

Executive Compensation

What You Need to Know Today to Make
Good Decisions Tomorrow

October 20, 2010

■ Introduction

Objectives

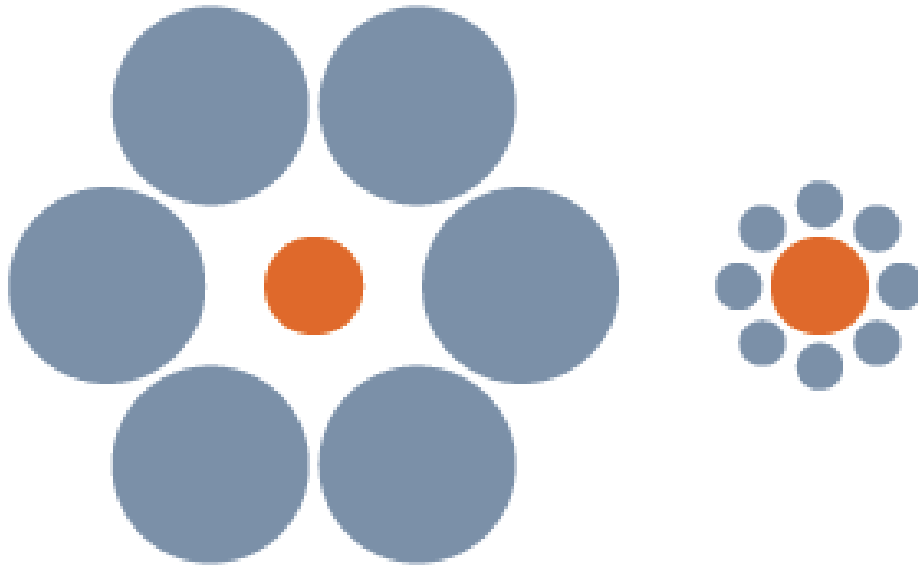
- Provide insights into contemporary issues in executive compensation
- Prepare directors to make pay-related decisions in late 2010 and early 2011

Topics

- Context
- Trends
- Philosophy
- Performance
- Compliance
- Risk
- Scrutiny

Context Is Everything

Which of the orange circles shown below is larger?

