to be flexible, because the world can change very quickly. But if you have the processes, the goal, the best people in place, and the best oversight you can muster, and the integrity, then you'll be an effective board for the long term.

We all know that 2009 was a very chaotic year, but Prudential came out of it much stronger than many, because it had the good processes, the good plan, the talent, the leadership and the oversight.

CSI: Say on pay has long been a talking point for politicians, academics and business leaders alike. While a lot of people talk about it, you've actually done something about it. In fact, Prudential has become the industry leader in adopting an advisory vote on pay. Can you detail your experience with this?

PF: Sure. About a year ago, when I came to Prudential, the company had just received a majority vote from shareholders requesting an opportunity to have a say on pay policy. The board and executive team said that they heard the message, so we went out and spoke with various shareholders, large institutions for the most part at first.

We want shareholders to make their own determination to take this topic seriously, we want engagement, and we are trying on many different levels to encourage engagement. Although we all agreed it was time for this, we came to the conclusion that it may require too much work on the part of our large, institutional investors to conduct the due diligence they would need to do every year.

So we've instituted say on pay for every other year. I think, consequently, several other companies have followed in Prudential's footsteps.

A second aspect relates to how you engage your shareholders–not only your largest ones, but your medium-sized and smaller shareholders as well. We decided to do a number of things. For example, the board challenged us to put our proxy statement in a language that was easier for everyone to understand, while still recognizing that we certainly have to comply with all SEC regulations.

As a result, our proxy statement now starts with a three-page letter from the board of directors to shareholders that talks about how board members do their jobs as stewards of the company. It gives an update of things they did over the past year for shareholders. And it is signed by the individual directors. Prudential is the first company to do this, the first to say, "let's try this."

We also have a CD&A in much cleaner language, and a summary that gives shareholders a sense of the highlights before they read the whole thing.

CSI: You also solicited feedback from shareholders, right?

PF: Yes, we took another step as well. The board wanted communication and wanted to know what was on shareholders' minds. So, in addition to our compensation website, which Prudential had put in place the prior year, we actively asked for feedback in a particular section of our proxy card.

CSI: And did you find shareholders to be responsive?

PF: We received more than 2,600 comments, really important information that we gave to the board.

We also thought long and hard about how to get shareholders to vote, particularly small shareholders. We came up with this idea to leverage

our very strong environmental sustainability program by offering a small incentive. We weren't concerned so much with how they voted; only that they did vote and that we could get them engaged!

So if they voted, we offered shareholders the choice between planting a tree in their name, or receiving a biodegradable, reusable, union-made bag.

CSI: Was this effective?
PF: It was very successful! An additional 23 percent of our registered shares were voted in 2010, as compared to 2009, and 68,000 shareholders voted who had not voted in the prior year. We consider this to be an enormous success in engaging shareholders. It was also a very efficient way to get the feedback the board wanted.

CSI: With all of this information, how do you strike a balance between providing a sufficient amount of information to inform the board, without overwhelming members?
PF: We provide board members with as much information as we think they need and want and then we ask them what else we should be providing. They are not shy about asking. Our executive officers want to keep the board up to date on all important issues.

We also strive to get our information from diverse sources. We certainly have a diversity of opinion among our shareholders; if you put several people in the same room, you'll find that not everyone thinks the same way. Nor would we expect them to. Then it's the board's duty to take all this information and make their decisions.

CSI: This raises the question about how ethics may play a role in the way you perceive of business and how it should be conducted. Are there any bedrock principles that you have held throughout your career?
PF: Integrity is the first thing that comes to mind. You also have to be at an organization that values transparency, respect for people, and excellence. Maybe that's why I'm attracted to governance, because good boards are looking for these very things.

I can't be motivated without these principles, and I can't motivate people on my staff if I don't believe in them. They're the cornerstones to driving long-term greatness.

Innovation is important within this context, too. Board members will always ask if there's a better way to do something.

CSI: Do you expect any additional challenges to arise from the Dodd-Frank bill?
PF: With any new legislation and regulations, I'm always a little concerned. Sometimes there are regulatory disconnects, so you need to go back and forth with regulators to make sure you are providing information to shareholders that is correct, but not confusing.

At times, we have given our small shareholders too much information for them to digest, but there are regulatory reasons for doing this.

We need to be sure not to obfuscate things or confuse shareholders, because instead of engaging them, we could end up doing the opposite.

Again, looking at innovation, we need to ask how we can present new information in a way that people understand it, are informed by it, and provide feedback. We also need to be sure we are being innovative, thoughtful and respectful. It should be an interesting year. C

WE NEED TO BE SURE NOT TO OBFUSCATE THINGS OR CONFUSE SHAREHOLDERS, BECAUSE INSTEAD OF ENGAGING THEM, **WE COULD END UP DOING THE OPPOSITE.**

INTERVIEW WITH ROBERT J. JACKSON. JR.

"The notion that we'd have a government official charged with setting compensation at some of the largest public companies was something we'd never done before."

ROBERT J. JACKSON, JR. IS Associate Professor of Law at Columbia Law School, where his research projects focus on the empirical study of corporate governance.

Professor Jackson previously served as an advisor on executive compensation and corporate governance to the Department of the Treasury and as Deputy Special Master for TARP Executive Compensation. Prior to joining the Treasury, Professor Jackson practiced in the Executive Compensation Department at Wachtell, Lipton, Rosen & Katz.

Mr. Jackson has previously worked in investment banking and as a consultant to financial institutions. He also served as a Law Clerk to the Hon. Amalya L. Kearse on the U.S. Court of Appeals for the Second Circuit, and as Articles Co-Chair of the Harvard Law Review. He received his J.D. from Harvard Law School; an M.A. in Public Policy from Harvard's Kennedy School of Government; an M.B.A. from the Wharton School; and a B.A. in politics, philosophy, and economics, and B.S. in economics, from the University of Pennsylvania, after studying at Pembroke College at Oxford University.

C-Suite Insight: You put a teaching gig on hold at Columbia to contribute as a member of Special Master Kenneth Feinberg's team. What was this experience like for you?

Robert Jackson: It was extraordinary in a number of ways. First of all, it was in every respect an unprecedented enterprise. The notion that we'd have a government official charged with setting compensation at some of the largest public companies in the United States–AIG, Citigroup, General Motors, Bank of America–was something we'd never done before, and I doubt we'll do it again. It meant that we had to answer completely novel questions each and every day. What information does a "Special Master for Compensation" need to know from the companies he supervises? How should he render his decisions–in written opinions, like a judge, or in a less formal manner? How should he explain his rulings to the public and the Congress? How should he interact with the boards of directors of these companies? All of that was brand new.

Second, for a novel policy approach, the stakes were extraordinarily high. Taxpayers had, and in many cases still have, billions of dollars invested in these firms, and our job was to set the pay for the most critical employees at these companies. Our margin for error was incredibly small, and that was something that was never far from our thoughts.

Third, the work required us to take some very general ideas about compensation practices and turn them into actual decisions on pay for actual individuals at actual companies. It's one thing to say that compensation should be appropriate, focused on the long term, and performance-based. But what does that mean for how we should pay the Chief Financial Officer of AIG? Turning those ideas into real-life decisions was an extraordinary experience.

CSI: As you've stated, you were asked "to take general principles from the ether and come up with exact instruments" on how you were going to pay executives at TARP recipients. How did you approach this task? What were the general principles you came up with and how did you forge those exact instruments?

RJ: The President, Secretary Geithner, and Ken Feinberg had all articulated the general ideas before we started our work. They explained, in very clear terms, that compensation for these employees had to be performance-based, and that executives should not receive substantial rewards until the taxpayer was repaid and shareholders received strong, sustainable returns on their investments in the companies' stock. Separately, Congress had provided in the Recovery Act clear guidance that governed how compensation could be delivered to the top earners.

Our team took that guidance and decided to make a new instrument, "salary stock," a critical component of executive pay packages. We lowered cash based salaries, and in place of that cash, we gave employees a portion of their regular paycheck in company stock, requiring them to invest their salary alongside taxpayers. We then required that the employees hold the stock over a long period–subject to acceleration if the taxpayers were repaid–so that the executives' payments depended on the long-term value of the company. Although the idea of "salary stock" was relatively new, it became a very significant component of the pay packages we approved.

CSI: It seems that what could have been viewed as a punitive measure has resulted in a positive situation.

RJ: Absolutely. You might imagine that such a radical change to compensation structures–for the first time, requiring individuals to take their paycheck and invest it in the company–would result in mass resignations. But that's not what happened. Instead, we found that the employees took the opportunity to make an investment in the firm as a challenge. They were much more willing than many expected to link their futures to those of the companies.

It's much too soon to know the results of our work, but the early data on how we did in terms of retaining employees has been very encouraging. Over 85% of the employees who we first ruled over in October 2009 are still in their chairs today, working for taxpayers.

CSI: In previous statements, you've mentioned that boards need to restore investor trust. Trust, you said, "is the source of liquid capital markets that has been driving our economy for generations." What can companies do, in addition to posting good financial results, to restore this trust?

RJ: Boards of directors are now just starting to accept that, from now on, they'll need to explain themselves–not just to shareholders, but to the public at large–about the decisions they make, especially on compensation matters. The press, the public, and the government are going to be asking hard questions, and boards are just now starting to prepare to give thoughtful answers. One of the most valuable aspects of being on Ken Feinberg's team was to be able to observe his talent for asking these hard questions–and demanding complete answers.

One reason that boards have been slow to understand this is that they have been lulled into thinking that their SEC disclosures do this job for them. Most directors think that their annual proxy answers most of the hard questions they could get about compensation and governance. Nothing could be further from the truth. Proxies are written to satisfy arcane legal requirements, not to explain to a skeptical public why the board thinks a decision is best for the company.

Directors responsible for compensation should start by asking themselves: could I explain this decision to the typical "Main Street" investor in a short elevator ride? If not, what about the decision is hard to understand? And how do I bridge that gap now by telling our investors, and the public, what they need to know to understand our choices?

Many directors are now asking these questions–I'm frequently hearing that directors are less interested in their advisors' views about what they're required to tell the public than what they should tell the public. In my view, boards that get ahead of these questions now will be doing their shareholders an important service.

CSI: How does this relate to policy discussions on transparency and disclosure?

RJ: Disclosure provides shareholders, and researchers like me, with important details about the decisions the board has made. To give those details, disclosures are generally written in a highly technical way. Most U.S. public companies' securities disclosures are generally designed to be, and succeed in being, impenetrable for most readers.

For that reason, disclosure and transparency are not the same thing. You can file a two-hundred page proxy statement detailing your compensation decisions and have excellent disclosure but fail utterly with respect to transparency. For example, for years companies have been including details about their CEOs' pension benefits in disclosures. But when Lucian Bebchuk and I did a study in 2006 and discovered that the average retired CEO was entitled to a pension worth over $15 million, many were surprised. Those pensions were disclosed, but not transparent.

