



# Executive Compensation

---

PLI's 14<sup>th</sup> Annual  
Preparation of Annual Disclosure Documents

December 14, 2009

To protect the confidential and proprietary information included in this material, it may not be disclosed or provided to any third parties without the approval of Exequity LLP.

# Introduction

---

- SEC Proposals, Developments, and Guidance Impacting Executive Compensation
- Regulatory and Legislative Developments and Proposals
- Compensation Discussion & Analysis (CD&A) Practice Pointers
- Equity Incentive Compensation Matters
  - RiskMetrics Group (RMG) 2010 Policy Updates for Compensation

# SEC Proposals, Developments, and Guidance

# SEC Developments

---

## Final Rule Changes

- Elimination of broker non-votes in the election of directors
  - Effective for the 2010 proxy season
  - Directors could see slightly higher AGAINST/WITHHOLD votes as a result

# SEC Proposals, Developments, and Guidance

---

## Proposed Rule Changes

- Proxy disclosure and solicitation enhancements
  - Comment period closed; waiting for SEC to issue final rules, expected December 16, 2009
  - Unknown whether these changes will apply to the 2010 proxy season
  - Proposed rule changes include:
    - ▶ CD&A broadened to include disclosure of how a company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk, *if material*
    - ▶ Changes to the Summary Compensation Table and the Directors Compensation Table to report the full grant date fair value of all equity awards granted during the year, instead of the accounting expense for the year of all outstanding equity awards of an executive
    - ▶ Enhanced director and nominee disclosure regarding experience and qualifications to serve on the board and any committee
    - ▶ Disclosure of company leadership structure and the board's role in the risk management process
    - ▶ Voting results to be reported more quickly on a Form 8-K instead of a 10-Q
    - ▶ Disclosure of nature and extent of a committee's compensation consultant's additional services, including a breakout of fees on an aggregate basis for other services and for executive and director compensation consulting services

# SEC Developments

---

## Recent Staff Speech

- Shelley Parratt, Deputy Director, Division of Corporation Finance, *Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010*, 4<sup>th</sup> Annual Proxy Disclosure Conference, San Francisco, CA
  - Observations concerning 2009 proxy disclosures:
    - ▶ SEC was pretty consistent in comments issued on executive compensation
    - ▶ Companies the SEC had previously reviewed continued to provide enhanced executive compensation disclosure and address the primary themes of comments the SEC identified in 2007 report
    - ▶ Companies that had not previously had their executive compensation disclosures reviewed received a substantial number of comments addressing the SEC's comment themes, even those have been public since October 2007
    - ▶ Conclusion: Many companies are reluctant to address these comments themes until the SCE provide specific comments requesting enhanced disclosure.
    - ▶ Companies are missing the "how" and the "why" in their disclosures
    - ▶ Companies need to provide "analysis" as part of the CD&A
    - ▶ 2010 comment process: the SEC expects companies to understand the rules and apply them thoroughly. Any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.

# SEC Proposals, Developments, and Guidance

---

## Staff Guidance – New Compliance and Disclosure Interpretations in 2009

- Q. 117.03 – If a company actually claws back compensation during a year for a prior bonus, the portion clawed back is not deducted from the current year’s compensation used to determine whether the individual is a NEO. If the individual is an NEO, then if the prior fiscal year from which the bonus clawed back was originally granted is shown, it should be reduced by the clawed back portion and a footnote should describe the clawback.
- Q. 119.18 – If a person is an NEO in Year 1, but not in Year 2, but will be an NEO again in Year 3, then compensation for all three years gets disclosed in the Summary Compensation Table.
- Q. 119.19 – If an NEO is entitled to a tax gross-up on perquisites or other compensation in Year 1, but the tax gross-up payment isn’t made until Year 2, the tax gross-up payment is reported in the Summary Compensation Table for Year 1.
- Q. 120.05 – If an incentive performance plan will pay out at different levels depending upon actual performance, the grant date fair value reported in column (I) of the Grants of Plan-Based Awards Table is based on maximum performance.
- Q. 120.06 – If an NEO receives a target number of shares at the start of a 3-year performance period, with one-third allocated to each year, the grant date fair value is determined in accordance with FAS123R (ASC 718)—if all annual targets are set at beginning of the 3-year period, that is the grant date for the entire award; if each annual performance target is set at the start of each year, each date is a separate grant date for purposes of measuring grant date fair value.
- Q. 120.07 – If an outstanding equity incentive award is amended or modified during the year such that incremental fair value results under FAS 123R (ASC 718), then that incremental amount must be reported in column (I) of the Grants of Plan-Based Awards Table.