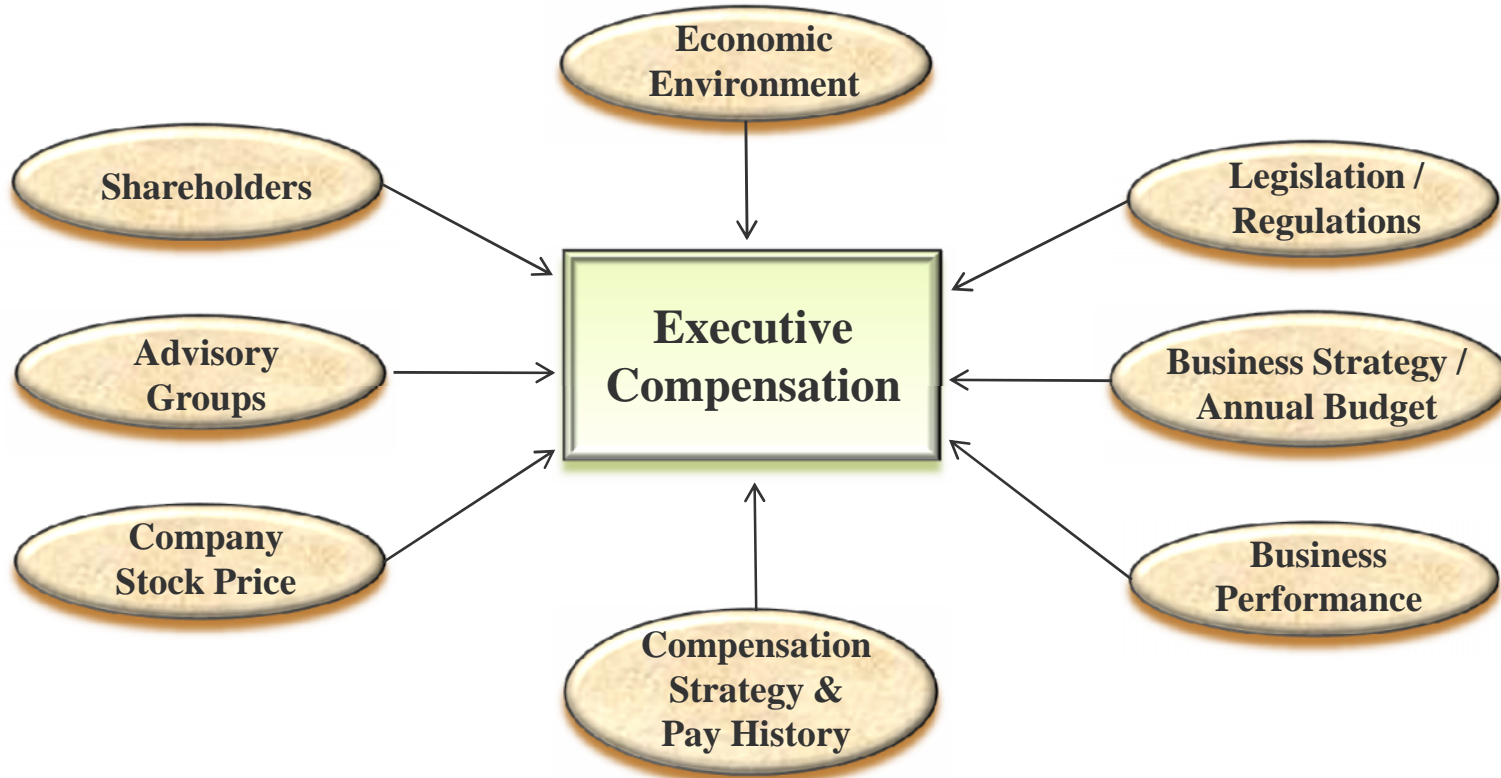


Context is everything, and perception is relative

Context for executive compensation has changed significantly in recent years

Context Is Everything

Current Context for Executive Compensation



Volatile environment, competing points of view

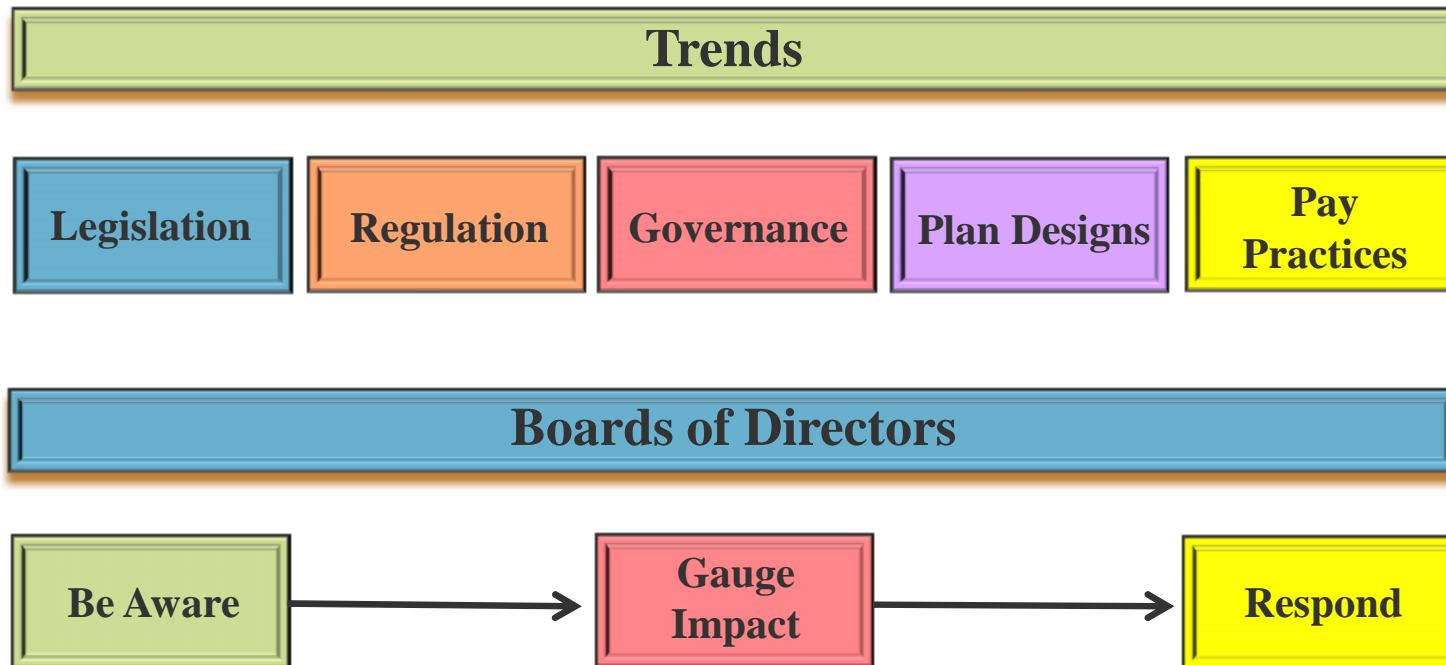
■ Context Is Everything

Current context for executive compensation includes

- Populist anger over “bailouts,” “pay for failure,” “excessive pay,” etc. results in intense scrutiny and ferocious criticism, triggering ongoing attempts to regulate executive pay
 - Compensation Committees respond with caution, focus on compliance, “disclosure optics,” and risk management

- Weak economic recovery makes it difficult for many businesses to forecast results and perform at desired levels
 - Committees and management teams are reviewing their processes for selecting performance measures and setting goals

