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Executive Compensation – What Is and What Could Be

By

RAF*advisors* LLC

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Agenda

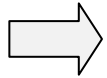
What Is:

- Business Economics Will Continue to Drive Executive Pay
- Public Pressure Will Continue to Target Outliers

What Could Be:

- The Executive Labor Market Becomes More Rational
- Performance Takes Center Stage
- Compensation Committees Manage Multi-Year, Holistic, and Independent Processes

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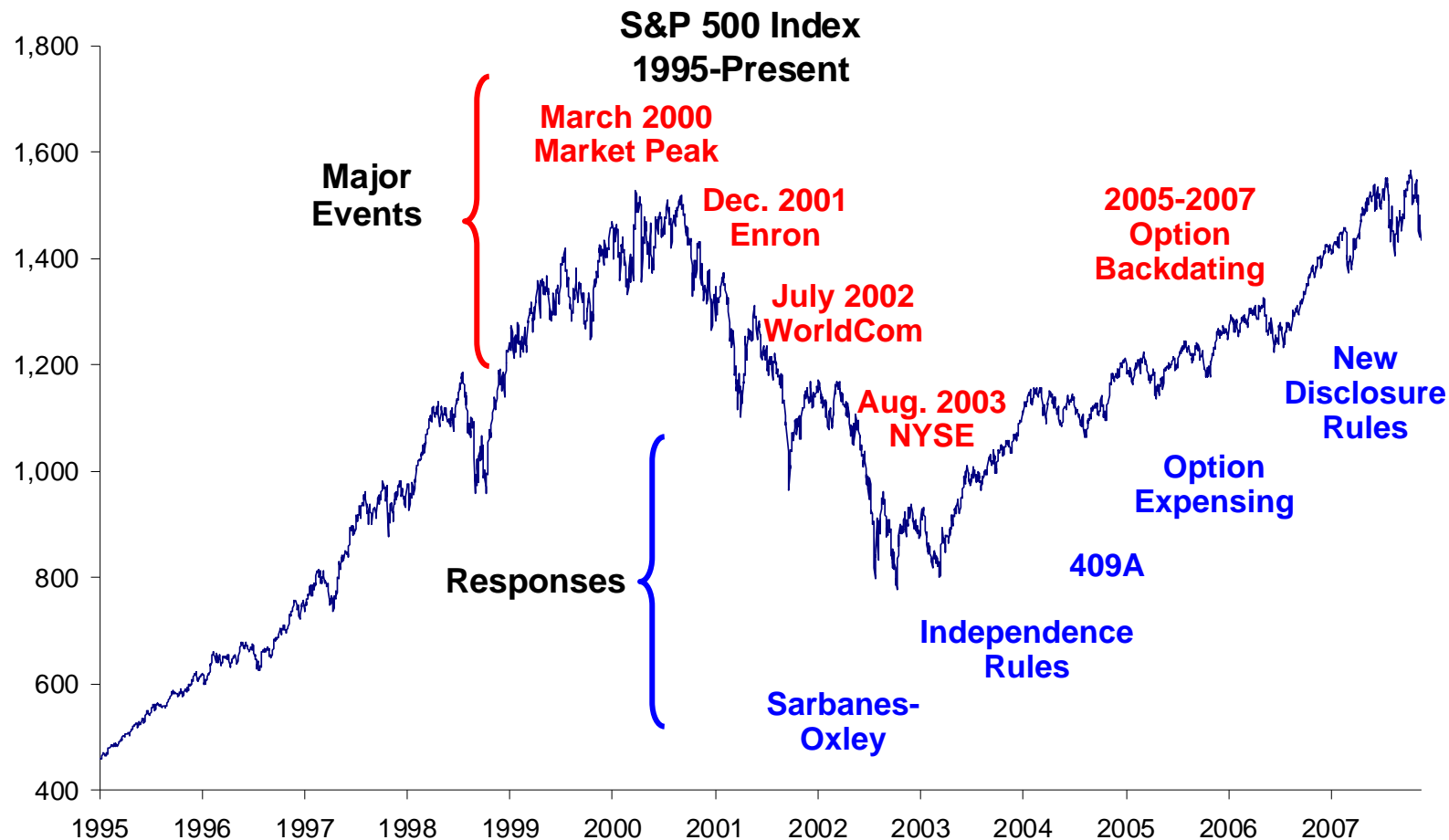
What Could Be:

- Executive Pay Analysis with More Integrity and Insight
- Performance Takes Center Stage
- Compensation Committees Manage Multi-Year, Holistic, and Independent Processes