# SEC Proposals, Developments, and Guidance

---

## Staff Guidance – New Compliance and Disclosure Interpretations in 2009

- A. 122.03 – If a company grants performance-based RSUs that measure performance over a 3-year period such that after the first year the Compensation Committee evaluates performance to determine the number of RSUs that could be earned if the NEO remains employed by the company for the subsequent 2 years, the information about the number of shares should be based on the actual number of shares underlying the RSUs that were earned at the end of the 3-year performance period, even if the number is reported in columns (i) and (j) because they are no longer subject to performance-based conditions [instead should then be reported in columns (g) and (h) because they are subject to service-based vesting].
- Q. 125.05 – If an equity award vests and the plan under which it was granted provides for the deferral of its receipt, the required deferred receipt of the vested equity award must be included in the Nonqualified Deferred Compensation Plan Table---SEC staff indicates this is the case whether the deferral is at the election of an NEO or pursuant to the terms of the equity award or plan.
- 217.14 – Generally the disclosure rules require companies to include the dollar value of any insurance premiums paid by, or on behalf of, the company with respect to life insurance for the benefit of an NEO, both in the Summary Compensation Table and in the description and quantification of the estimated payments and benefits that would be provided to each NEO in each covered termination circumstance. However, if an executive dies during the year, the proceeds of a life insurance policy funded by the company and paid to the deceased executive's estate need not be taken into account for purposes of determining the compensation to be reported in the Summary Compensation Table or in determining whether the executive is among the company's up to two additional individuals for whom disclosure would be required under Item 402(a)(3)(iv).

# Regulatory and Legislative Proposals and Developments

# Legislative and Regulatory Developments

- Legislative and regulatory initiatives affecting executive pay have been evolving for years

Tax	Accounting	Securities
<p>1984 §280G—Golden parachute rules limiting deductibility of severance benefits in changes in control</p> <p>1993 §162(m)—Limit on deductibility of nonperformance-based compensation</p> <p>2005 §409A—Rules governing deferrals of compensation</p> <p>2009 §423 Regulations—Final regulations for employee stock purchase plans</p>	<p>2005 FAS 123R—Requires all U.S. companies to account for share-based payment awards using a fair-value methodology rather than an intrinsic value construct</p> <p>2009 FASB Accounting Standards Codification (A.S.C.)</p>	<p>2006 Item 402—Enhanced proxy statement disclosure of executive compensation policies and procedures, and increased tabular disclosure of pay for named executive officers</p> <p>2009 Item 402—Revisions of the 2006 rules</p>

# Legislative and Regulatory Developments

---

- As of this point, the most effective influences on executive pay practices to date have risen from the “grass roots” level
  - Proxy advisory and shareholder activist groups (RMG, Glass-Lewis, The Corporate Library)
  - Media (The New York Times, The Wall Street Journal)
  - Shareholders and institutions (ASCME, CalPERS, CalSTRS, TIAA-Cref)
  
- TARP rules define Washington’s standards for acceptable pay practices



# Legislative and Regulatory Developments

- The Obama Administration is encouraging Washington to take a leadership position on the issues
- 2009 likely will be a watershed year for pay-related rules