■ Monitor Trends & Emerging Issues



■ Monitor Trends & Emerging Issues

- Total pay for S & P 500 CEOs has declined 7.5% - 8.0% each of the last 2 years
- Salary increase budgets continue to be modest
- “Portfolio approach” still prevalent for long-term incentives (use of 2 or more types of awards by majority of companies)
- Challenging economic conditions and recent focus on risk assessment lead companies to revisit incentive plan metrics, forms of award and / or timing of payments
- Pressure to more closely align pay with performance, but difficult to set meaningful goals due to poor visibility
- More detailed and transparent disclosures enable closer scrutiny

■ Monitor Trends & Emerging Issues

- We have seen and will continue to see
 - Elimination / reduction of perquisites
 - Less use of tax gross ups
 - Increased prevalence of clawbacks
 - Moderation of extreme pay-for-performance leverage
 - Consideration of longer vesting periods and / or deferral
 - Less use of stock options, more use of service-based restricted stock and performance-based shares or cash

■ Monitor Trends & Emerging Issues

- More emphasis on stock ownership guidelines and / or holding requirements
- Continued and growing influence of proxy advisory firms and shareholder activists
- Greater transparency and more detailed disclosure, with emphasis on making a compelling “business case” for a company’s compensation program

Confirm Your Compensation Philosophy and Executive Pay Strategy

- Clearly articulate a strategy, and confirm agreement / understanding between Compensation Committee and management
- Use it to guide decisions
- Key issues include
 - Business strategy / operating plan
 - » Update to reflect current circumstances (e.g., lower growth)
 - Peer Group
 - » Update to reflect industry consolidation, etc.
 - » Consider size, business lines, complexity, etc.
 - Pay Positioning
 - » Market targets
 - » Mix of pay elements
 - Results of Risk Assessment
 - Trends and Emerging Issues

■ Reward Performance

- The Compensation Committee's primary responsibility is to pay appropriately for performance
- This is more likely to occur when
 - The Committee and management reach consensus as to what really constitutes "pay for performance" in their company
 - » Determine which performance measures are critical to company success
 - Select metrics and set realistic goals grounded in analytics and focused on value creation
- Recent history has demonstrated the challenge that boards face in aligning executive pay with business performance and shareholder experience
- Review your company's annual and long-term incentive plans and practices to ensure they are appropriate for the current environment

■ Reward Performance

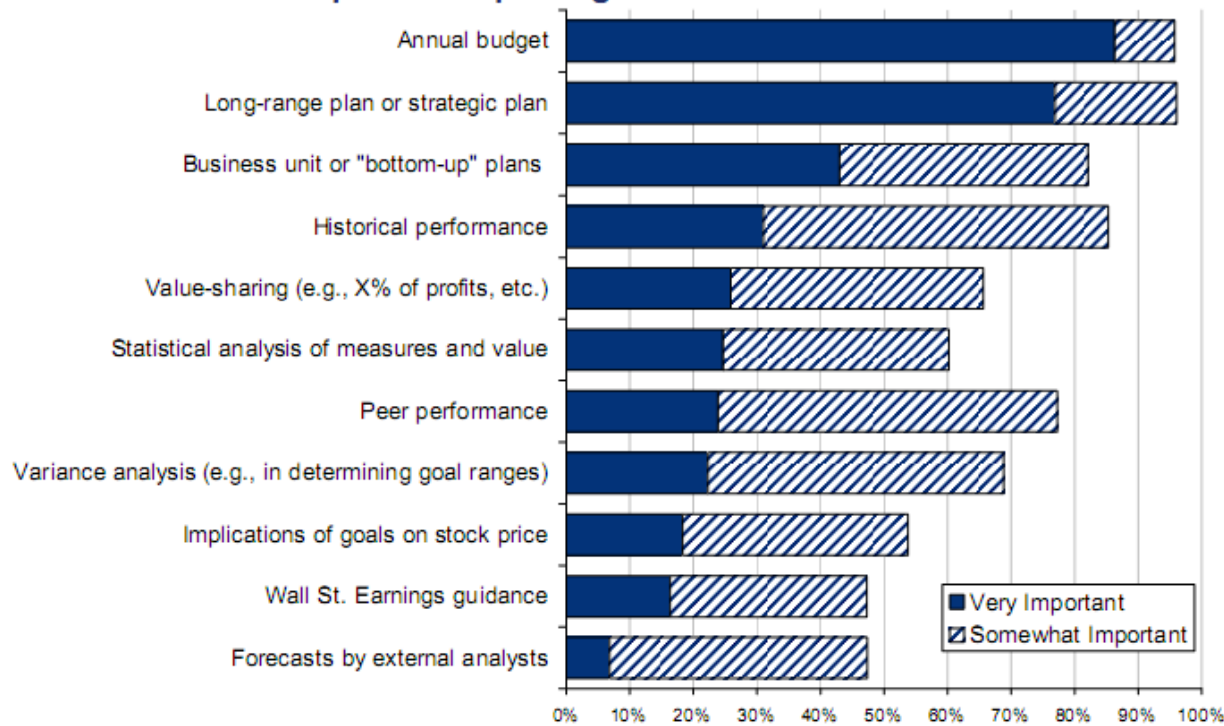
- The Pearl Meyer & Partners 2010 Executive Pay for Performance Survey provides some insights for directors to consider in making decisions about 2010 incentive payments and 2011 plan designs
- Annual Incentive Plans
 - Emphasis on financial measures (profitability, revenues, margins, returns)
 - Absolute rather than relative metrics
 - Significant use of non-financial metrics (safety, customer satisfaction, individual)
- Long-Term Incentive Plans
 - Split between absolute and relative performance measures
 - 3-year performance periods still most common, but significant use of 1-year periods with additional service requirement
 - Portfolio approach (use of 2 or 3 award types) still most common
 - Use of performance-contingent awards up significantly
 - Share-based awards far more common than cash-based