The current economic outlook is uncertain

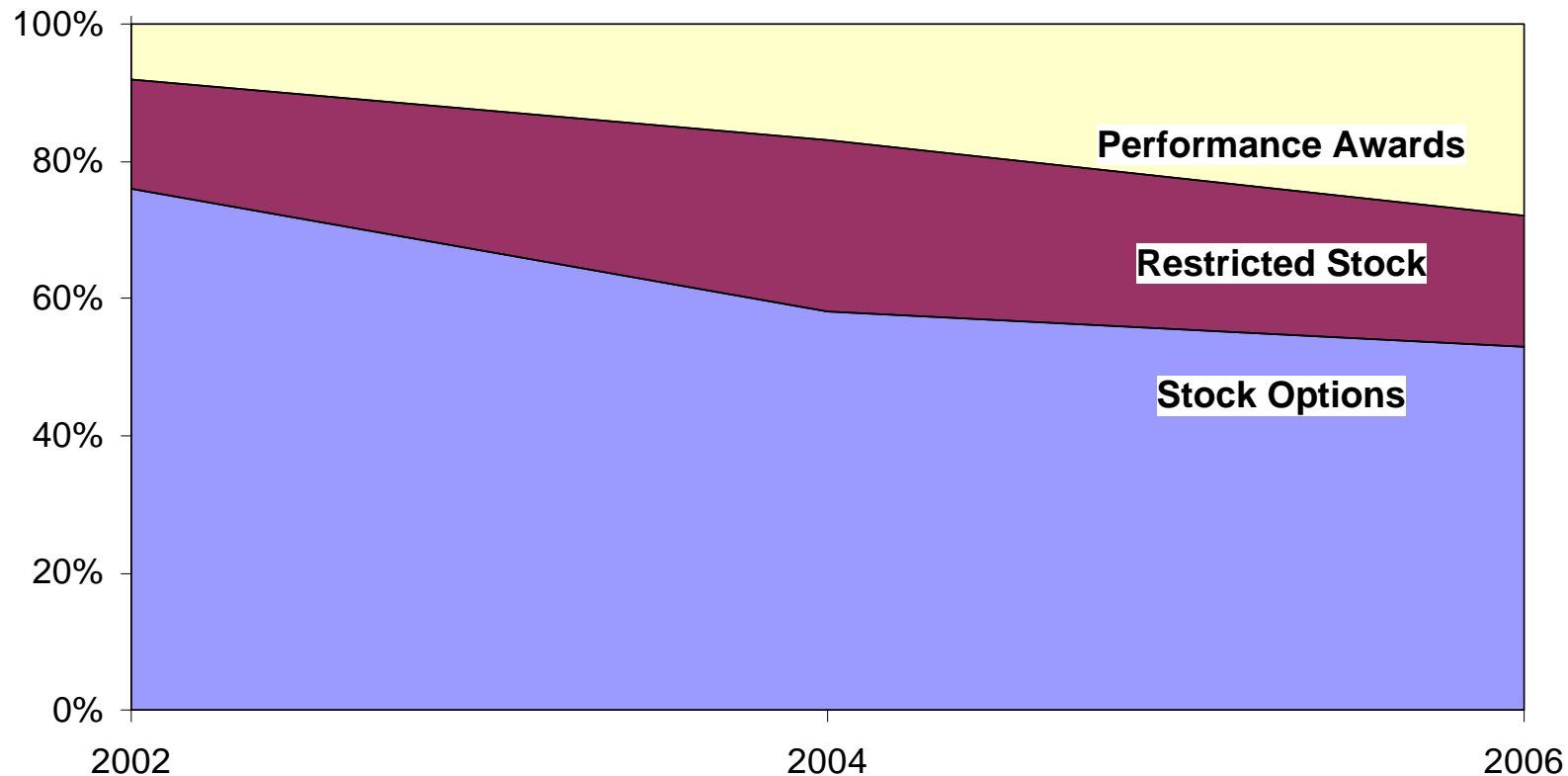
- *“This is a resilient, flexible economy that has shown an ability to withstand shocks” -- Tony Fratto, White House deputy press secretary*
- *“For the next year, the global economy will be strong” -- David Huether, Chief Economist, National Association of Manufacturers*
- *“When you get this far away from a recession, forces build up for the next recession” -- Alan Greenspan, former Chairman of the Federal Reserve*
- *“We have not seen a decline in housing like this since the Great Depression” -- John Stumpf, CEO Wells Fargo*

The economic downturn in 2000 brought about significant shifts in executive compensation. The regulatory response was severe



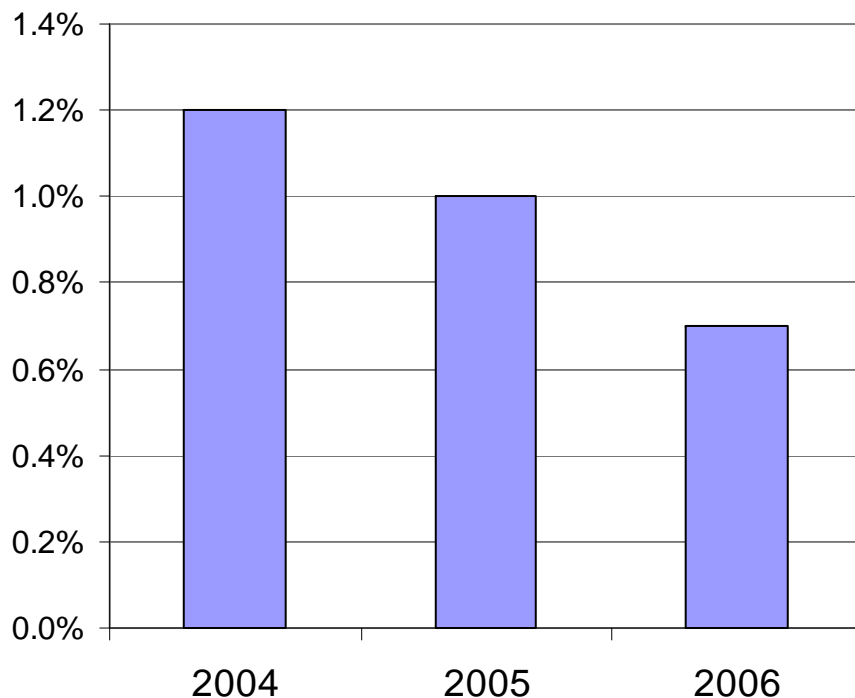
Performance awards will continue to displace restricted stock for executives