Many companies have begun to understand this, and have begun to provide the public with explanations for their decisions totally apart from their formal disclosures. For example, just before bonus season last year, Goldman Sachs released a detailed presentation describing exactly how they chose to compensate their top earners–and why. That was not required by any securities rule, but it provided tremendous transparency to the public at a critical time.

As I mentioned earlier, many boards have been lulled into the sense that satisfying disclosure requirements is all they need to do to address questions on compensation. That view is unwise and unfortunate, as the experience of the last two years has shown.

CSI: Is the problem in the nature of the rules that govern disclosure? The companies doing the disclosing? Or a combination of the two?

RJ: For years the SEC has been trying to persuade companies and counsel to provide more clear disclosures that give shareholders and the public meaningful explanation rather than simply after-the-fact information. In my view, they've not been very successful.

One reason for this is that the rules themselves are inadequate to the task of

understanding compensation at these firms. For example, the SEC's disclosure rules apply only to compensation of the top few "executive officers" at large public companies. But the financial crisis showed that compensation matters not only for top executives but for employees throughout the organization. After all, none of the traders at AIG Financial Products were executive officers.

Another reason is that companies have been advised to provide only the disclosure the SEC has required–which relatively little explanation. But investors want to know more. What is it about the company's performance that justified large compensation? How does the company ensure that employees are only rewarded if shareholders realize long-term gains?

CSI: It seems that shareholders don't begrudge large compensation packages per se. There's no need to be defensive about a big pay package if you can explain how and why it was earned.

RJ: Absolutely. What I learned working for Ken Feinberg and Treasury is that we don't have a Congress or a country that is opposed to success, or is opposed to paying people for hard work. In fact, we have an ethic that demands that people be fairly compensated for their efforts.

What was hard for the public, the press, and Congress to understand is why people should be compensated for failing. In particular, large pay packages for executives that had presided over the destruction of incomprehensible amounts of wealth were unjustifiable. That is something so fundamentally contrary to the American ethos that it generated tremendous populist furor over these compensation issues, which is likely to be with us for some time.

CSI: With Dodd-Frank now signed into law, what effect do you think it will have in restoring trust?

RJ: It's too soon to know. Many of the Dodd-Frank governance provisions, some of which we in the Administration proposed last July, will help the public better understand these questions. But they leave the SEC with important discretion to craft new rules to implement the law, and the amount of progress we'll make depends on how the SEC writes those rules.

For example, at companies that pay executives in stock, CEOs often "hedge" the stock. In essence, executives use hedges to turn performance-based stock into virtual guarantees. Allowing them to do so makes very little sense, and Ken Feinberg's rulings banned it at the firms under his purview. Dodd-Frank requires that all companies disclose whether employees are permitted to do this. But the SEC will have to explain: what if, rather than hedging the stock, the employees simply sell the stock? And if employees can do this, does the firm have to tell shareholders whether employees actually did do it?

These questions are critical, and they're just a couple of examples of the enormous amount of rulemaking the SEC has to do under Dodd-Frank. And for these rules to apply to next proxy season, they'll need to be in place within six months or so. It wasn't surprising that the SEC announced last month that they're welcoming comments on these issues immediately.

That's why, this fall, I'll be teaching a seminar at Columbia in which students will work with me on a detailed comment letter to the SEC on how to implement these provisions. I'm hopeful that the SEC will take a careful look at these important questions. There's a great deal in Dodd-Frank that might help address the compensation practices that contributed to the financial crisis, but only if the SEC uses the new legal tools they've been given by Congress.

CSI: So here's your chance. What would you advise the SEC to do now?

RJ: There are three priorities, I think. First, the SEC has to keep in mind that Congress was so consumed by the national outrage over compensation that it took the unprecedented step of adding twenty-two pages to the U.S. code mandating reforms that neither the SEC nor public firms had undertaken themselves. This is not the kind of legislation that should be interpreted narrowly. The new rules should be written expansively, to reach not only the pay practices that contributed to this crisis but to help us anticipate the practices that could lead to the next crisis.

Second, the SEC should

consider that context when thinking about its existing rules–which, as I've said, gave shareholders no information about the most controversial and damaging pay practices. Currently, payments to the traders at AIG Financial Products would not be required to be disclosed, because the SEC still takes the view that those employees are not senior enough to require disclosure. Those rules should obviously be reconsidered.

Third, and perhaps most importantly, the SEC should have rules out in time for next proxy season. Many companies, and their counsel, are struggling to figure out exactly what they're required to do under the new law. It's unlikely that the SEC will be able to write new rules on all of these matters by next year. But there's no reason they can't provide preliminary guidance about their expectations that will shape what shareholders learn about pay practices next year.

So I'd urge the SEC to move expansively, to move quickly, and to recognize that its existing rules do not provide us with the kind of understanding about these issues that Congress, the public, and shareholders are now demanding.

CSI: You mentioned shareholders. How can institutional investors get better at asking the tough questions on compensation that you've talked about?

RJ: Well, Dodd-Frank has given institutions a critical tool that will give them a lot more leverage for asking the tough questions: "say on pay," a shareholder vote on compensation. But whether the institutions will take advantage of these tools remains to be seen. There are three key signs that they're improving on this front for us to watch for.

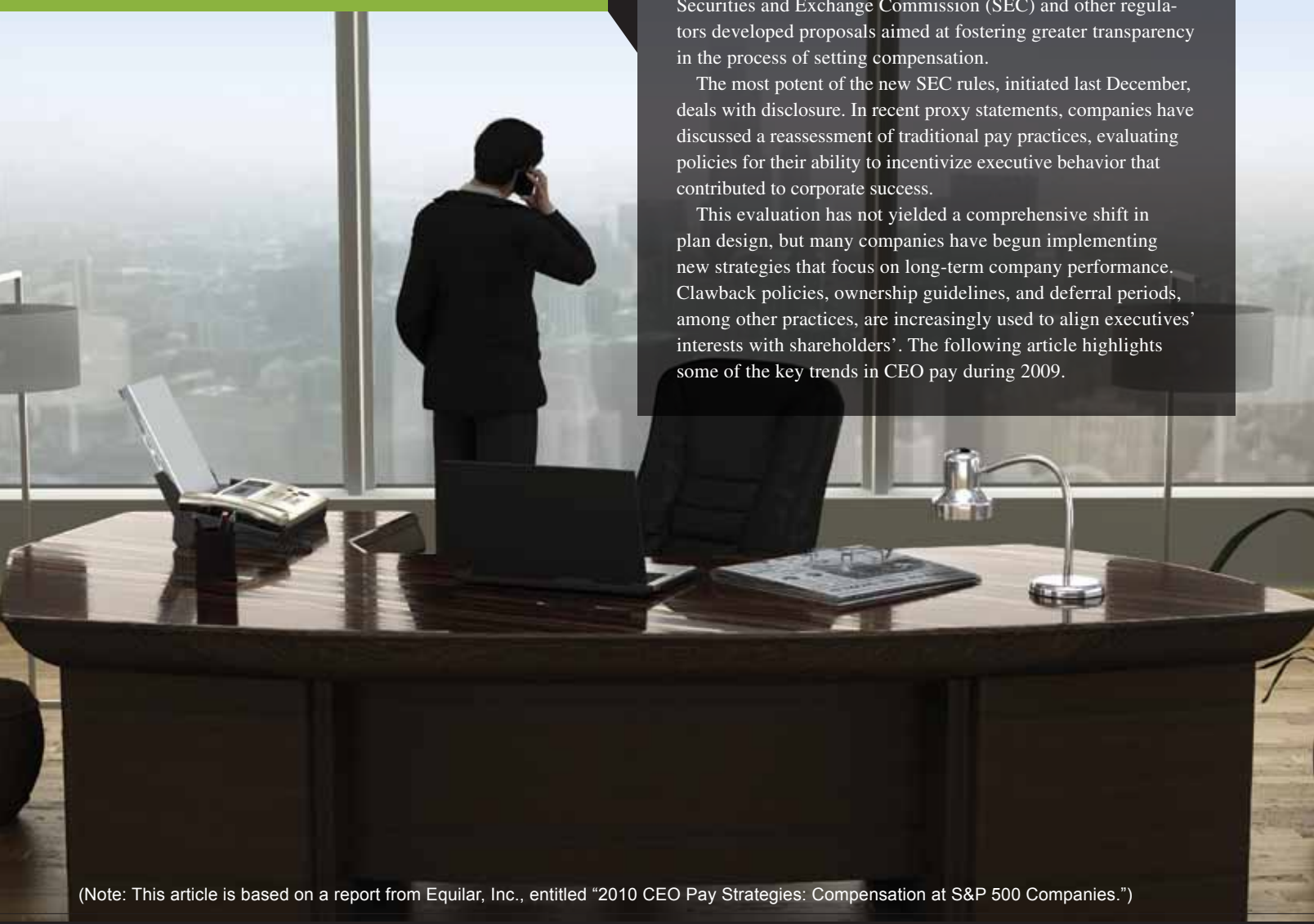
The first is proactive discussions with directors and management about pay. For a very long time, institutional investors have been mostly reactive: they get a proxy statement, see the numbers, and decide whether to withhold their votes on directors. Now that they've got a separate vote on pay, they need to be much more proactive in reaching out to boards about pay decisions–what they'll vote for and what they won't. The proxy should be a result of those negotiations, not a unilateral act by the company. From here on out, institutional investors should never be surprised by a proxy statement's compensation information. Second, like companies, institutional investors need to expand the scope of their thinking about compensation. Limiting their questions to the CEO or the top few executives, as we've seen, is a mistake. They should be actively inquiring about company-wide compensation practices, asking hard questions about how those decisions reflect investors' interests.

Third, institutions should draw bright-line principles that give companies a very good sense right now as to what they'll vote for and what they won't. Companies and their counsel are working hard to anticipate next spring's say on pay votes, and they'll be much more successful if they know what they're aiming for. How close they'll come to that target remains to be seen. C

MANY BOARDS HAVE BEEN LULLED INTO THE SENSE THAT SATISFYING DISCLOSURE REQUIREMENTS IS ALL THEY NEED TO DO TO ADDRESS QUESTIONS ON COMPENSATION. **THAT VIEW IS UNWISE AND UNFORTUNATE,** AS THE EXPERIENCE OF THE LAST TWO YEARS HAS SHOWN.

CEO PAY 2010

CEO PAY UNDER DURESS



SHARP DECLINE IN OPTIONS TRUMPS SALARY AND BONUS INCREASES

OVER THE YEARS, companies have continued to refine their compensation programs with the goal of effectively aligning pay with performance. The events of 2009 compelled companies to re-examine their current compensation practices. Overall CEO pay has dropped slightly, driven by a sharp decline in options that outweighed slight increases in salary and bonus.

In the wake of 2008's market volatility, and amidst a nascent 2010 market recovery, the value of balanced pay practices, transparent disclosure, and corporate accountability cannot be overstated.