Reward Performance

How are Performance Goals Set?

A minority of companies make use of the advanced analytics, but many appear to be using multiple perspectives.

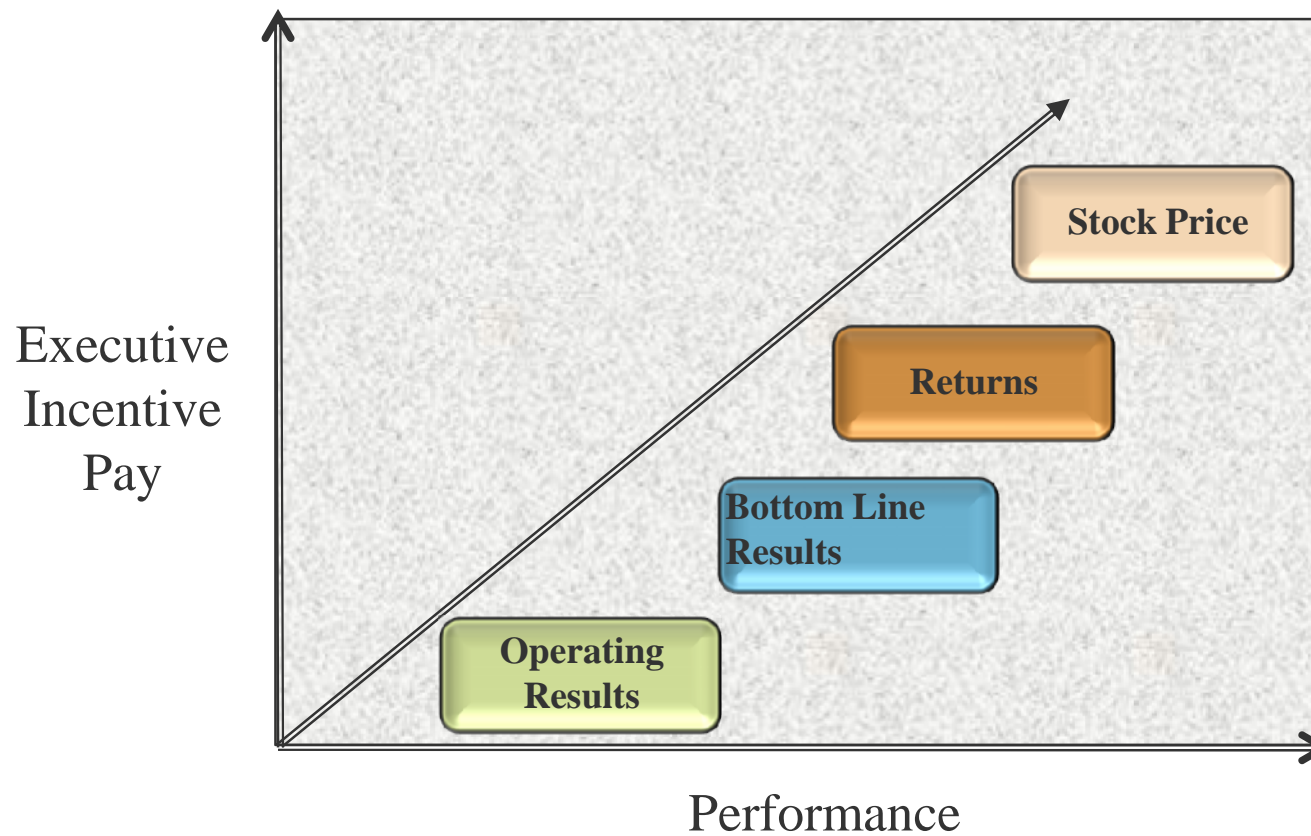
% of Companies Reporting Factors Used to Set Performance Goals



Key PM&P Observations: Not surprisingly, the annual budget and long-range plan are key to goal-setting. Historical and peer comparative performance are also fairly common, with advanced analytics and modeling used less often.