Executive Long-term Incentive Mix

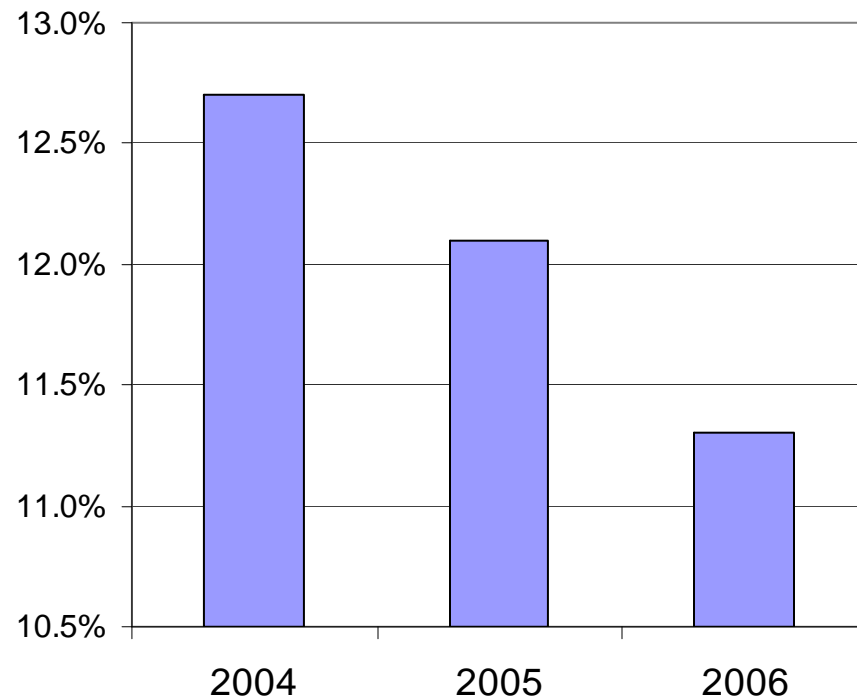


Dilution levels are bottoming out

**Median Run Rate
Fortune 1000**



**Median Overhang
Fortune 1000**

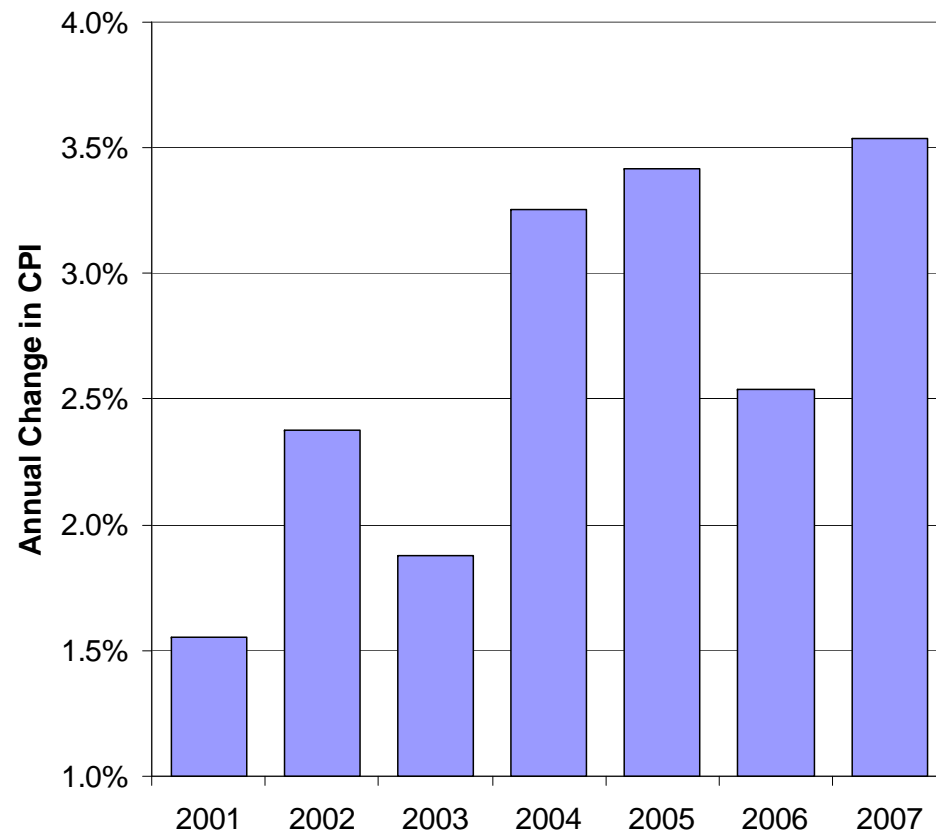


We are seeing a weak dollar, inflationary pressures, and collapses in the housing market . . .

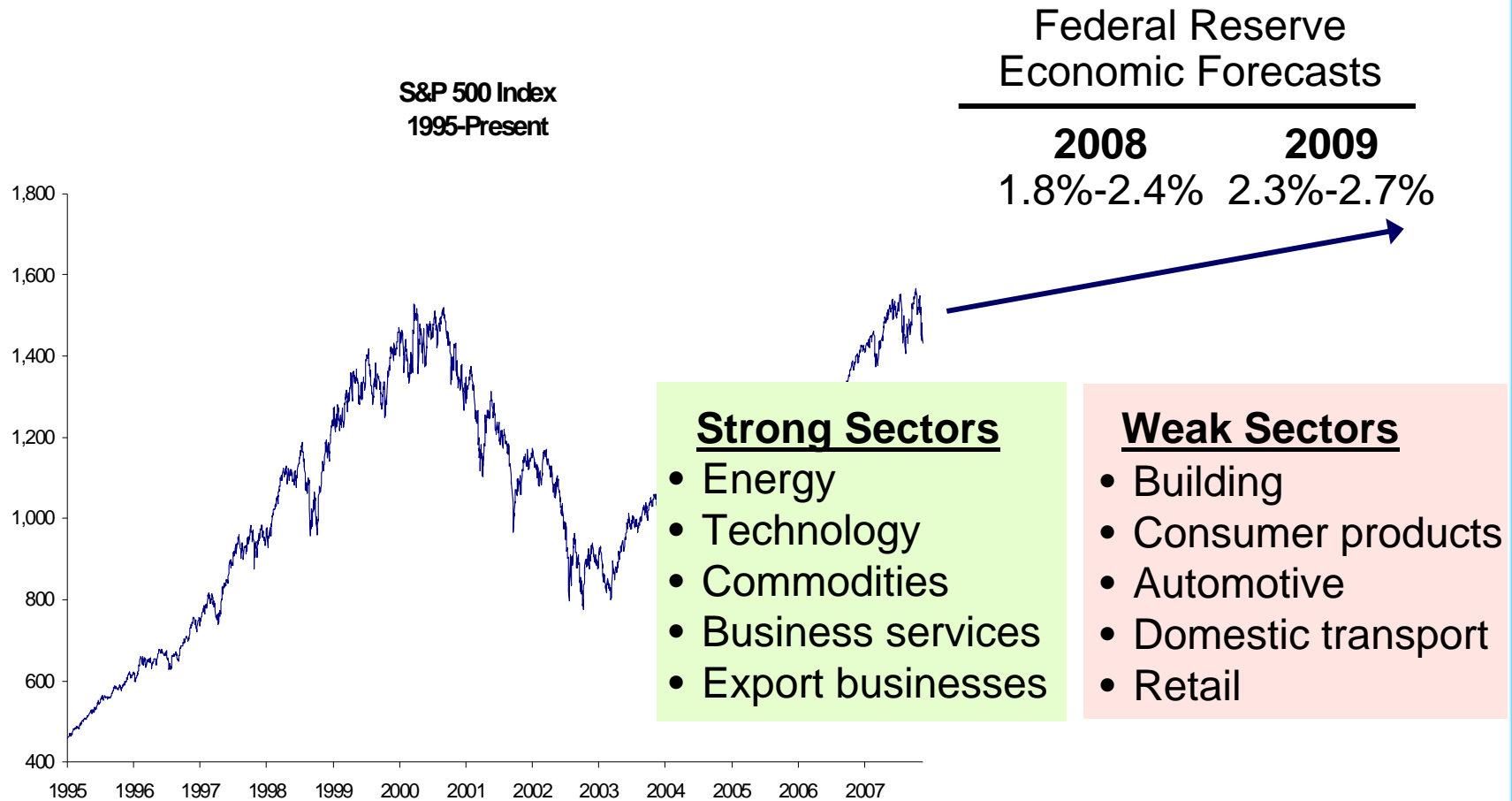
Value of US Dollar
Euros per Dollar



Year-End Rate of Change in Consumer Price Index
Dec 2000-Present



... which likely will cause low growth for US equities, although growth will vary by sector



In this environment, we predict little change in executive compensation trends . . .