During 2009, Congress was flooded with legislative proposals to rein in executive pay and align pay with performance. The Securities and Exchange Commission (SEC) and other regulators developed proposals aimed at fostering greater transparency in the process of setting compensation.

The most potent of the new SEC rules, initiated last December, deals with disclosure. In recent proxy statements, companies have discussed a reassessment of traditional pay practices, evaluating policies for their ability to incentivize executive behavior that contributed to corporate success.

This evaluation has not yielded a comprehensive shift in plan design, but many companies have begun implementing new strategies that focus on long-term company performance. Clawback policies, ownership guidelines, and deferral periods, among other practices, are increasingly used to align executives' interests with shareholders'. The following article highlights some of the key trends in CEO pay during 2009.

(Note: This article is based on a report from Equilar, Inc., entitled "2010 CEO Pay Strategies: Compensation at S&P 500 Companies.")

Total Compensation Declines

Median total compensation—calculated as the sum of base salary, annual and long-term cash bonus payouts, the grant-date value of stock and option awards made during the year and any other compensation—fell by 7.9 percent from 2008 to 2009, marking the second year in a row of overall compensation decline. Median total compensation in 2009 was approximately $7.5 million, down from $8.2 million in 2008. A sharp decrease in option awards drove much of the overall decline in compensation. The median value of option awards fell from approximately $2.3 million in 2008 to $1.9 million in 2009.

Bonuses Larger, More Prevalent

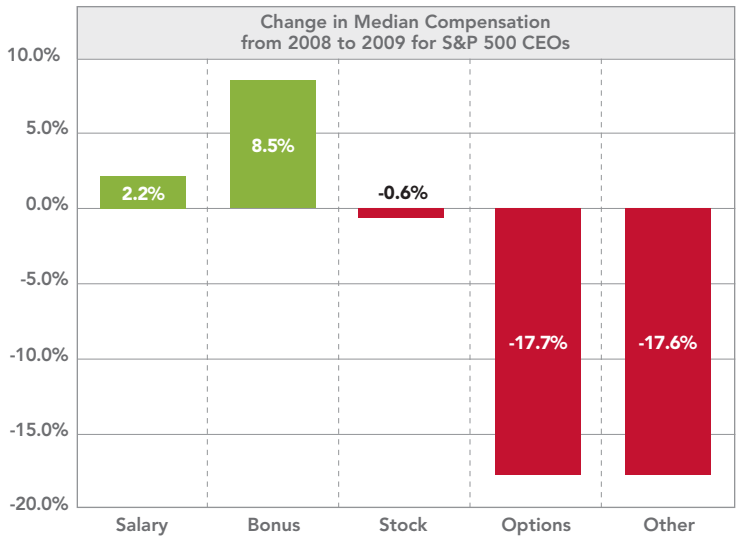
Aggregate bonus payouts, which include annual incentive payouts, discretionary bonuses, and long-term cash incentive payouts, rose from a median of $1,383,000 in 2008 to a median of $1,500,000 in 2009, an increase of 8.5 percent.

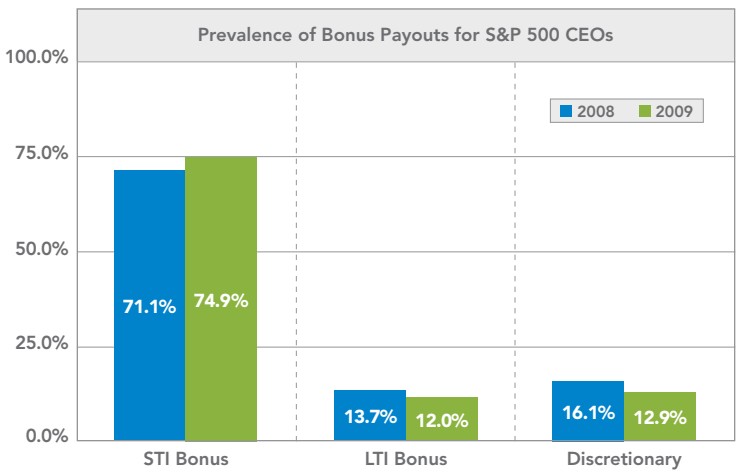
There remained a high prevalence of CEOs receiving short-term incentive plan bonuses, long-term incentive plan bonuses, and discretionary bonuses in 2008 and 2009. While fewer CEOs received payouts under long-term incentive plans or received discretionary bonus awards, more CEOs were awarded payouts under annual incentive plans. These plans rewarded CEOs for company performance after the downturn.

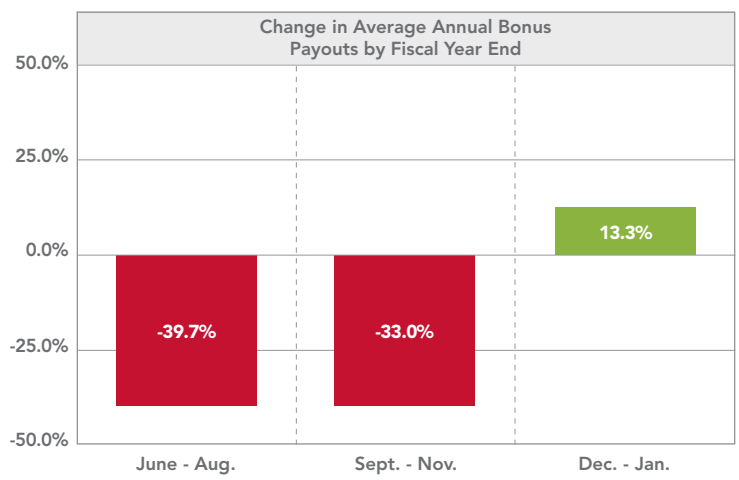
Annual Bonuses Bounce Back

To demonstrate how bonus payouts tracked overall economic performance, the chart on the right compares the change in bonus payout by fiscal year-end. The S&P 500 was divided into three groups, based on when they completed their most recent fiscal year: June 2009 to August 2009 for the first group, September 2009 to November 2009 for the second group, and December or January 2010 for the final group.

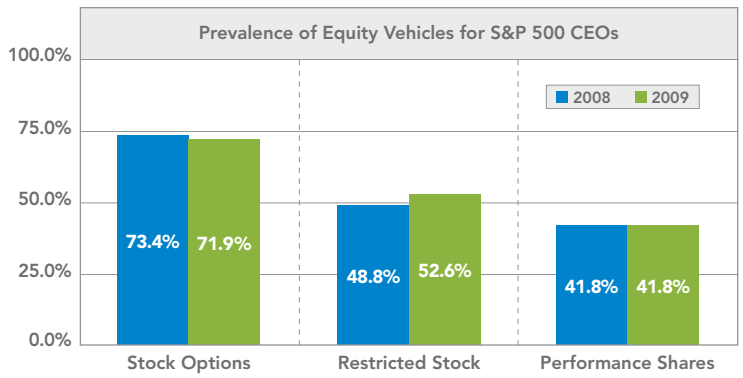
Members of the first group completed their fiscal year amidst the turmoil of the last quarter of 2008. Subsequently, the average annual bonus for this group decreased from 2008 to 2009. Influenced by market trends, the second group of companies continued to see reduced bonus levels. However, companies in the final group (which constituted over 80 percent of the total companies in this study) saw a 13.3 percent increase in average bonus payouts from 2008 to 2009.

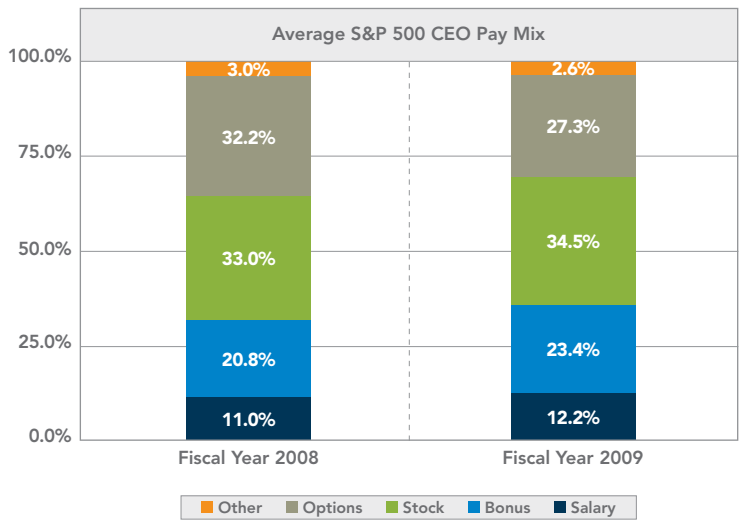






Source: Equilar, Inc.





Source: Equilar, Inc.

THE PERCENTAGE OF COMPENSATION PAID IN **BONUSES GROW** FROM 20.8 PERCENT TO 23.4 PERCENT OVER THE PAST YEAR.

Rise in Use of Restricted Stock

The troubled market certainly had its effect on the equity portion of pay during the last year. Option-value declines of over 15 percent played a significant role in the overall drop in pay in 2009. Options saw a decline of 17.7 percent, while restricted stock fell by 0.6 percent from its 2008 level. Since the timing of many companies' equity grants, awarded in early 2009, overlapped with the low point of their stock prices, the unit value of options and stock was lower than in years past. In order to maintain a consistent level of value for restricted stock, companies were forced to grant more shares.

Now that the markets have begun to rebound, we are already seeing signs of growth in equity values for 2010, and a subsequent decrease in the number of shares granted.

Restricted stock made the biggest gains among equity types employed in 2009, transitioning from a minority-used to a majority-used vehicle. The prevalence of full-value shares grew from 48.8 percent to 52.6 percent among the CEOs studied, continuing the move towards full-value shares and away from options that has been seen in recent years.

A somewhat surprising trend is the stability of performance shares. Despite pressure from the government and shareholders to tie pay with performance, companies appear to be choosing time-vested stock over performance-based equity. Prior to 2009, there was an increase in the use of performance shares as a pay vehicle.

Pay Design Shows Incremental Change

While the value of pay, and option awards in particular, shifted significantly, the overall design of pay packages remained relatively stable. The only major change was the percentage of compensation paid in options, which fell from 32.2 percent of aggregate S&P 500 CEO pay in 2008 to 27.3 percent in 2009.

The percentage of compensation paid in bonuses grow from 20.8 percent to 23.4 percent over the past year. In general, other pay components saw little change.