Tax	Securities	Pending Legislation
<p><b>June 10</b> Secretary Geithner issued five principles to guide the future of pay practices with the goal of “developing standards that reward innovation and prudent risk taking without creating misaligned incentives.”</p> <ul style="list-style-type: none"> <li>• Properly reward long-term performance</li> <li>• Structure pay to fit time horizon of risks</li> <li>• Align pay with risk management</li> <li>• Reexamine (from investor’s perspective) value of SERPs and golden parachutes</li> <li>• Promote transparency and accountability in pay-setting process (mandate SOP)</li> </ul>	<p><b>July 10</b> SEC issued proposed rules that would enhance existing disclosure in the CD&amp;A and associated compensation tables</p> <ul style="list-style-type: none"> <li>• Require discussion of relationship between pay policies and risk</li> <li>• Improve disclosure of compensation consultant fees and services</li> <li>• Report grant date option and share values in Summary Compensation Table</li> </ul>	<p><b>July 21</b> H.R. 3269 (“Corporate and Financial Institution Compensation Fairness Act of 2009”)</p> <ul style="list-style-type: none"> <li>• Mandates Say On Pay vote</li> <li>• Requires vote on golden parachutes</li> <li>• Stipulates a requirement for independence standards applicable to compensation committees’ compensation consultants and other advisors</li> </ul>

# Legislative Developments

---

## Significant Proposed Legislation

- Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269)
  - Sponsor: Rep. Frank (D-MA) [*supported by the Obama Administration*]
  - Status: House passed bill by a vote of 237-185 on July 31, 2009; bill (or a similar one) will be taken up by the Senate
  - Key provisions:
    - ▶ Shareholders given an advisory vote on compensation at public companies
    - ▶ Separate advisory vote on golden parachutes
    - ▶ Compensation committees required to be wholly independent
    - ▶ Require compensation consultants to satisfy independence requirements established by the SEC
    - ▶ Financial institutions would have to disclose their incentive structures with sufficient detail to permit the regulator to determine whether the compensation structure:
      - Is aligned with sound risk management,
      - Is structured to account for the time horizon of risks, and
      - Meets such other criteria as the regulators determine is appropriate to reduce unreasonable incentives covered by such institutions for employees to take undue risks
    - ▶ Would prohibit any incentive-based payment arrangement at covered financial institutions that regulators determine encourages inappropriate risks that could:
      - Threaten the safety and soundness of the institution, or
      - Have serious adverse effects on economic conditions or financial stability

# Legislative Developments

---

- Restoring American Financial Stability Act of 2009 (Discussion Draft)
  - Sponsor: Sen. Dodd (D-CT) *[appears to pull provisions from many other proposed bills]*
  - Status: Sen. Dodd released a discussion draft of this 1,100+ page bill on November 10, 2009
  - Key executive compensation and corporate governance provisions:
    - ▶ Provides shareholders with a vote on executive pay and golden parachutes
    - ▶ Gives shareholders proxy access to nominate directors
    - ▶ Requires that compensation committees be independent (tracks SEC's proposed rule)
    - ▶ Requires public companies to implement clawback policies to recapture compensation if based on inaccurate financial statements that don't comply with accounting standards
    - ▶ Requires the SEC to clarify disclosures regarding compensation, including requiring companies to provide charts that compare executive compensation with stock performance over a 5-year period
    - ▶ Requires disclosure of whether a company permits employees to engage in hedging activities of company equity awards
    - ▶ Requires majority voting for directors in uncontested elections
    - ▶ Requires disclosure of why a company has chosen to separate, or not separate, the positions of chairman of the board of directors and CEO
    - ▶ Staggered/classified boards would be prohibited unless specifically approved by a shareholder vote; would generally require annual election of directors

# Legislative Developments

---

## Other Proposed Legislation

- Ending Excessive Corporate Deductions for Stock Options Act (S. 1491), Sen. Levin (D-MI)
  - Would change the amount companies get to take as a compensation deduction for stock options and the year in which they could take the deduction, and prohibit nonqualified stock options from qualifying as performance-based compensation under Section 162(m)
- Corporate Governance Reform Act of 2009 (H.R. 3272), Rep. Ellison (D-MN)
  - Provides for an annual advisory shareholder vote on compensation, requires board chairmen to be independent, requires establishment of a risk committee, requires compensation committees to be entirely independent, requires SEC to study feasibility of requiring SEC certification of all director candidates
- Shareholder Empowerment Act of 2009 (H.R. 2861), Rep. Peters (D-MN)
  - Provides an annual advisory shareholder vote on senior executive compensation, requires use of clawbacks, requires split of CEO and Chairman roles, prohibits golden parachutes where termination for poor performance, requires performance target disclosure, requires majority director votes in uncontested elections, gives proxy access to shareholders that meet certain requirements, eliminates uninstructed broker votes, requires compensation consultants to be independent
- Shareholder Bill of Rights Act of 2009 (S. 1074), Sen. Shumer (D-NY)
  - Provides an annual advisory shareholder vote on executive compensation, requires golden parachute disclosure, confirms SEC's authority to grant proxy access to certain shareholders, requires board chairmen to be independent, requires annual director elections using majority voting, requires establishment of a risk committee