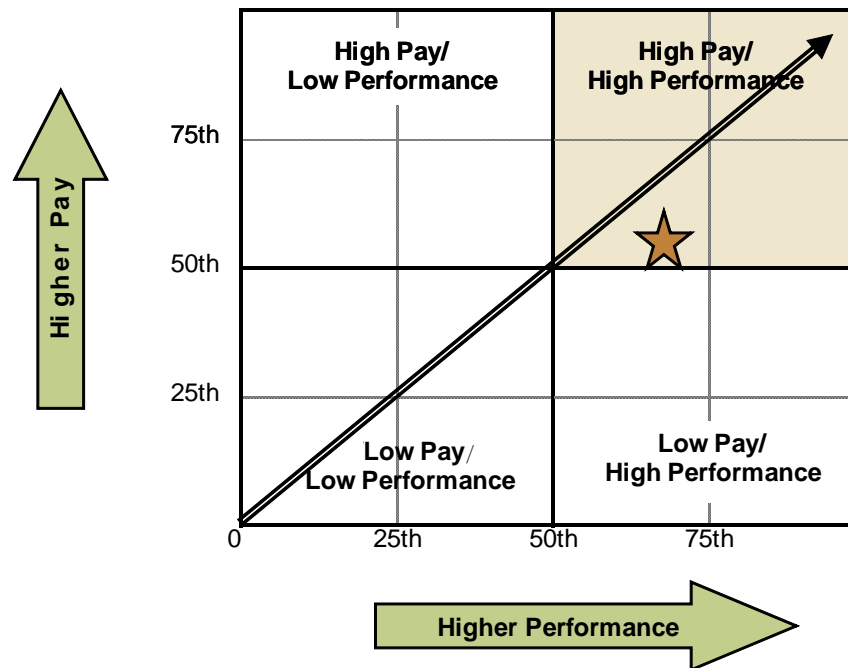
■ Reward Performance

■ Incentive Pay and Performance



Reward Performance

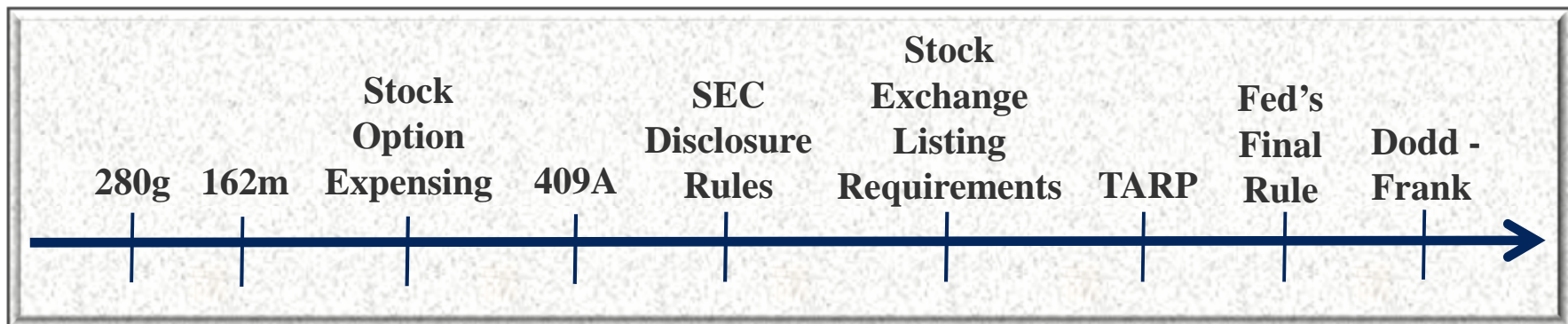
- Goal = Alignment of Executive Pay with Company Performance



★ Company's relative pay and relative performance positioning versus peers

Comply with Recent Legislation & Pending Regulations

- Era of increased regulation of executive compensation
- Time line of regulatory initiatives



Comply with Recent Legislation and Pending Regulations

- Dodd-Frank Wall Street Reform and Consumer Protection Act includes numerous provisions related to executive compensation and pay governance
 - SEC and others in process of developing rules for implementation
- Committees should focus on complying with “first wave” of regulations related to Dodd-Frank
- Say on Pay / Say on Frequency / Say on Golden Parachutes
 - Non-binding SOP votes every 1 to 3 years
 - SOF votes at least every 6 years
 - Non-binding votes on CIC agreements upon a transaction
 - Votes required in 2011 proxy season
 - » SEC’s final rules expected January – March 2011
 - Review and update pay-related disclosures to ensure favorable vote
 - Consider preferences for frequency of future votes (every 1, 2 or 3 years)

Comply with Recent Legislation and Pending Regulations

- Prepare for more in-depth disclosure of company rationale for choosing a combined or separate CEO / COB role
 - Review / update role definition of Lead Director / Non-Executive Chairman, and adjust compensation as needed to reflect expanded responsibility
- Also assess adequacy of pay for Compensation and / or Governance Committees due to increasing regulatory burden
- Monitor developments and prepare for “second wave” of regulations related to Dodd-Frank
- Review Compensation Committee independence standards to be developed by SEC, and confirm independence of Committee members
 - Consider sources of any additional compensation paid to members
 - Consider any affiliations with company, subsidiaries or affiliates
 - Ensure compliance
 - » Proposed rules expected November – December 2010
 - » Final rules expected April – July 2011