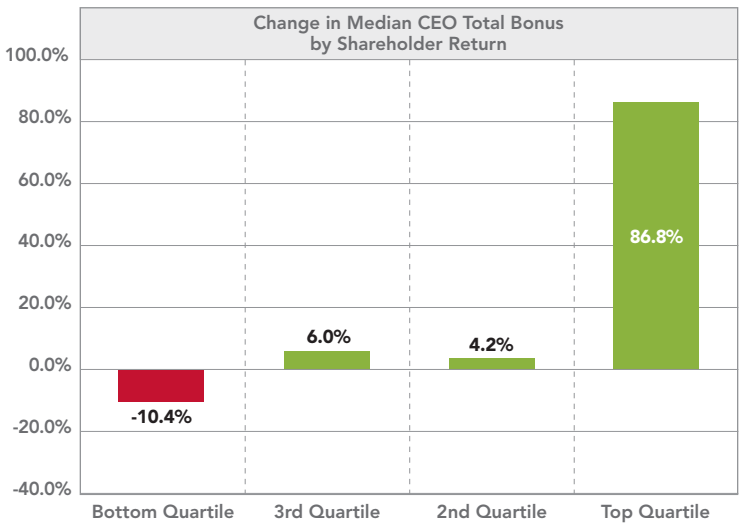
To determine these figures, Equilar added up each element of pay, then calculated the percentage of aggregate total pay each element represented. The following chart shows the percentage of total pay consisting of each compensation element in 2008 and 2009 for S&P 500 CEOs.

THE CONCEPT OF "PAY FOR PERFORMANCE" HAS BECOME **INCREASINGLY IMPORTANT TO SHAREHOLDERS.**

Bonuses Respond to Performance

The concept of "pay for performance" has become increasingly important to shareholders. To study this trend, Equilar divided the 342 surveyed companies into four equal quartiles, based on one-year TSR performance. Companies with the highest TSR were placed in the top quartile, and companies in the next-highest TSR group were in the second quartile. For this study, the top quartile had a median TSR of 82.7 percent in 2009.

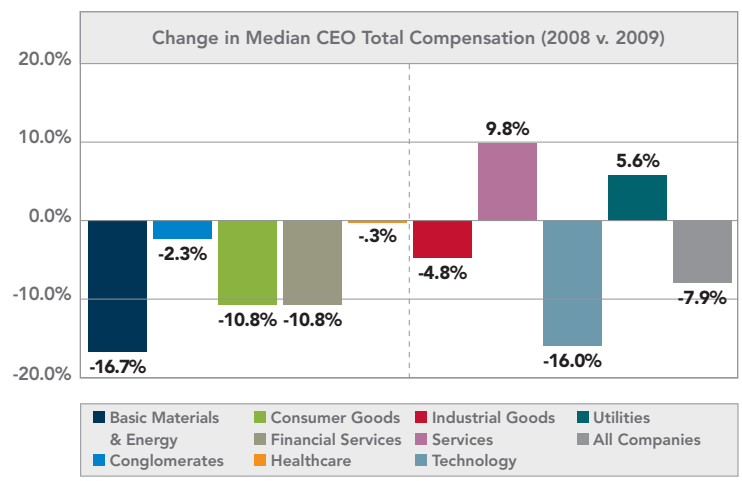
This was a substantial improvement over the bottom quartile, which had amedian TSR of -9.3 percent for the year. As can be seen in the chart, top-performing companies rewarded their CEOs with bonus payouts that were 86.8 percent higher in 2009 compared to 2008. CEOs in the bottom quartile experienced bonus declines, with the median total bonus falling by 10.4 percent for this group.



Pay by Sector

As one might expect, CEOs in certain sectors took harder hits than their peers in other fields. Basic Materials and Technology companies saw the largest decline in median total compensation for their CEOs, falling by 16.7 percent and 16.0 percent, respectively, from 2008 to 2009. Despite the steep drop in pay at Basic Materials and Technology companies, total compensation was lowest at Financial firms, for the second year in a row.

Total pay at Conglomerate and Healthcare firms remained steady in 2009; Healthcare CEOs received the highest median total compensation, at $10.5 million. Services and Utilities companies were the only firms that saw an increase in CEO compensation compared to 2008. The median total compensation grew 9.8 percent for Services CEOs and 5.6 percent for Utilities CEOs.



Source: Equilar, Inc.

Want to learn more? See the full report by visiting www.equilar.com, calling (650) 286-4512, or e-mailing info@equilar.com.

COO & CFO PAY 2010

COO AND CFO PAY MAY RISE AGAIN

A MARKET RALLY IN LATE 2009 COULD PROVIDE A HAPPIER ENDING THAN EXPECTED

THE LONG-TERM SUSTAINABILITY of a corporation relies on its ability to recruit and maintain highly qualified C-Suite executives, including the COO and CFO. Designed to assist co mpensation professionals, Equilar's reports on COO and CFO pay strategies are intended to provide a broad-based analysis of compensation strategies at S&P 1500 companies.

Although few Chief Operating Officers are as well-known as their CEO counterparts, COOs nevertheless play a critical role in assuring the success of a corporation's day-to-day activities. Charged with the responsibility of overseeing daily corporate operations, COOs must possess a wealth of business and industry knowledge to ensure that resources are efficiently allocated, operations effectively managed, and organizational structures sufficiently calibrated to guarantee the success of the overall corporate strategy.

An increasing amount of attention has been placed on the role of the CFO. After risk management became a major topic of interest in late 2009 and early 2010, companies looked to their boards of directors and top financial executives to re-evaluate corporate risk-management strategies, often redesigning programs to ensure accordance with best practices.

(Note: This article is based on two reports from Equilar, Inc., entitled "2010 COO Pay Strategies: Compensation at S&P 1500 Companies" and "2010 CFO Pay Strategies: Compensation at S&P 500 Companies.")

Total Compensation Declines

For COOs in the S&P 1500, the median total compensation decreased by 11.7 percent from 2008 to 2009. Median total compensation in 2009 was $1,929,483, down from $2,186,313 in 2008.

The median value of option awards fell from $208,578 in 2008 to $81,976 in 2009. In addition, stock awards saw a 16.2 percent decline, falling from a median of $443,884 in 2008 to a median of $372,144 in 2009.

Median bonus payouts grew from a median of $350,000 in 2008 to a median of $400,000 in 2009, representing 14.3 percent growth. Similarly, median salary rose by 3.5 percent from 2008 to 2009, reaching $519,750 in 2009.

For CFOs in the S&P 500, the median total compensation decreased by 3.1 percent from 2008 to 2009. Median total compensation in 2009 was $2,675,529, down from $2,760,008 in 2008.

The median value of option awards fell from $655,788 in 2008 to $560,153 in 2009. In addition, stock awards saw a 12.2 percent decline, falling from a median of $724,499 in 2008 to a median of $635,830 in 2009.

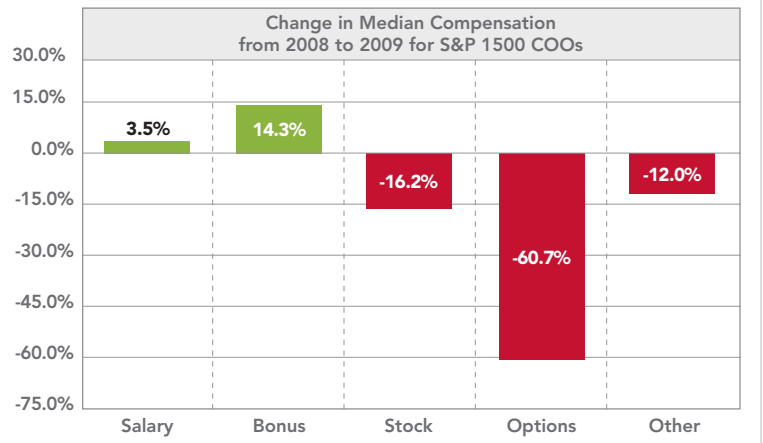
Salary and bonus amounts increased. Median bonus payouts grew from a median of $443,413 in 2008 to a median of $536,250 in 2009, representing 20.9 percent growth. Similarly, median salary rose by 7.4 percent from 2008 to 2009, reaching $549,170 in 2009.

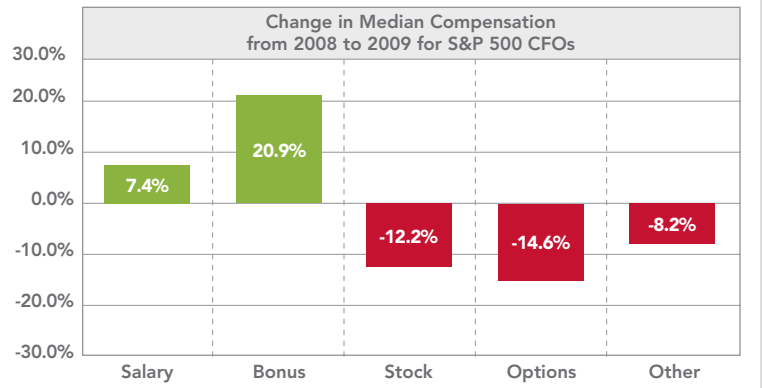
Equity Values

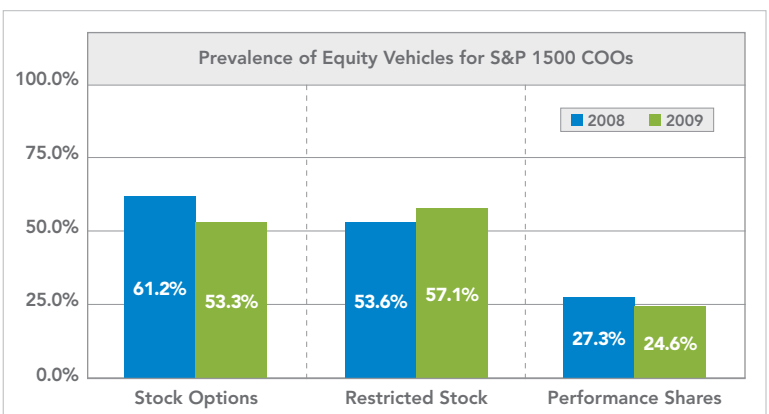
Option values for COOs saw a decline of 60.7 percent, while restricted stock values fell by 16.2 percent from their 2008 level. For CFOs, options saw a decline of 14.6 percent, while restricted stock fell by 12.2 percent from its 2008 level.

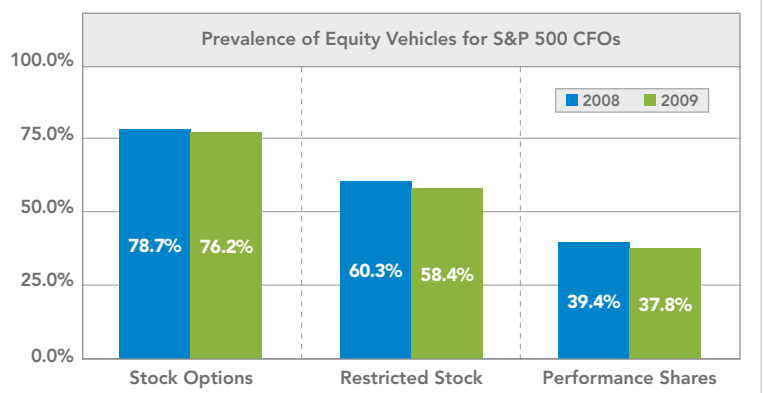
The number of COOs receiving stock awards grew 6.5 percent in 2009, while the number of COOs receiving options fell 13.0 percent. The prevalence of chief operating officers receiving performance shares also fell, dropping 10.1 percent. Stock awards emerged as the most prevalent equity type awarded to chief operating officers, with 57.1 percent of COOs receiving stock awards in 2009.