# Legislative Developments

---

- Excessive Pay Shareholder Approval Act (S. 1006), Sen. Durbin (D-IL)
  - Requires 60% of shareholders to approve compensation structure of any employee in any year in which she/he receives in excess of 100 times the average compensation of all employees
  - Compensation includes salary, commissions, fringe benefits, deferred compensation, retirement contributions, stock options, bonuses, and other pay
- Excessive Pay Capped Deduction Act (S. 1007), Sen. Durbin (D-IL)
  - Limits the compensation tax deduction for any employee to 100 times the average compensation for all employees at a company
  - Compensation includes salary, commissions, fringe benefits, deferred compensation, retirement contributions, stock options, bonuses, and other pay
  - Companies that exceed the deduction limit would be required to report certain compensation information to the IRS
- Patient Protection and Affordable Care Act (H.R. 3590 AS), Sen. Reid (D-NV)
  - Limits the annual deduction for compensation paid to officers, employees, directors, and other workers or service providers to \$500,000
  - Causes 162(m) performance-based compensation and other exceptions not to apply

# CD&A Practice Pointers

# CD&A Practice Pointers

---

- Drafting Considerations
- Analysis in CD&A
- Benchmarking
- Performance Targets and Bonuses
- Best practices:
  - Focus on total compensation and use of tally sheets
  - Compensation for individual NEOs and internal pay equity
  - Clawback provisions
  - Benchmarking
  - Performance-based compensation
  - Risk disclosure
  - Discretion for annual bonuses
  - Full walk-away numbers for terminations
  - Need for pensions and SERPs
  - Perquisites
  - Accounting and tax implications of compensation
  - Stock ownership/holding guidelines/requirements

# Equity Incentive Compensation Matters : RiskMetrics Group (RMG) 2010 Policy Updates for Compensation

# Changes for Shareholder Value Transfer (SVT) and Burn Rate Policies

---

- Stock price
  - Will use 200-day average stock price for shareholder meetings on or after February 1, 2010
  - During 2009, used 90-day average stock price
- Volatility
  - Will use 200-day volatility for shareholder meetings on or after February 1, 2010
  - During 2009, used 400-day volatility
- Updated GICS industry group burn rate table for 2010

# Implications of Changes for SVT and Burn Rate Policies

---

- Impact is inversely related to a company's market cap
- Larger the relative market cap, the more positive the impact likely will be
- Across the board, burn rate cap dropped, some by more than half of what they were in 2009
- We looked at 40 random companies—10 each from large, mid, small, and micro cap groups
  - Large cap company stock option valuations drop by about 16% under policy changes (measured as a percent of stock price), compared to only about a 3% drop for micro caps
  - Large caps: Exxon Mobil, Microsoft, Procter & Gamble, Apple, Johnson & Johnson, International Business Machines, JPMorgan Chase, Chevron, AT&T, General Electric
  - Mid caps: TJX Companies, Avon Products, Precision Castparts, Lorillard, H.J. Heinz, Sempra Energy, T. Rowe Price Group, Spectra Energy, Marsh & McLennan, Murphy Oil
  - Small caps: Human Genome Sciences, Tupperware Brands, Solera Holdings, Bally Technologies, E\*Trade Financial, MFA Financial, J. Crew Group, 3COM, Highwoods Properties, Revlon
  - Micro caps: Schweitzer-Mauduit International, Veeco Instruments, First Financial Bancorp, Vivus, ArvinMeritor, Dana Holding, Prospect Capital, U.S. Airways, Radian Group, Georgia Gulf