- Only modest increases in pay levels
- Continued adoption of (and experimentation with) performance-based equity plans
- Bottoming out of dilution levels
- An unforgiving external environment

External pressures will include:

SEC Disclosures

- Why decisions were made
- Performance targets
- Competitive benchmarks
- Role of executives in making compensation decisions

ISS

- Support “Say on Pay”
- Pressure to align pay and performance
- Limited relief for high-cost equity plans
- Support independent Board Chairs

Politics and Media

- Negative attention on outliers
- Spotlight on governance, particularly conflict of interest, e.g:
 - Waxman hearings
 - Director compensation

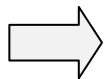
This year, we have an opportunity to “raise the bar.” Areas where we as compensation professionals can do a better job include:

- Analyze executive pay with greater integrity and insight
- Put “performance” on center stage
- Help Compensation Committees manage multi-year, holistic, and independent processes

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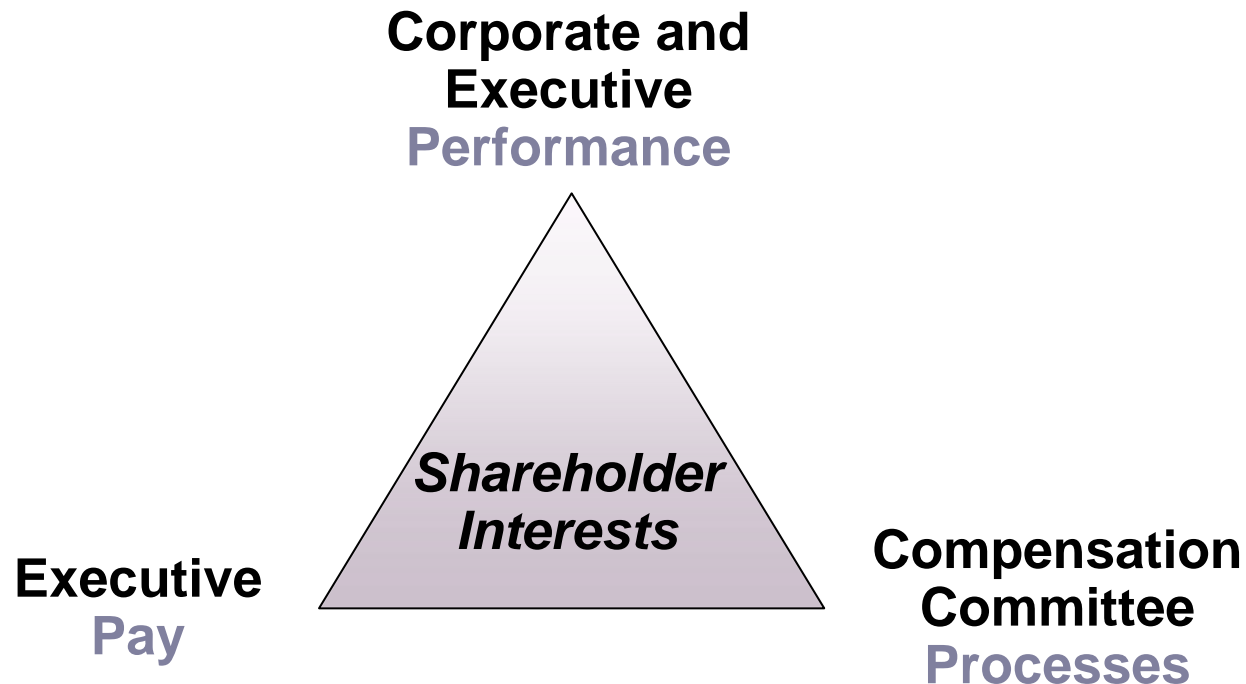


What Could Be:

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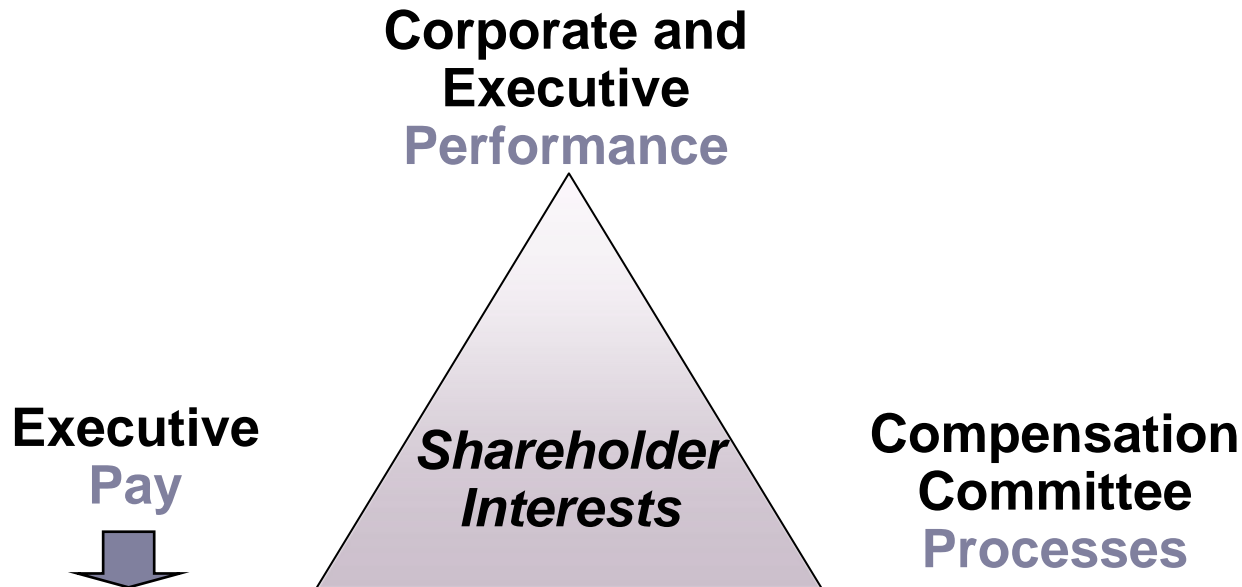
Companies will need to pay more attention to the three Ps: Pay, Performance, and Processes