The number of CFOs receiving options or stock awards declined 3.2 percent in 2009, while the number of CFOs receiving performance shares fell 4.0 percent. Stock options continued to be the most prevalent equity type awarded to chief financial officers, with 76.2 percent of CFOs receiving options in 2009.









Source: Equilar, Inc.

Pay Design Shows Incremental Change

While the value of pay, and equity awards in particular, shifted significantly, the overall design of pay packages remained relatively stable. The only major change in pay design was the percentage of pay awarded as cash compensation versus equity compensation.

To determine these figures, Equilar added up each element of pay, and then calculated the percentage of aggregate total pay each element represented. The following charts show the percentage of total pay consisting of each compensation element In 2008 and 2009 for S&P 1500 COOs and S&P 500 CFOs.

For COOs in 2008, cash compensation, including salary, bonus, and other compensation, made up an average of 39.4 percent of pay. This number increased significantly in 2009, when cash compensation made up an average of 46.8 percent of total pay.

For CFOs in 2008, cash compensation, including salary, bonus, and other compensation, made up an average of 37.6 percent of pay. In 2009, cash compensation rose, making up average of 44.4 percent of total pay for CFOs.

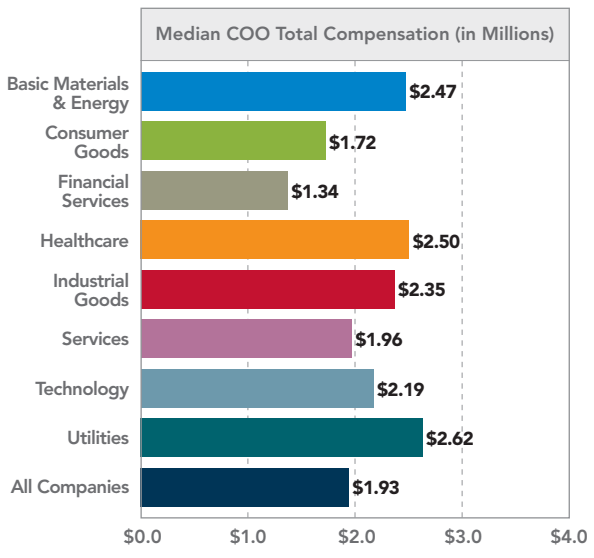
More Attention to Pay for Performance

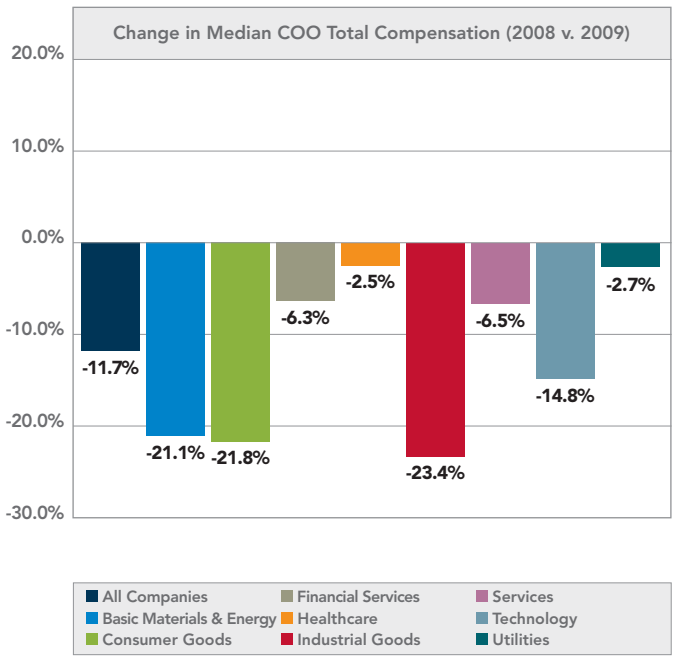
The concept of "pay for performance" has become increasingly important to shareholders, given the severe market issues of late 2008 and the subsequent reaction.

To examine the state of pay for performance, Equilar divided the companies it studied into four equal quartiles, based on one-year TSR performance. Companies with the highest TSR were placed in the top quartile, and companies in the next-highest TSR group were in the second quartile.

In the COO study, the top quartile had a median TSR of 101.9 percent in 2009. This was a substantial improvement over the bottom quartile, which had a median TSR of -17.2 percent for the year. Top-performing companies rewarded their COOs with bonus payouts that were 30.5 percent higher from 2008 to 2009. COOs in the bottom quartile experienced bonus declines, with the average total bonus falling by 26.1 percent for this group.

In the CFO study, the top quartile had a median TSR of 80.5 percent in 2009. This was also a sizable improvement over the bottom quartile, which had a median TSR





Source: Equilar, Inc.

of -7.6 percent for the year. Top-performing companies rewarded their CFOs with bonus payouts that were 56.5 percent higher from 2008 to 2009. CFOs in the bottom quartile experienced bonus declines, with the average total bonus falling by 15.5 percent for this group.

Sectors Vary, Market Rebounds

As with CEO pay (see the related article on page 32), COOs and CFOs in certain sectors took harder hits than their peers in other fields.

For COOs, Consumer and Industrial Goods companies saw the largest decline in median total compensation, falling by 21.8 percent and 23.4 percent, respectively, from 2008 to 2009. Median total pay at Financial firms was lower than any other sector, with a median total compensation of $1.34 million. Utilities COOs received the highest median total compensation, at $2.62 million.

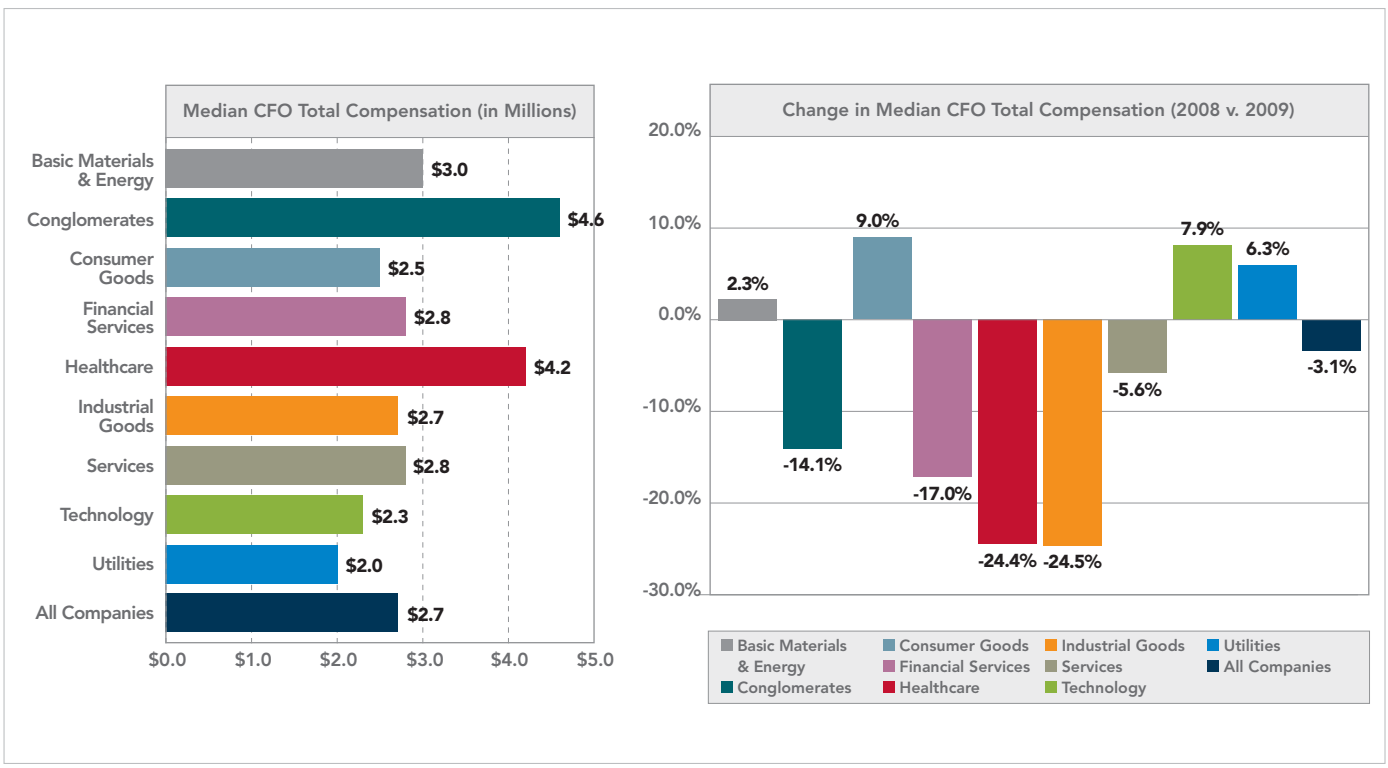
For CFOs, Healthcare and Industrial Goods companies saw the largest decline in median total compensation, falling by 24.4 percent and 24.5 percent, respectively, from 2008 to 2009. Conglomerate CFOs received the highest median total compensation, at $4.6 million. Median total pay at Utilities firms was lowest, with a median total compensation of $2.0 million.

Thanks to the market rebound in the second half of 2009, a number of executives may end up realizing more pay than they originally estimated. Falling stock prices not only lowered the value of equity awarded, but also forced companies to grant more shares in an attempt to mitigate the difference.

Due to the steep drop in stock prices at the end of 2008 and the beginning of 2009, a majority of executives found their 2008 options underwater. Meanwhile, many of the 2009 annual awards grew well into the money, as stock rebounded towards the end of the year.

Consequently, this increase in shares has begun to provide executives with strong values for their awards—only a year after they were granted. The pessimism surrounding the value of equity granted in 2008 has been replaced by excitement about the fortunate timing of increased shares and decreased exercise prices for equity granted in 2009.

Want to learn more? See the full report by visiting www.equilar.com, calling (650) 286-4512, or e-mailing info@equilar.com.



Source: Equilar, Inc.

"Every company has its own specific risks, which aren't necessarily dealt with effectively through broad-brush legislation."

JIM WOODRUM IS a Senior Advisor with Exequity, which is the fourth largest independent executive compensation advisory firm in the United States. In addition to this role, Jim is an adjunct faculty member at the University of Wisconsin–Madison. He also serves as a member of the Board (and Compensation Committee) at Packaging Corporation of America, a producer of containerboard and corrugated products with 2009 revenues of more than $2 billion. Jim was with Hewitt Associates from 1984 until 2006, where he spent the majority of his time advising large companies on executive compensation matters.