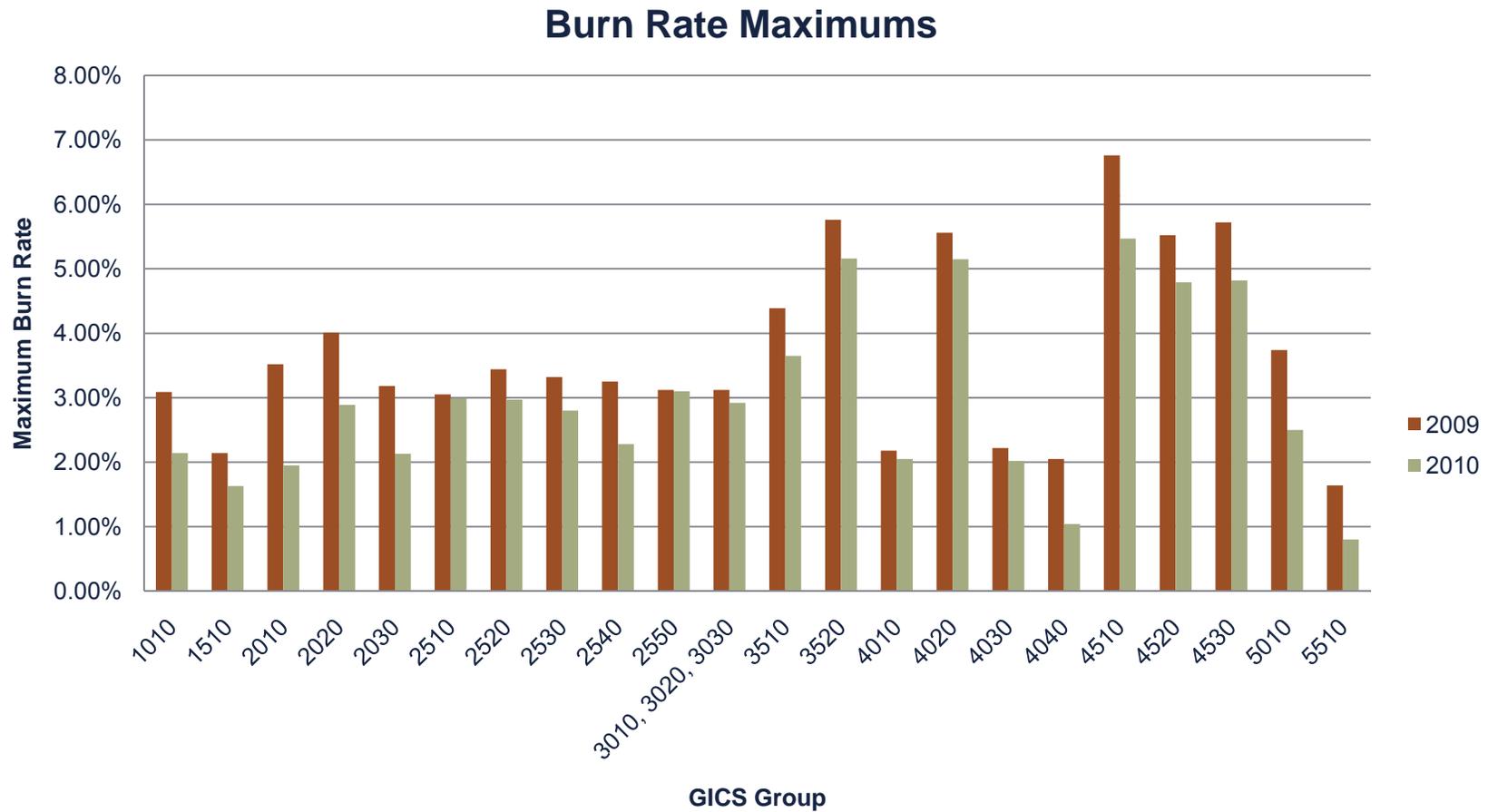
# Volatility Under the 2010 Methodology Compared to 2009 Methodology