Effectively Managing Executive Compensation



What Could Be: Analysis of executive pay could have greater integrity and produce more valuable insight

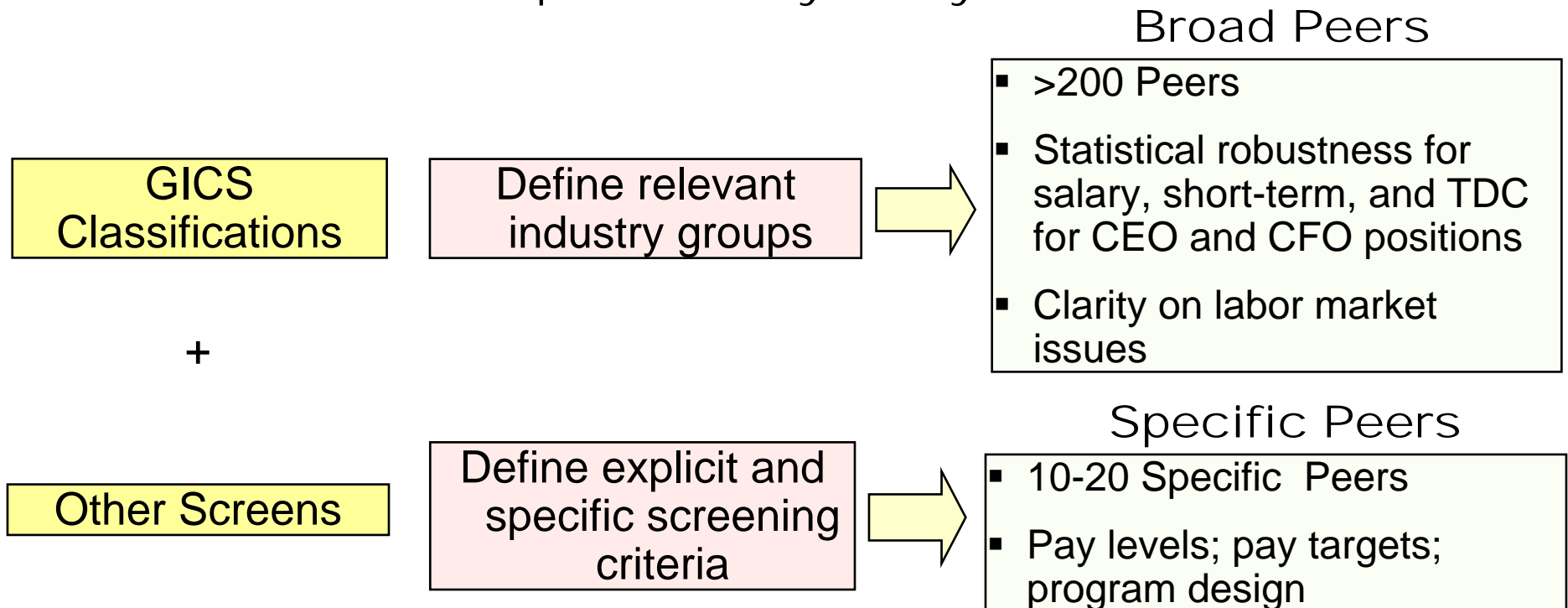
Effectively Managing Executive Compensation



- *Peer group(s) reflecting the broader executive labor market*
- *Sound analytic methodologies, with greater integrity, transparency, and consistency*
- *More intelligent review of structural vs. performance-adjusted pay*

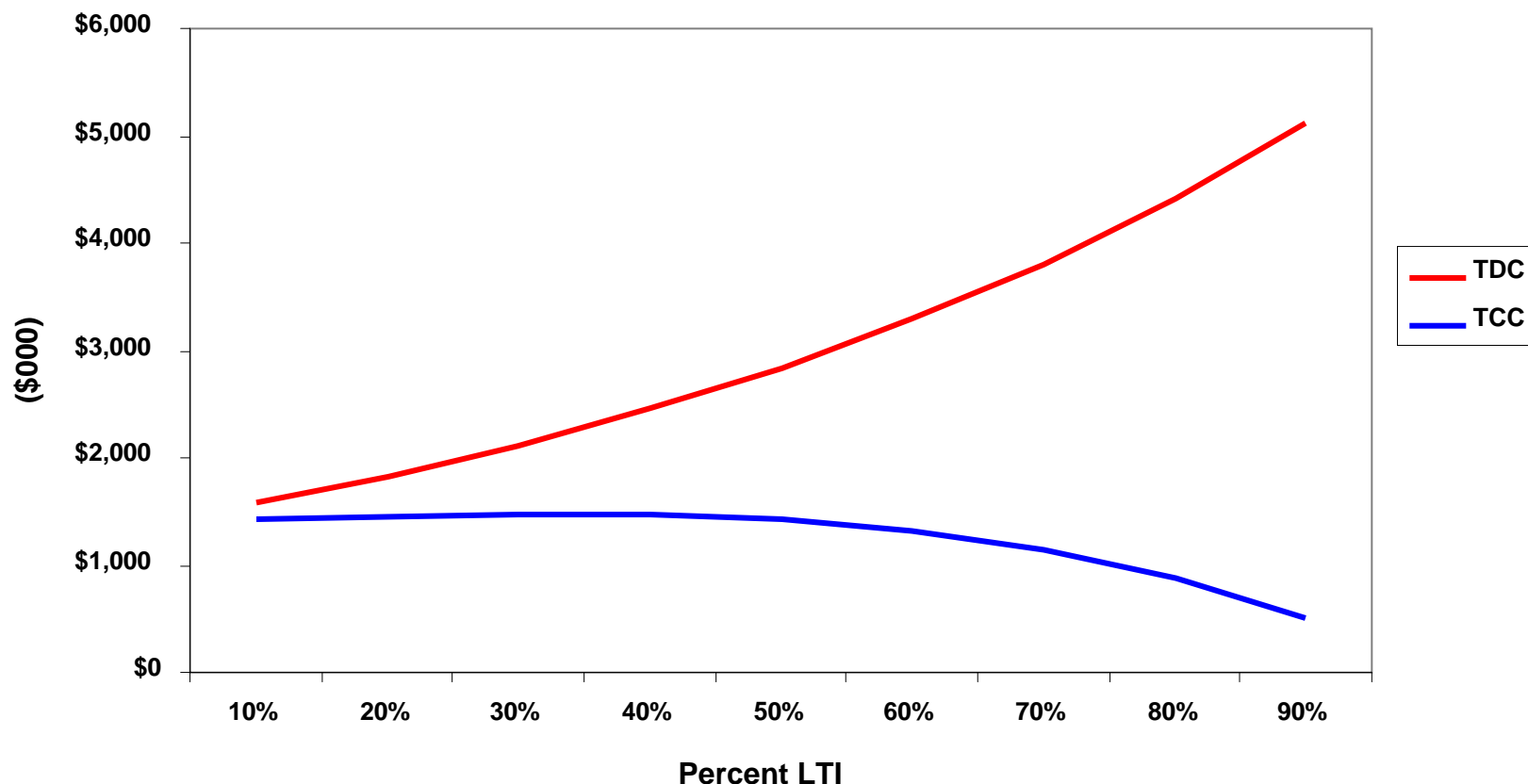
Broad peer groups provide statistical validity and clarity on labor market behavior; specific peers provide visibility into compensation practices