INTERVIEW WITH JIM WOODRUM

C-Suite Insight: You were one of the panelists at Equilar's Executive Compensation Summit in Washington, D.C. The topic of "unintended consequences" emerged as a principal theme during the discussion about risk. What unintended consequences have you witnessed resulting from various pieces of legislation?

Jim Woodrum: The classic one that everyone in the executive compensation industry deals with is Code Section 162(m), which imposes a deductible limit of $1 million on compensation. This started out as relatively simple legislation, but ultimately got watered down, and performance-based pay got exempted. This meant that options were more or less exempted, as they were considered performance-based, so overall compensation actually rose quite dramatically in the years after 162(m).

Christopher Cox (the SEC chairman under President George W. Bush) has said that 162(m) belongs in "The Museum of Unintended Consequences." More recently, we've had Sarbanes-Oxley. To me, the biggest concern with Sarb-Ox is that so much time is spent on a given set of compliance issues that

companies can, to some degree, miss the forest for the trees.

The reality is that every company has its own specific risks, which aren't necessarily dealt with effectively through broad-brush legislation. And we can see that in the financial collapse of 2008, very few of the things that caused it were anticipated by Sarb-Ox.

CSI: Do you foresee any unintended consequences arising from the Dodd-Frank Bill?

JW: One thing I'm concerned about is the idea that you'll compare CEO pay to the median pay of all other employees. Although this idea seems logical at first blush, calculating the median pay at companies with employees in many different places with a number of different benefits programs will be challenging and potentially very expensive.

Further, if a company has lots of low-paid employees (say a call center, for example), and therefore has a ratio between CEO and median employee pay that looks bad, they could, in theory, simply outsource those employees. This will make the ratio look better but is not necessarily the best thing for the employees or the company. I don't think anyone intended to push companies down that path.

CSI: From your perspective, will Dodd-Frank have an effect on consultants, too?

JW: Yes, there's also this notion that a compensation committee has to take into account any business or personal relationship with an outside advisor when determining whether they are independent. Taken to the extreme, companies might be reticent to hire a consultant that works with a committee member at another company. Within the confines of Dodd-Frank it could viewed as a conflict of interest, ignoring the possibility that someone may get additional opportunities because they are good at their job.

So yes, people may look back at certain aspects of Dodd-Frank and say, "Oops, we didn't mean for that to happen."

CSI: Legislation tends to be reactive; the mindset is, "Hey, there's a problem. Let's fix it!"

JW: Yes. Legislation tends to address yesterday's scandal. But it's entirely possible that yesterday's scandal won't happen again because of market forces.

CSI: How's that?

JW: Once people have figured out how a particular game can be played, the market is likely to prevent it from happening again. Pension funds are much less likely to buy collateralized obligations of various kinds today, because they've seen that these things are not worth as much as they were portrayed to be worth.

CSI: You mentioned during the Summit that it might be time for companies and their top executives to start acting with "modesty, transparency, and certainty." What exactly does this mean?

JW: There was a time, during the 80s and 90s, when the justification for the latest bonus plan or stock-option plan was "it won't matter as long as the shareholders make money." But somewhere along the way, the numbers got big enough that things changed. With seven- or even eight-figure stock-option grants, it does matter.

Modesty means "don't stick out." Look at the market data, look at the world in which you're operating, and unless you have some very good business reasons to do so, you don't want to be operating on the edges.

CSI: How about transparency?

JW: There's an old adage in sales compensation called the "dome light test." If your salespeople can't read and figure out their compensation

plan under the dome light of their car, then it's too complicated.

This simplicity relates to transparency: how many benefits and perks do you have and how many moving parts are there? Over time, we've developed this notion that executive compensation is very complicated. The result is you can have plans that are not only difficult for shareholders to figure out, which is bad, but now, maybe even your executives can't figure it out.

If your executives need a spreadsheet to figure out the compensation implications of the various decisions they make, your company clearly doesn't have enough transparency in its approach to executive compensation.

CSI: And what of certainty?
JW: Certainty is a tradeoff for modesty. As you go through a transition from a highly leveraged plan, in which you had a good chance of sticking out, to one where that's not as likely, then a reasonable tradeoff is to tell your CEO, "You're going to have less upside, but your odds of getting something will be enhanced along the way."

Remember, executive compensation is not only about how you choose to pay, but also about who you choose to pay. So this is where compensation and succession planning come together—the idea of creating the right program and finding executives who will be happy with it.

CSI: Is it reasonable to require that all public companies fall under the same penumbra of scrutiny as a result of the problems that were centralized, for the most part, in the financial services industry?
JW: I'm not sure it's relevant whether it's reasonable or fair. The reality is that were it not for the reasons that caused the crash, this sort of regulation might have happened anyway with a different justification.

The arrow is pointing to more regulation. If and when energy companies are further regulated because of the recent oil spill in the Gulf of Mexico, the legislation and regulations may certainly include more companies than just energy companies. It may even include additional regulation of executive compensation.

So the management and boards of public companies have to be reconciled to two things: first, there will be continued regulation, and second, new regulation is very difficult to take out once it's in place.

Going back to 162(m), most people would agree that it's not a terribly helpful piece of legislation, but it's about to celebrate its 20th anniversary and it's not going anywhere.

CSI: With all the emphasis on reducing risk these days, how can companies sustain a healthy balance of risk-taking?
JW: One very important point to think about is that executives—and the entire population of an organization—are human beings, and human beings don't always act rationally.

There's been a lot of literature published about behavioral economics and behavioral finance, which addresses how people are inherently unpredictable and don't always act rationally when interacting with their financial life.

CSI: And this notion extends to top executives and how they behave?
JW: Yes, I think it holds true for compensation programs. There's probably too much focus on technical compliance and corporate finance and not enough on how people are going to react (rationally and irrationally) to the things that are put into place for them.

By way of example, it's generally thought that stock ownership guidelines are a good thing, and that more executive stock ownership is a good thing. But there exists

the possibility that holding a bunch of company stock may make some people risk-averse. They may think, "I already have enough money where my net worth meets my needs, and I don't want to blow it."

CSI: During the Summit, you commented that CEOs may in fact have many more eggs in their basket than many of the largest institutional investors. Could you elaborate on this thought?

JW: Yes, there's this interesting phenomenon underlying this, and that is that large shareholders—mutual funds, pension funds, etc.—have the option of being fully diversified, whereas executives do not. A particular stock might be 2 percent of the fund's portfolio, but the executives may have 70 to 80 percent of their net worth tied up in stock through their compensation program.

The program was designed to do just that, but it might cause executives to act in ways that are very different from what shareholders might want, given their concentration of ownership.

People also tend to measure their net worth at its peak. So if a stock drops significantly, an executive might think, "Hey, I'm not worth as much and I feel bad about not having what I had before." As a result, they may do some risky things in an attempt to get their net worth back up to where it was.

To me, thinking about the behavioral implications of executive compensation, as opposed to just the tax accounting and financial implications, is very important.

CSI: You wear many hats, among them consultant, board member, and professor. How did that evolve and how does each role influence the other?

JW: After 20-plus years in consulting, I had the opportunity to do some guest lecturing at the University of Wisconsin-Madison. I focused on that, and now help direct the Evening and Executive MBA program.

But I missed consulting soon enough, so decided to have a few clients to create a balance. Then the opportunity to join a board came along in 2009.

I crave variety, and now have it with teaching, consulting, and board service. Fortunately, each of these roles makes me better at the others. As an example, the preparation required to teach Organizational Behavior to MBA students definitely makes me better in the other two roles.

I CRAVE VARIETY, AND NOW HAVE IT WITH TEACHING, CONSULTING, AND BOARD SERVICE. FORTUNATELY, **EACH OF THESE ROLES MAKES ME BETTER AT THE OTHERS.**

CSI: And what is your current academic focus on?

JW: The biggest question that has been raised is about the inherent value of an MBA. Beyond that, we seek to deliver a program for working professionals that furthers the University of Wisconsin's history of producing as many CEOs as Harvard University.

John Morgridge, a Wisconsin graduate and the former Chairman of Cisco, once told a group of our students that companies are likely to focus on the East Coast if they're looking for financial engineers, the West Coast if they're looking for start-up executives, but will go to the Midwest if they're trying to find a good general manager.

So we focus on helping our Executive and Evening MBA students find their "inner general manager." C

BENEFITS & PERQUISITES 2010

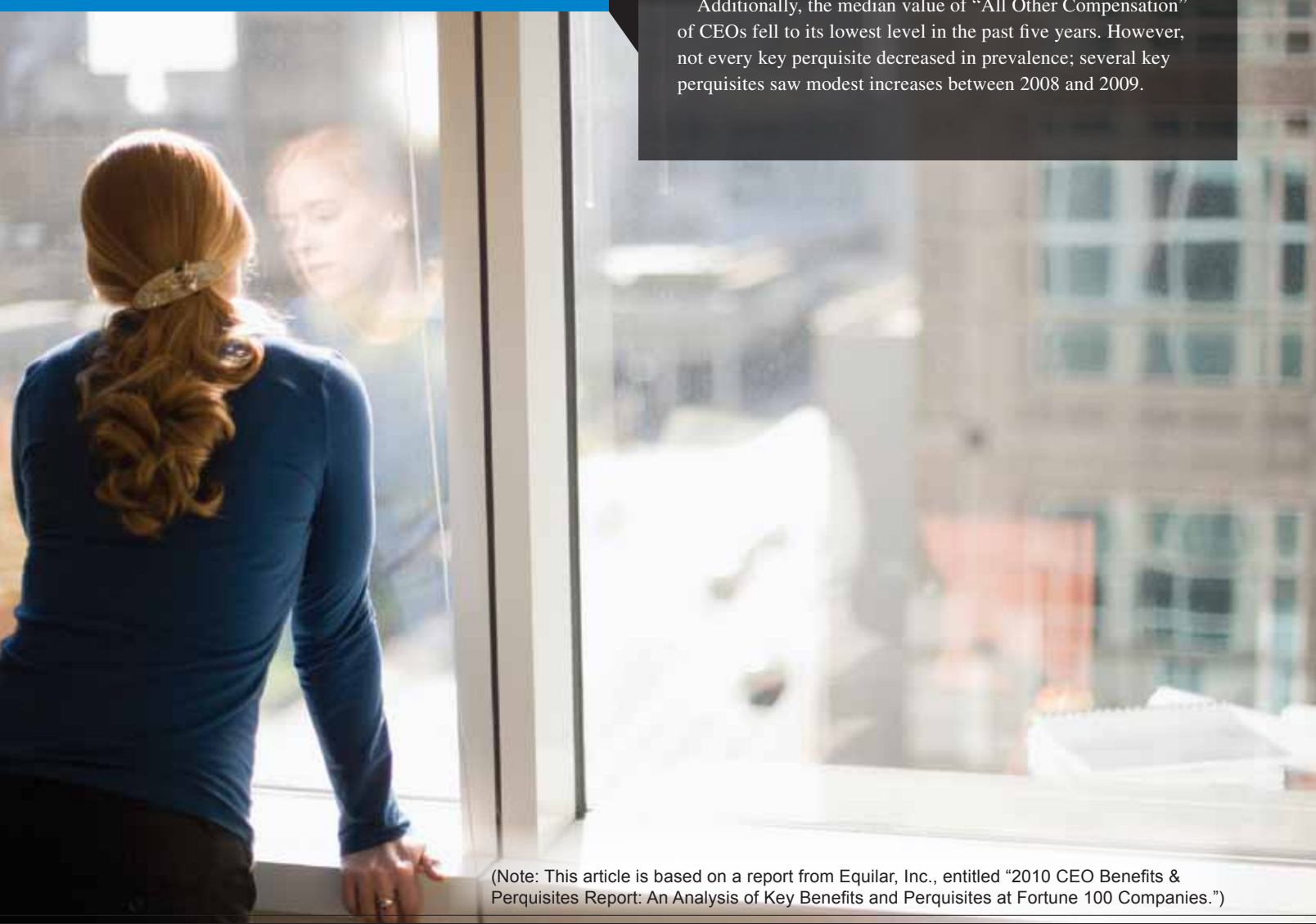
BENNIES AND PERKS UNDER SCRUTINY

RESEARCH FINDS PROGRAM REDUCTIONS, PRUDENCE

THE BACKLASH AGAINST high levels of executive compensation that began with 2008's economic downturn continued through 2009. The increase in media coverage and demand for accountability kept executive compensation at the forefront of public interest. With both shareholders and government officials calling for increased transparency, companies face growing pressure to justify the components of their executive compensation, especially their executive perquisites.