<b>Overall</b>		2009 Methodology	2010 Methodology	Diff. (+/-)	Diff. (%)
	<b>Lowest</b>	<b>26.86%</b>	<b>18.29%</b>	<b>-102.68%</b>	<b>-47.48%</b>
	Average	81.73%	70.12%	-11.61%	-20.36%
	<b>Median</b>	<b>63.79%</b>	<b>51.91%</b>	<b>-12.31%</b>	<b>-24.09%</b>
	Highest	216.25%	255.13%	50.87%	28.37%
<b>Large Cap</b>					
	<b>Lowest</b>	<b>26.86%</b>	<b>18.29%</b>	<b>-20.69%</b>	<b>-43.42%</b>
	Average	47.06%	33.59%	-13.47%	-30.09%
	<b>Median</b>	<b>45.42%</b>	<b>26.46%</b>	<b>-13.38%</b>	<b>-30.99%</b>
	Highest	89.74%	73.46%	-6.27%	-12.73%
<b>Mid Cap</b>					
	<b>Lowest</b>	<b>29.81%</b>	<b>19.26%</b>	<b>-21.16%</b>	<b>-39.89%</b>
	Average	49.24%	34.41%	-14.83%	-31.06%
	<b>Median</b>	<b>46.17%</b>	<b>31.75%</b>	<b>-14.13%</b>	<b>-31.48%</b>
	Highest	76.12%	60.97%	-10.55%	-19.91%
<b>Small Cap</b>					
	<b>Lowest</b>	<b>54.12%</b>	<b>34.04%</b>	<b>-102.68%</b>	<b>-47.48%</b>
	Average	103.41%	90.09%	-13.32%	-14.87%
	<b>Median</b>	<b>76.81%</b>	<b>64.61%</b>	<b>-10.08%</b>	<b>-14.94%</b>
	Highest	216.25%	230.19%	50.87%	28.37%
<b>Micro Cap</b>					
	<b>Lowest</b>	<b>65.09%</b>	<b>58.28%</b>	<b>-40.97%</b>	<b>-28.81%</b>
	Average	127.22%	122.39%	-4.83%	-5.42%
	<b>Median</b>	<b>118.32%</b>	<b>104.11%</b>	<b>-1.58%</b>	<b>-2.22%</b>
	Highest	214.58%	255.13%	40.55%	18.90%

# Stock Price Under the 2010 Methodology Compared to 2009 Methodology

<b>Overall</b>		2009 Methodology	2010 Methodology	Difference (+/-)	Difference (%)
<b>Lowest</b>		\$ 1.5902	\$ 1.4923	\$ (32.2477)	-47.77%
Average		\$ 37.5988	\$ 32.4056	\$ (5.1932)	-16.41%
<b>Median</b>		\$ 28.1913	\$ 25.7198	\$ (3.2106)	-12.52%
Highest		\$ 183.3402	\$ 151.0925	\$ (0.0979)	-2.07%
<b>Large Cap</b>					
<b>Lowest</b>		\$ 15.0945	\$ 13.0935	\$ (32.2477)	-17.59%
Average		\$ 67.4420	\$ 60.4832	\$ (6.9588)	-9.24%
<b>Median</b>		\$ 58.4535	\$ 54.5339	\$ (3.9197)	-8.02%
Highest		\$ 183.3402	\$ 151.0925	\$ (1.0645)	-2.07%
<b>Mid Cap</b>					
<b>Lowest</b>		\$ 18.9415	\$ 16.6578	\$ (13.8998)	-16.95%
Average		\$ 48.1246	\$ 42.8499	\$ (5.2748)	-11.03%
<b>Median</b>		\$ 43.3858	\$ 38.7077	\$ (4.9110)	-10.77%
Highest		\$ 95.8780	\$ 81.9782	\$ (2.2243)	-6.35%
<b>Small Cap</b>					
<b>Lowest</b>		\$ 1.5902	\$ 1.4923	\$ (10.2166)	-47.77%
Average		\$ 19.3791	\$ 14.8372	\$ (4.5419)	-20.16%
<b>Median</b>		\$ 13.9857	\$ 8.5934	\$ (2.8237)	-17.52%
Highest		\$ 40.6015	\$ 31.9199	\$ (0.0979)	-6.16%
<b>Micro Cap</b>					
<b>Lowest</b>		\$ 3.6512	\$ 3.2546	\$ (16.5530)	-44.13%
Average		\$ 15.4494	\$ 11.4523	\$ (3.9971)	-25.23%
<b>Median</b>		\$ 9.2942	\$ 7.7501	\$ (2.4978)	-27.87%
Highest		\$ 52.4331	\$ 35.8802	\$ (0.3966)	-9.60%