Comply with Recent Legislation and Pending Regulations

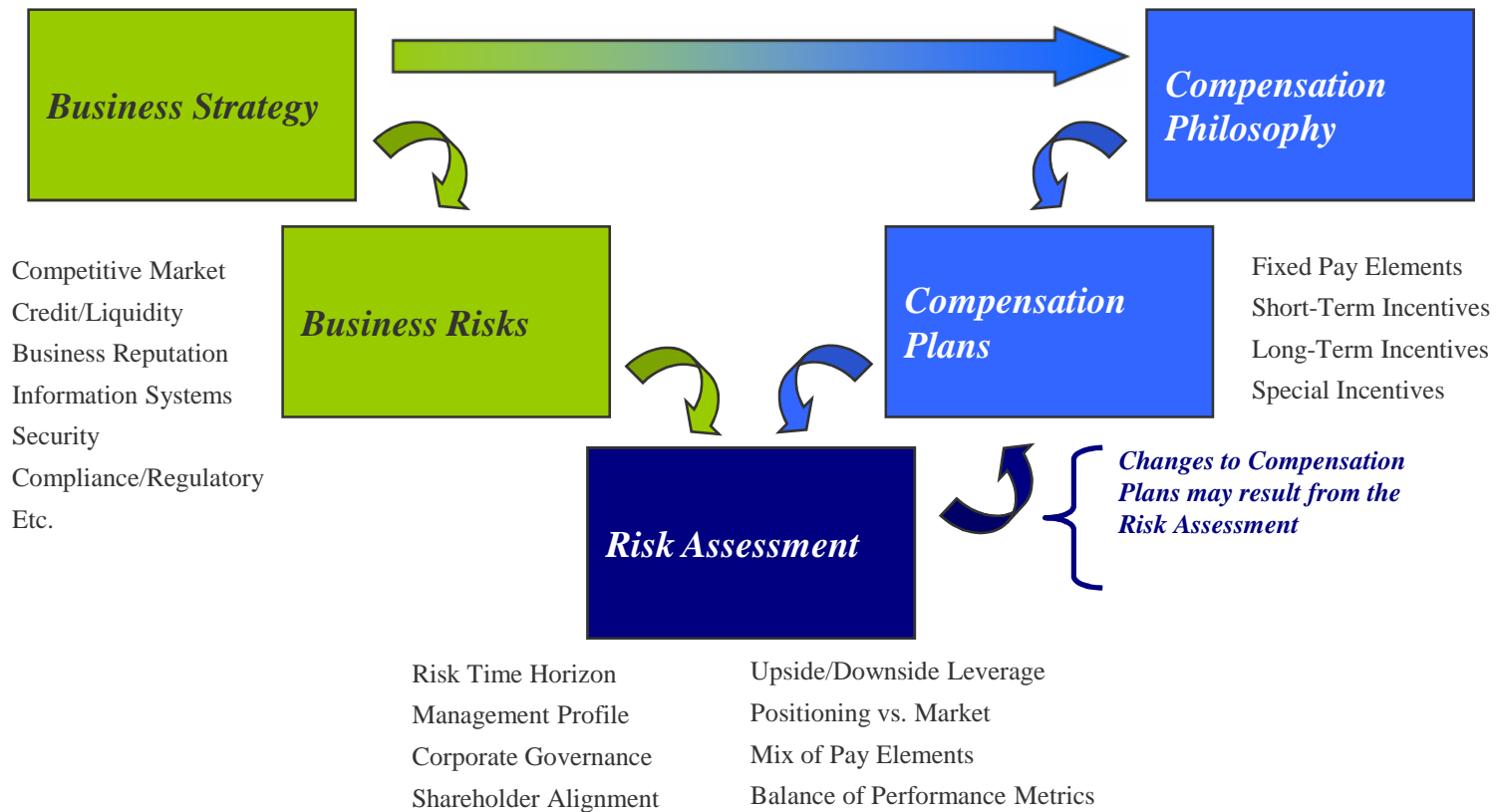
- Monitor development of independence standards for Compensation Committee advisors (consultants, attorneys and other advisors)
 - Identify other services provided by current advisors and any potential conflicts of interest
 - Ensure compliance
 - » Proposed rules expected November – December 2010
 - » Final rules expected April – July 2011
- Monitor progress of legal challenge to proxy access rule (impact likely delayed to 2012 proxy season)
- Monitor development and implementation of other rules related to Dodd-Frank that are likely to impact 2012 proxies (proposed rules expected Q2, 2011)
 - Clawback policy
 - Hedging policy
 - Pay for performance disclosure
 - Internal equity ratio disclosure
 - Broker non-vote on executive compensation