Due to the increased scrutiny, many companies amended their compensation policies in 2009. During 2009, over one third of the Fortune 100 companies included in this report eliminated at least one perquisite program.

Additionally, the median value of "All Other Compensation" of CEOs fell to its lowest level in the past five years. However, not every key perquisite decreased in prevalence; several key perquisites saw modest increases between 2008 and 2009.



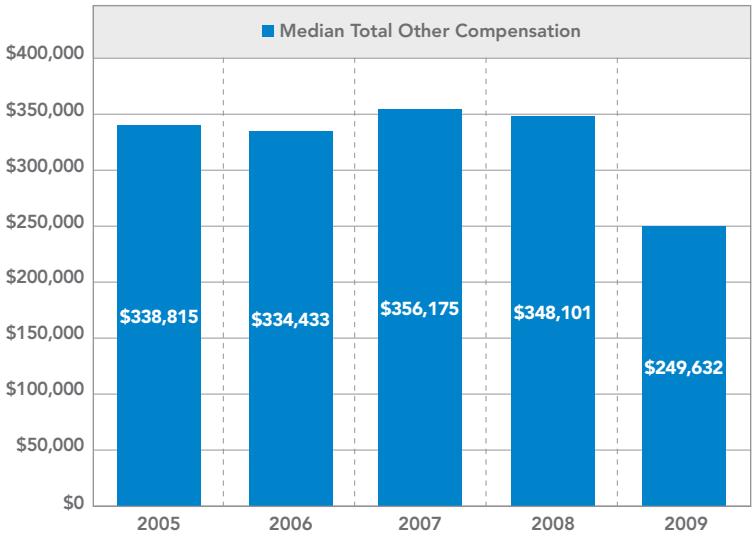
(Note: This article is based on a report from Equilar, Inc., entitled "2010 CEO Benefits & Perquisites Report: An Analysis of Key Benefits and Perquisites at Fortune 100 Companies.")

Total Other Compensation

From 2008 to 2009, the median value of total other compensation for chief executives at Fortune 100 companies fell by 28.3 percent, dropping from $348,101 in 2008 to $249,632 in 2009. This reduction followed a 2.3 percent decrease in CEO total other compensation from 2007 to 2008. Overall, total other compensation decreased at an annualized rate of 7.4 percent from 2005 to 2009.

For fiscal year 2005, total other compensation is calculated as the sum of the "Other Annual Compensation" and "All Other Compensation" columns of the Summary Compensation Table. With the implementation of new SEC disclosure requirements for fiscal year 2006 and onwards, these two columns have been merged into a single "All Other Compensation" column.

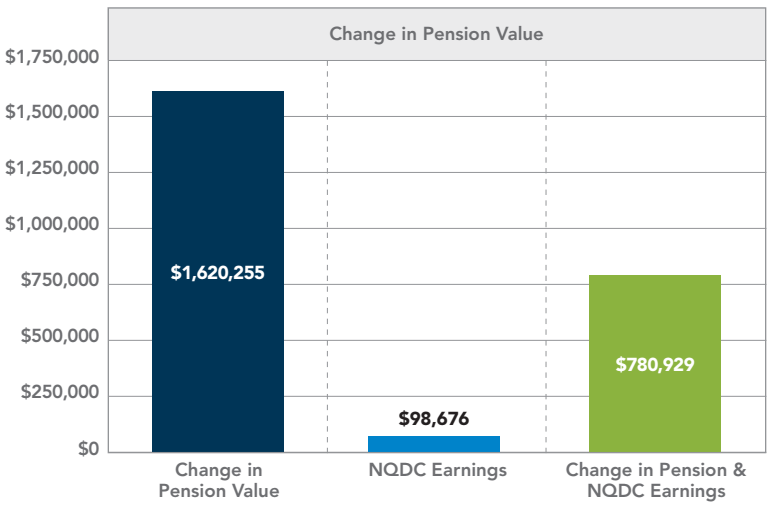
Additional changes to perquisite disclosure thresholds make direct comparisons between years before and after fiscal 2006 difficult.



Retirement Benefits

In 2006, the SEC introduced a new column to the Summary Compensation Table, the "Change in Pension Value and Nonqualified Deferred Compensation Earnings" column. This column includes new data elements, as well as information that was previously disclosed in the "Other Compensation" columns of the old Summary Compensation Table.

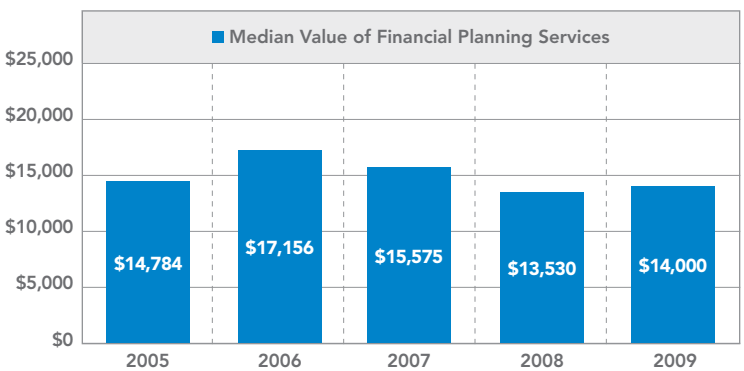
The chart featured on the right illustrates the median value of the "Change in Pension Value and Nonqualified Deferred Compensation Earnings" column and its two core components for Fortune 100 chief executives in fiscal year 2009.



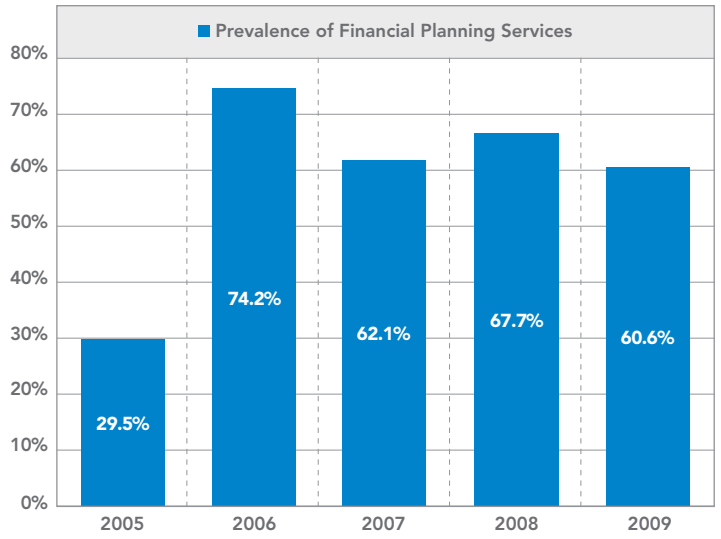
Financial Planning Services

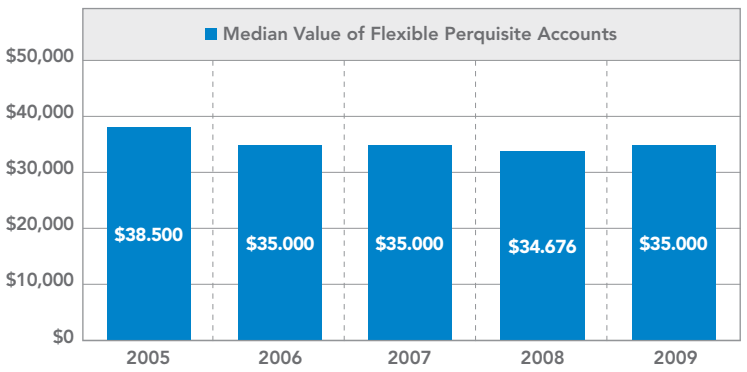
In 2009, Fortune 100 CEOs received a median of $14,000 in financial planning and other professional services benefits, representing an increase of 3.5 percent over the 2008 median of $13,530. Looking back to fiscal years 2005, 2006 and 2007, Fortune 100 CEOs received $14,784, $17,156 and $15,575 respectively in financial planning and other professional services benefits.

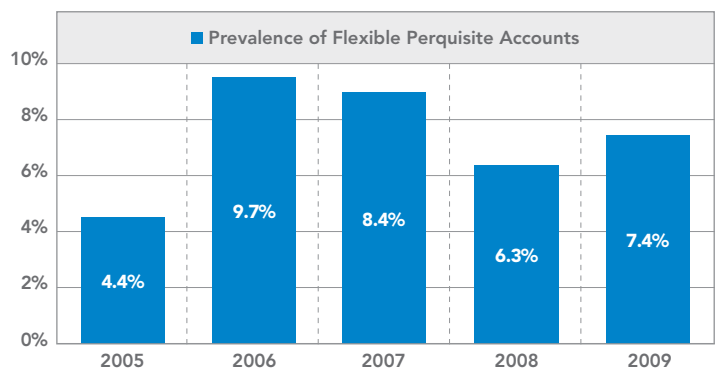
These values principally consist of the cost of personal financial planning, but may also include other services such as tax preparation, corporate financial planning and personal legal services. Overall, financial planning benefits decreased in median value at an annualized rate of 1.4 percent from 2005 to 2009.



Source: Equilar, Inc.







Source: Equilar, Inc.

Financial Planning Services – Prevalence

The prevalence of Fortune 100 companies reporting financial planning and other professional services for their CEO decreased from 2008 to 2009, falling from 67.7 percent to 60.6 percent. From 2005 to 2006, the year-over-year prevalence jumped from 29.5 percent to 74.2 percent.