Peer Groups for Competitive Pay Analyses



For example, broad statistical analysis provides more clarity on how pay mix affects compensation

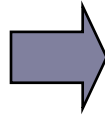
Market CEO Pay vs Percent LTI



What Could Be: We should spend as much time analyzing performance as we do pay

Effectively Managing Executive Compensation

**Corporate and
Executive
Performance**



**Shareholder
Interests**

- *Benchmarks for performance, not just pay*
- *Pay for performance, not just size*
- *Measures/goals that reflect business strategy, industry, and sustainable value drivers*
- *Clarity on pay for performance relationships*
- *Visibility into multi-year outcomes*

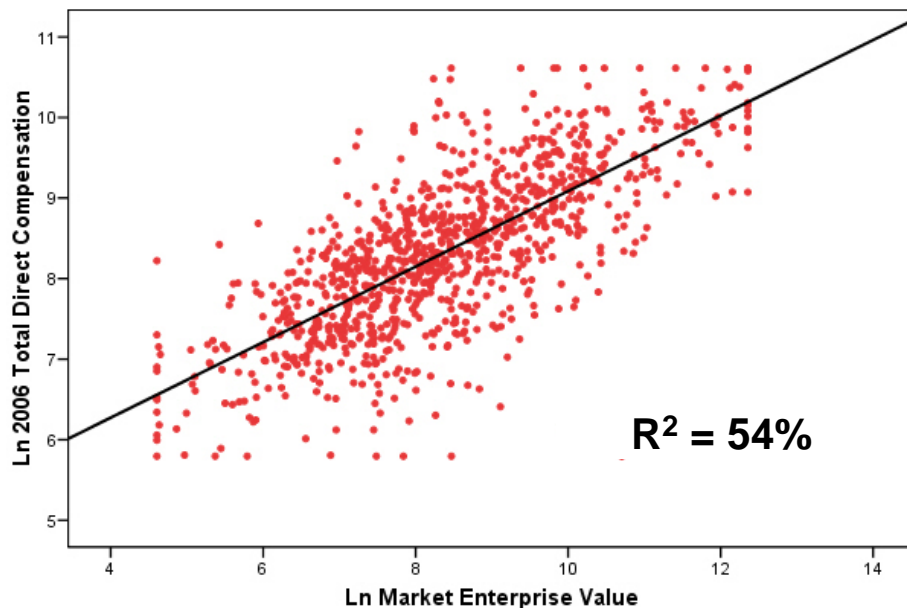
**Executive
Pay**

**Compensation
Committee
Processes**

Executive pay continues to be driven more by size than performance

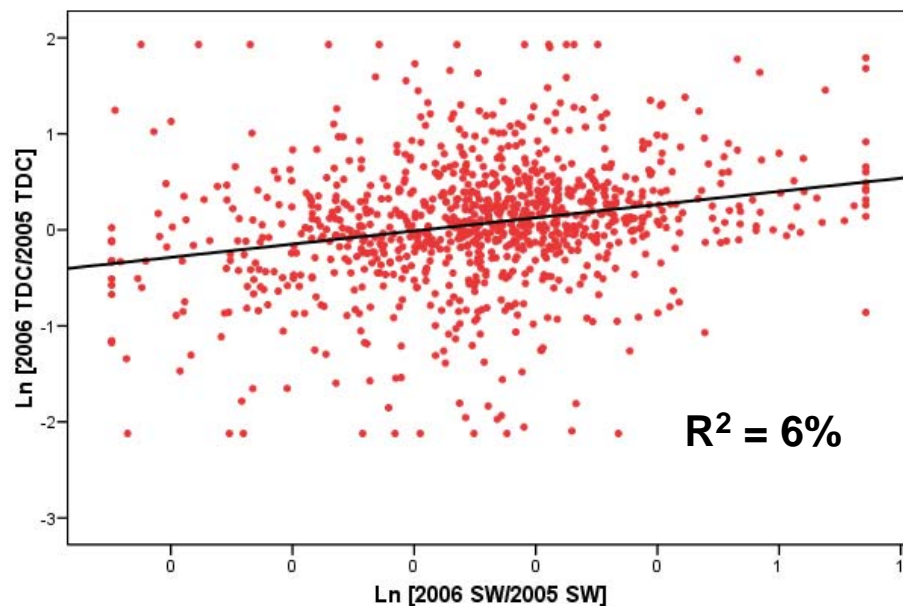
CEO Pay vs. Size

Total Comp vs. Enterprise Value



CEO Pay vs. Performance

Total Comp Change vs. 1 Yr Return



Compensation should be calibrated to future performance scenarios over multi-year periods