■ Manage Risk

- Risk assessments of incentive plans originated with TARP and spread from there
- Requirement is to review *all* compensation plans and assess whether they might incent any employee or group of employees to take material risks that could threaten the future of the organization
- Issue applies to all companies but is most acute in financial services
- Make sure your company performs a rigorous risk assessment, and consider whether to modify incentive plans or pay practices based on results

Manage Risk

Risk Assessment

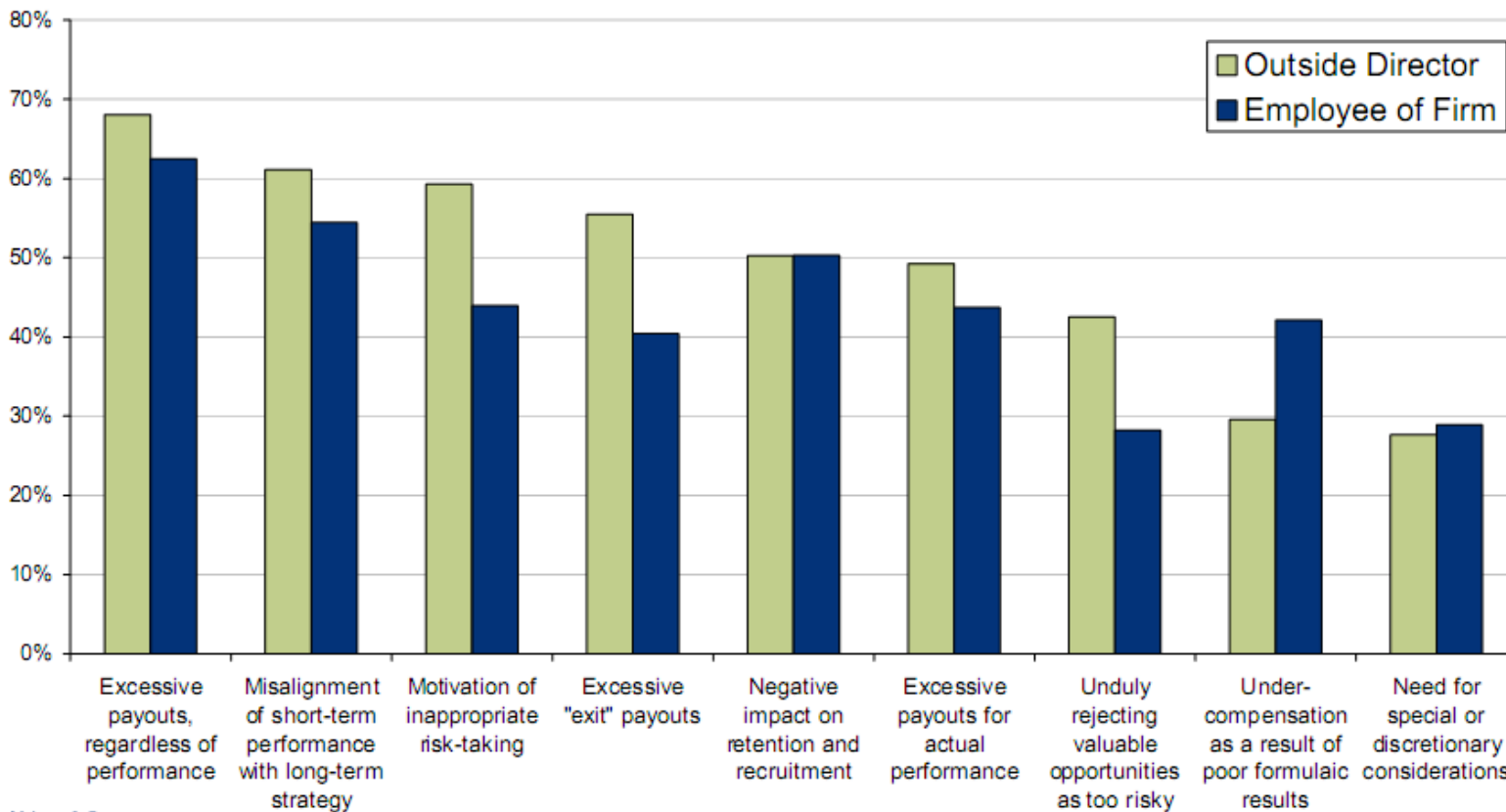


Manage Risk

What Compensation-Related Risks are of Most Concern?

Directors express more concern over the potential misalignment of pay and performance and the need to ensure that incentive plans balance, rather than mitigate risk.