# RMG Burn Rate Maximums by GICS—2009 vs. 2010



# Executive Pay Evaluation Policy

---

- Consolidates 3 existing policies:
  - Pay-for-Performance
  - Problematic (Poor) Pay Practices
  - Board Responsiveness and Communication on Compensation Issues
  
- RMG will re-order its Voting Manual into 4 policy sections:
  - Executive Pay Evaluations
  - Equity-Based and Other Incentive Plans
  - Director Compensation
  - Shareholder Proposals

# Pay-for-Performance Policy Changes

---

- RMG will consider the alignment of CEO total direct compensation (TDC) and total shareholder returns (TSR) for a longer period of at least 5 years
- Policy used for determining RMG vote recommendations on:
  - Management Say on Pay (MSOP) proposals
  - Elections of directors
  - Equity plan proposals
- The policy's screening questions:
  - Are a company's 1- and 3-year TSRs **both** below the company's 4-digits GICS industry group medians?
  - Has the CEO served at least 2 consecutive fiscal years at the time of the annual meeting at which the proposal will be voted on?
  - If "yes" to both of the above questions, RMG will:
    - ▶ Analyze whether the CEO's TDC is aligned with TSR, both recent and long-term (at least 5 years) [most recent year-over-year increase/decrease in pay remains a key consideration]
    - ▶ Review a company's CD&A to better understand the pay elements and whether they create or reinforce shareholder alignment
    - ▶ Consider the mix of performance-based compensation relative to TDC

# Problematic Pay Practices

---

- Formerly referred to as “poor” pay practices
- Now, two groups:
  - “Major”—can lead to negative vote recommendations if one exists
  - “Minor”—can lead to negative vote recommendations if more than one exists
- 2010 Policy Updates set out the “Major” Problematic Pay Practices
- 2010 Compensation FAQs set out the “Minor” Problematic Pay Practices
- RMG address some activity in relation to underwater stock options for the first time:
  - Voluntary surrenders of underwater stock options by executive officers
  - Cash buyouts of underwater stock options without shareholder approval
- RMG will utilize MSOP proposals as the initial vehicle to address problematic pay practices. RMG may recommend votes:
  - Against MSOP proposals
  - Against/Withhold from compensation committee members or, in rare cases where full board is deemed responsible for the practice, all directors, or when no MSOP item is on the ballot, or when the board has failed to respond to concerns raised in prior MSOP evaluations
  - Against an equity-based incentive plan proposal if excessive non-performance-based equity awards are the major contributor to a pay-for-performance misalignment

# Problematic Pay Practices

---

## “Major”

- Multi-year guarantees for salary increases, non-performance-based bonuses, and equity compensation
- Including additional years of service that result in significant additional benefits, without sufficient justification, or including long-term equity awards in the pension calculation
- Perquisites for former and/or retired executives, and extraordinary relocation benefits (including home buyouts) for current executives
- Change-in-control payments exceeding 3 x times base salary and target bonus
- Change-in-control payments without job loss or substantial diminution of duties (“single triggers”)
- New or materially amended agreements that provide for “modified single triggers”
- New or materially amended agreements that provide for an excise tax gross-up (including “modified gross-ups”)
- Tax reimbursements related to executive perquisites or other payments such as personal use of corporate aircraft, executive life insurance, bonus, etc.
- Dividends or dividend equivalents paid on unvested performance shares or units
- Executives using company stock in hedging activities, such as “cashless” collars, forward sales, equity swaps, or other similar arrangements
- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts and voluntary surrender/subsequent regrant of underwater options)