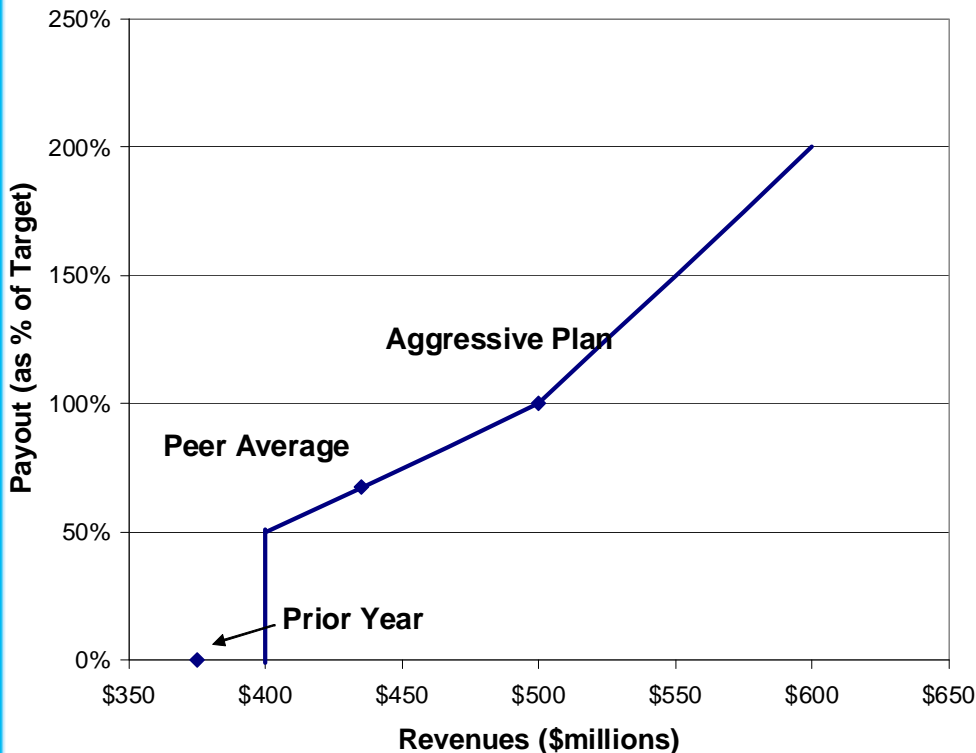
Realized Pay vs Shareholder Wealth



Goal-setting needs to occur in view of industry impact and competitive contexts

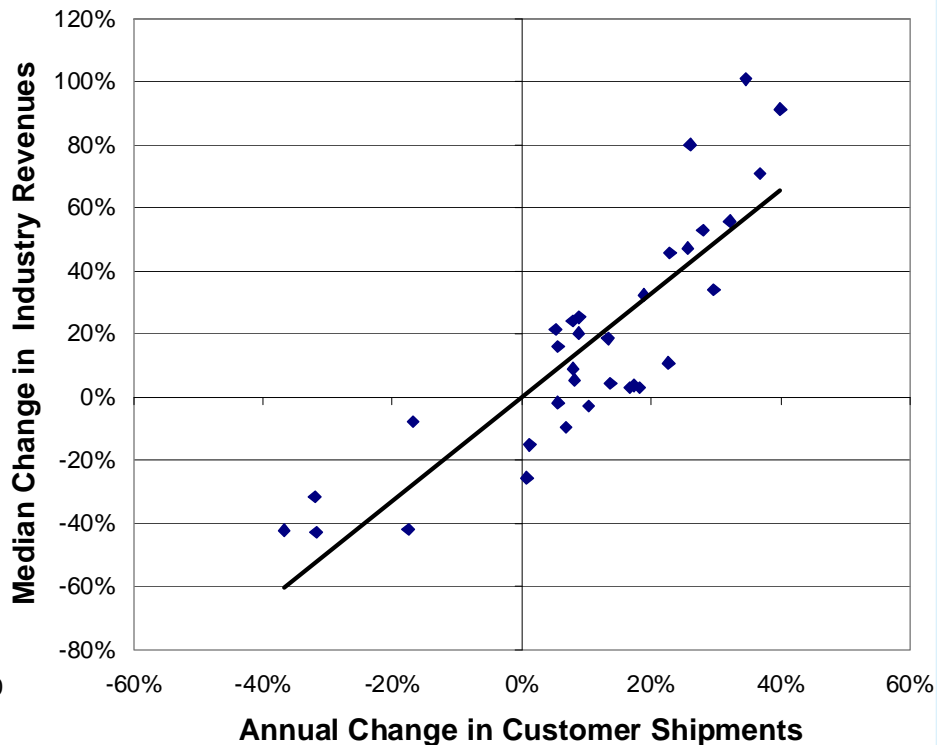
Good budgets do not necessarily equal good goals

2008 Performance Scenarios vs. Pay for Performance Leverage



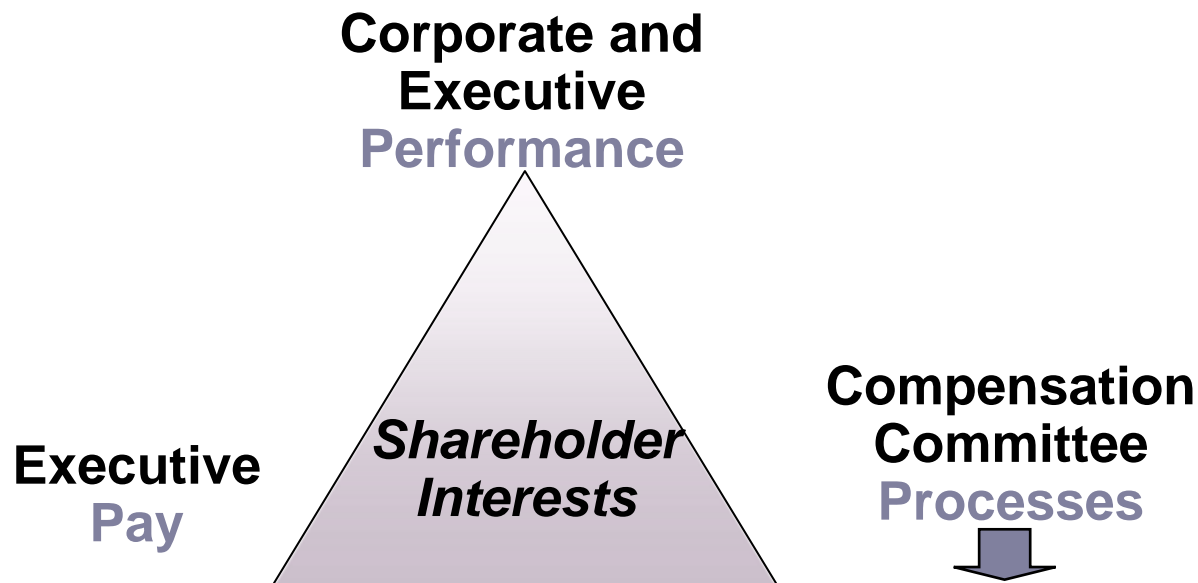
Externalities may legitimately affect compensation