A key reason for this increase was the lowering of perquisite disclosure thresholds instituted by the SEC. This climb was followed by a decrease in prevalence to 62.1 percent in 2007 and a climb in prevalence to 67.7 percent in 2008.

The prevalence of Fortune 100 companies disclosing the actual value for financial planning benefits for their CEO in 2009 decreased from 38.5 percent in 2008 to 24.5 percent in 2009.

Flexible Perquisite Accounts

The median value of flexible perquisite accounts for Fortune 100 CEOs rose by 0.9 percent over the last year, climbing from $34,676 in 2008 to $35,000 in 2009. This rise differs with the overall annualized rate of decline of 2.4 percent from 2005 to 2009.

The prevalence of Fortune 100 companies disclosing a flexible perquisite account for their chief executive increased from 6.3 percent in 2008 to 7.4 percent in 2009. Previously, from 2007 to 2008, flexible perquisites saw a decline in prevalence from 8.4 percent to 6.3 percent.

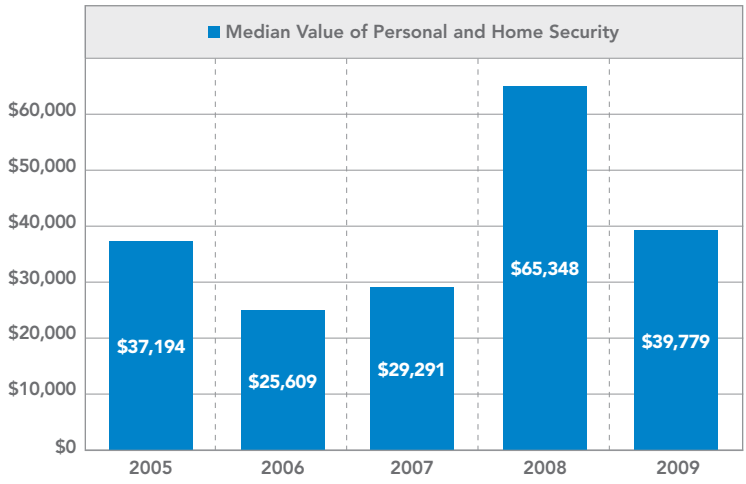
66%

2009 Prevalence of Personal Use of Corporate Aircraft

Personal and Home Security

From 2008 to 2009, the median value of personal and home security perquisites for Fortune 100 chief executives fell by 39.1 percent, decreasing from $65,348 to $39,779. This fall in median value follows an increase of 123.1 percent from 2007 to 2008. The overall annualized rate of increase in median values for personal and home security perquisites is 1.7 percent from 2005 to 2009.

From 2005 to 2006, there was a substantial increase in the prevalence of security-related benefits, from 23.3 percent to 53.8 percent. This increase accompanied the new SEC disclosure rules which went into effect in 2006. These rules prompted companies to disclose security benefits that fell below the old disclosure threshold of $50,000.



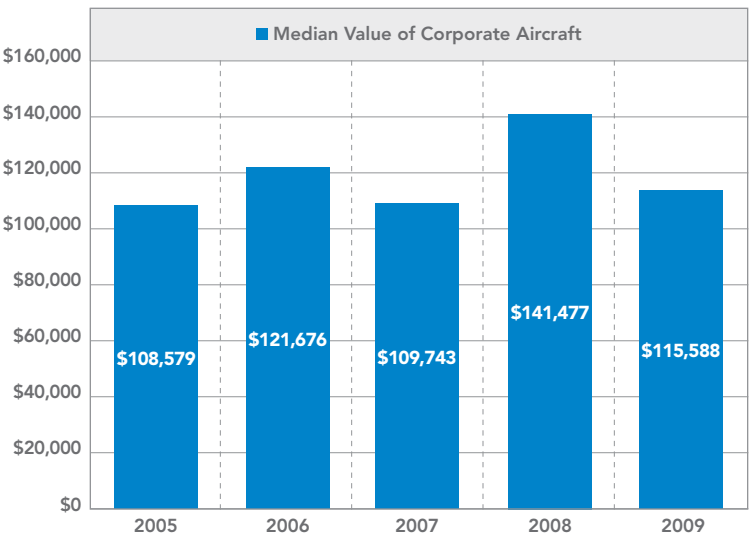
Personal Use of Corporate Aircraft

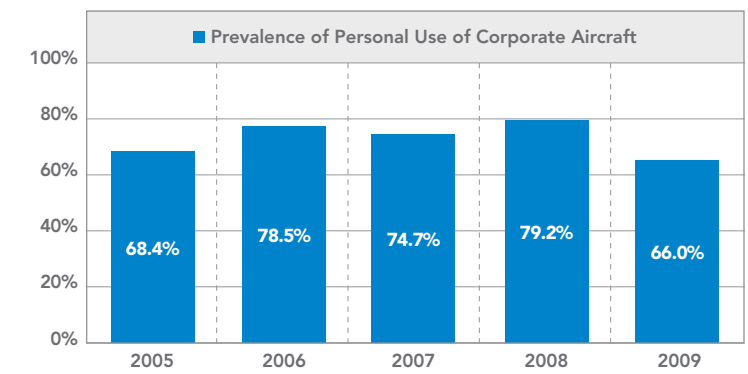
In 2009, the median value of aircraft-related perquisites for Fortune 100 chief executives fell to $115,588. This amount represents a decrease of 18.3 percent over the 2008 median of $141,477. The median value of CEO aircraft perquisites rose from 2007 to 2008. Prior years of data show that the median value of aircraft-related perquisites has increased at an annualized rate of 1.6 percent from 2005 to 2009.

From 2008 to 2009, the prevalence of Fortune 100 companies reporting the personal use of corporate aircraft by CEOs fell from 79.2 percent to 66.0 percent.

Among the 5.3 percent of Fortune 100 companies that disclosed a dollar amount for tax reimbursement of aircraft use, the median gross-up was $10,576. This represents an increase of 6.4 percent from 2008, when the median gross-up was $9,936.

The values cited above for all years exclude the value of tax reimbursements (also known as "gross-ups") associated with the personal use of corporate aircraft. In 2009, chief executives at 9.6 percent of Fortune 100 companies received tax reimbursements in connection with corporate aircraft use, a drop from 15.6 percent of Fortune 100 CEOs in 2008.





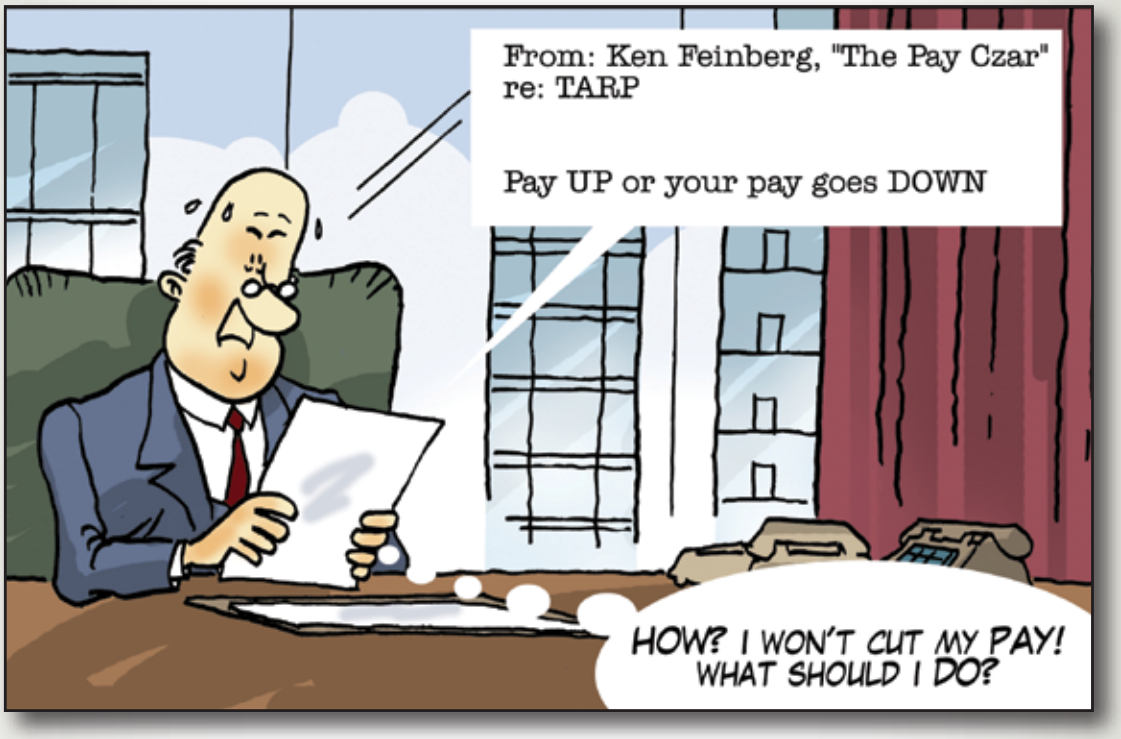
Other Perquisites

Other fairly common perquisites include tax reimbursements, automotive and parking expenses, club dues, annual physical exams, family and spousal travel on corporate aircraft, matching charitable contributions, and corporate housing.

Want to learn more? See the full report by visiting www.equilar.com, calling (650) 286-4512, or e-mailing info@equilar.com.

Source: Equilar, Inc.

$EYMOUR CASH


From: Ken Feinberg, "The Pay Czar"
re: TARP
Pay UP or your pay goes DOWN
HOW? I WON'T CUT MY PAY! WHAT SHOULD I DO?


CUT EVERYONE'S SALARY!
CLOSE THE CAFETERIA!
ALREADY DID!
ALREADY DID!
WELL, CAN WE INSTALL PAY TOILETS??
SPLENDID IDEA!
CFO

A new choice has emerged for Compensation Committees

Announcing a new independent executive compensation consultancy

Meridian Compensation Partners, LLC

- We are wholly owned by our partners, all former principals of Hewitt Associates' executive compensation practice.
- We are among the largest independent consulting firms specializing in executive compensation and corporate governance.
- We have the depth and breadth of knowledge, experience and resources to provide Directors the advice needed to make sound decisions.

We welcome the opportunity
to discuss your needs.

MERIDIAN
COMPENSATION PARTNERS, LLC

For more information, please call **847-235-3600.**

www.meridiancp.com

Lake Forest, IL | Atlanta, GA | Boston, MA | Chicago, IL | Dallas, TX | Houston, TX | New York, NY | Toronto, Canada

SOMEBODY'S WATCHING YOU

FIND OUT WHO INCLUDES YOU IN THEIR PEER GROUPS

WITH PEERINSIGHT

- ACHIEVE TOTAL PEER GROUP INTELLIGENCE
- QUICKLY REFERENCE DISCLOSURE BEST PRACTICES
- IDENTIFY THE CONSULTANTS YOUR PEERS ARE USING

EQUILAR®

www.equilar.com