## “Minor”

- Excessive severance and/or change-in-control provisions
- Payments upon an executive’s termination in connection with performance failure
- Liberal change-in-control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring
- Overly generous perquisites, which may include, but are not limited to the following:
  - Personal use of corporate aircraft
  - Personal security systems maintenance and/or installation
  - Car allowances
  - Executive life insurance
- Internal pay disparity-excessive differential between CEO total pay and that of next highest-paid named executive officer
- Voluntary surrender of underwater stock options by executive officers
- May be viewed as an indirect repricing/exchange program especially if those cancelled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or executives subsequently receive unscheduled grants in the future
- Other pay practices deemed problematic but not covered in any of the above categories

# 2010 Compensation FAQs—Executive Compensation Evaluation

---

- Not a new policy
- Will first resort to recommending against MSOP proposals unless egregious practices are identified or a company previously received a negative recommendation on an MSOP resolution related to an issue that is still ongoing
- Will evaluate problematic pay practices on a case-by-case basis
- If the initial screening questions under the pay-for-performance analysis require further analysis, RMG will consider:
  - Whether the CEO's pay increased or decreased, and the magnitude of the change
  - The reason for the change in pay with respect to the pay mix
  - The long-term alignment of the CEO's TDC with the company's TSR with particular focus on the most recent 3 years
- Increases in CEOs' TDCs resulting from a change in pension plan assumption generally will not result in an unfavorable vote recommendation
- Companies can make a prospective pay-for-performance commitment, tailored to the specific issues raised in RMG's analysis, and RMG will evaluate such commitments on a case-by-case basis to determine if an exception to the application of the negative vote recommendations will be made

# 2010 Compensation FAQs—Stock Option Carve-Out Exception

---

- The Stock Option Carve-Out Exception permits a company to have RMG exclude stock options that have been outstanding for more than 6 years and are in-the-money from the SVT analysis. This was as the policy was understood last year. This policy was introduced as part of the 2009 Policy Updates.
- RMG has thrown several roadblocks up for companies desiring to use this exception, including:
  - Companies must have sustained positive stock price performance
    - ▶ Generally means 5-year positive TSR, as well as positive year-over-year performance for the past 5 fiscal years
    - ▶ RMG permits negative TSR for first 2 years, so long as final 3 years' TSRs are strongly positive; but, vested stock options that were underwater during a substantial portion of the 5-year period are not eligible for the carve-out
  - Companies must have high overhang cost attributable to such in-the-money stock options
    - ▶ Means that outstanding stock options and stock awards should be in the range of 75% to 100% of total overhang
  - Concentration ratio should not be greater than 50%
    - ▶ Concentration ratio is the total number of equity grants to the top 5 executives divided by total equity grants to all employees and directors

# 2010 Compensation FAQs

---

## Option Repricing

- Only deeply underwater stock options should be eligible for exchange or other action
  - Rule of thumb: threshold exercise price should be the higher of the 52-week high or 50% above the current stock price

## Burn Rate Commitment

- If a company fails the RMG Burn Rate Policy, it can commit in a public filing on a prospective basis to maintain a gross 3-year average burn rate equal to the higher of 2% of the company's common shares outstanding (CSO) or the **mean** of its GICS peer group
  - *Note: we were informed that the FAQs contain a typo and companies can continue to commit to the higher of 2% of CSO or the mean plus one standard deviation of its GICS peer group.*

## Pay-for-Performance Timing of Equity Grants

- Companies that grant equity awards at the beginning of the fiscal year based on an analysis of the company's or individual's performance during the prior fiscal year may have an issue under RMG's pay-for-performance analysis unless they provide sufficient information to enable RMG to sufficiently understand and incorporate such grants into its analysis
  - Should provide all necessary information in the proxy

# Speakers' Contact Information

---

**Karen J. Garnett, Assistant Director, Division of Corporation Finance, U.S. Securities and Exchange Commission**

garnettk@sec.gov • (202) 551-3785

**Keir D. Gumbs, Covington & Burling LLP**

kgumbs@cov.com • (202) 662-5500

**Ed Hauder, Exequity LLP**

edward.hauder@exqty.com • (847) 996-3990

Ed's Equity Compensation Plan Blog: [www.edwardhauder.com](http://www.edwardhauder.com)

**Michael L. Hermsen, Mayer Brown LLP**

MHermsen@mayerbrown.com • (312) 701-7960