Importance of Compensation-Related Risks
 % of Responses that were a "4" or "5"
 (5 = Most Critical; 1 = Least Critical)

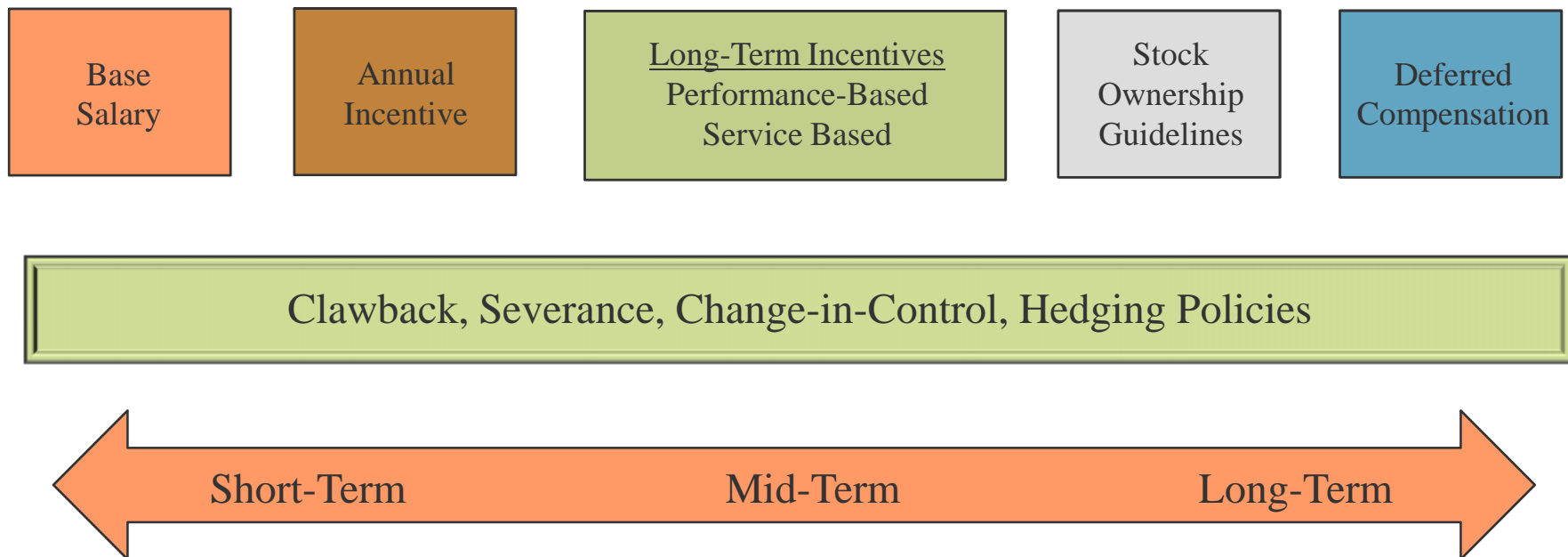


■ Manage Risk

- Compensation Committees can consider a variety of responses to reduce / mitigate inappropriate risk taking and strike a balance between risks and rewards
 - Multiple performance metrics
 - Multiple elements of pay
 - » Stock vs. cash
 - » Annual vs. mid-term vs. long-term incentives
 - “S” shaped payout curves
 - “Capped” or maximum incentive payments
 - Longer vesting / post-performance vesting
 - Mandatory deferral
 - Ownership / Holding requirements
 - Clawback policies

Manage Risk

- Balanced approach to risk and rewards



■ Anticipate Scrutiny / Avoid Criticism

- Avoid “red flag” or “egregious” pay practices
 - Guaranteed multi-year salary increases, non-performance-based bonuses or equity awards
 - Additional service credits and / or inclusion of LTI value in determination of retirement benefits
 - Extraordinary perquisites for current or former executives
 - Change in Control (CIC)
 - » Payments in excess of 3x total cash
 - » Single triggers or modified single triggers
 - » Excise tax gross ups
 - Dividends or equivalents on unvested performance shares or units
 - Executive hedging
 - Stock option re-pricing
 - Check for updates later this year
- Determine whether your company has any of the above and, if so, consider whether to change in advance of next shareholder meeting

■ Anticipate Scrutiny / Avoid Criticism

- Check your “GRiD” score (Governance Risk Indicators)
 - Scoring system intended to gauge levels of corporate governance risk. Compensation is one of 4 categories
 - Consider potential adjustments to plans or practices, especially if pro-forma score indicates “High” concern (0 – 55 points) or “Medium” concern (55 – 70) points
 - Check for updates later this year

- Engage in dialogue with institutional investors and / or their advisors as necessary to understand their points of view and explain your company’s rationale for any “non-standard” pay practices, plan designs, etc.

- Include an Executive Summary in the CD&A; consider use of supplemental tables and graphs
 - Clear explanation and compelling case for plan design and Committee decisions about executive pay

■ Summary

- The environment for executive compensation is one of intense scrutiny and ferocious criticism
- Economic conditions make it challenging for many companies to motivate, reward and / or retain executives
- The issues are complex, and there are no magic bullets
- By taking the following actions, board members can develop a “comfort level” as they make decisions about executive pay
 - Understand the current context for executive compensation
 - Monitor trends and emerging issues
 - Confirm your compensation philosophy and executive pay strategy
 - Focus on appropriately rewarding performance
 - Ensure compliance with recent legislation and new regulations
 - Manage risk related to compensation plans & practices
 - Anticipate scrutiny / avoid criticism