Change in Customer Shipments vs. Change in Revenues Rolling 4Q Changes 2Q99-2Q07



What Could Be: Compensation Committees should manage to a multi-year agenda and better processes


Effectively Managing Executive Compensation



- *More independent processes*
- *Multi-year planning*
- *Broader charters*
- *Linkage to other Board processes*

Compensation Committees need greater visibility to long-range processes

Example of Compensation Committee Calendar

2007				2008			
Spring	Summer	Fall	Winter	Spring	Summer	Fall	Winter
Annual Items <ul style="list-style-type: none"> • Proxy • Bonus payout • Equity grants 	<ul style="list-style-type: none"> • Director Pay • Broad Executive Pay Trends 	<ul style="list-style-type: none"> • Exec Pay Strategy and Review 	<ul style="list-style-type: none"> • Exec Pay Actions • Goal-setting 	<ul style="list-style-type: none"> • Proxy • Bonus payout • Equity grants 	<ul style="list-style-type: none"> • Director Pay • Broad Executive Pay Trends 	<ul style="list-style-type: none"> • Exec Pay Strategy and Review 	<ul style="list-style-type: none"> • Exec Pay Actions • Goal-setting
Special Items <ul style="list-style-type: none"> • Pay Strategy and Plan Design Review • New Incentive Design 				<ul style="list-style-type: none"> • Change-in-Control Assessment • Succession plan re: CEO retirement 			
 <ul style="list-style-type: none"> • Ad hoc items 							

Roles and responsibilities should be regularly clarified

Roles and Responsibilities Matrix

Item	Consultant Role	Management Role	Committee Role	Board Role
Overall compensation philosophy	Propose	Input	Approve	Review
Salary increases	Input	Propose	Approve	Review
Short-term compensation <ul style="list-style-type: none"> ▪ Annual incentive plan design ▪ Specific bonus award levels 	Propose Input	Input Propose	Approve Approve	Review Review
Long-term incentive compensation <ul style="list-style-type: none"> ▪ Long-term incentive plan design ▪ Overall equity grant pool ▪ Specific LTI grants and awards 	Propose Input Input	Input Propose Propose	Approve Approve Approve	Review Review Review

Key takeaways include:

What Is:

- Economics will continue to drive executive pay, but we have come to a landing point on many issues
- External pressures will continue to keep the heat on
 - SEC
 - ISS
 - Court of public opinion

What Could Be:

- We as a profession can get out in front. We can help our companies and our Compensation Committees:
 - Do a more insightful job of analyzing pay
 - Drive performance to center stage, taking advantage of opportunities to artfully design performance-based executive pay
 - Manage multi-year, holistic, and independent processes

About RAF *advisors* LLC

RAF *advisors* provides superior advice, information, and service on the three P's: Pay, Performance, and Processes, supported by our fourth P, People

- Corporate and Executive Performance**
- *Insights into business, talent, and industry, and implications for compensation design*
 - *Analysis of shareholder value drivers, measures, and goal-setting*
 - *Appropriate design of pay for performance outcomes*

- Executive Pay**
- *Sound methodologies, applied with integrity, transparency, and consistency*
 - *Fact-based analysis; opinion-based advice*
 - *Clarity on appropriate executive value relative to shareholder value*

Our Clients

- Compensation Committee Processes**
- *Complete independence, working for the Compensation Committee*
 - *Processes geared to multi-year needs*
 - *Stability and availability of seasoned and trusted resources*
 - *Sensitivity to external developments*

Our People

- *Trained, trusted resources*
- *Driving toward optimal results for the Company and its shareholders*
- *Serving over the long-term*
- *Providing quality, reliable service for a manageable number of client relationships*

Robin Ferracone
CEO, RAF *capital* LLC
Executive Chair, RAF *advisors* LLC



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Over the last 25 years, Ms. Robin A. Ferracone has dedicated herself to building businesses that align organizational systems with business strategy. She is founder and CEO of RAF *capital* LLC, a firm that makes strategic investments in HR-related businesses, one of which is RAF *advisors* LLC. RAF *advisors* LLC, of which she is Executive Chair, helps Compensation Committees make performance-enhancing, defensible, and timely executive compensation decisions that are in the best interests of the Company's shareholders. Ms. Ferracone provides executive advisory services to public and private companies.

Prior to her roles at RAF *capital* LLC and RAF *advisors* LLC, Ms. Ferracone was President of Mercer's global Human Capital division. Prior to Mercer, Ms. Ferracone was President/Chairman of SCA Consulting, an executive compensation consulting firm she co-founded and was sold to Mercer in 2001. Ms. Ferracone serves on the Duke University and Harvey Mudd College Boards. She has an MBA from the Harvard Business School and a BA from Duke University.

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John Borneman is a Senior Vice President with RAF*advisors* LLC. Mr. Borneman has over 10 years of experience advising Compensation Committees regarding executive compensation and rewards issues. Mr. Borneman's areas of expertise include developing pay strategies, identifying performance metrics, and calibrating performance goals to align pay with business needs and shareholder interests. He is a thought leader in the area pay for performance, and he is a regular speaker on the topic of selecting the right measures for rewards programs and aligning rewards with performance.

Mr. Borneman's previous experience includes Mercer Human Resource Consulting, where he was a Principal in the Executive Compensation practice area and developed many of the firm's standards for performance measurement. Prior to Mercer, he was with SCA Consulting, which was acquired by Mercer in 2001.

Mr. Borneman holds an MBA from the University of Chicago and an undergraduate degree from the University of Michigan.