



Executive Compensation – A New Day in Director Oversight November 13, 2009

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A New Environment For Executive Compensation



- **June 10 - Obama Administration/Treasury Outlines Broad Compensation Best Practices and Lays Groundwork for More Change**

- Five Broad Principles
- Supports Say on Pay
- Supports Increased Compensation Committee Independence Requirements



Who's impacted?

All Financial Institutions / Public Companies

- **July 10 - SEC Proposes New Disclosure Requirements for 2010 Proxy Season**

- Expands Corporate Governance Disclosure
- Changes to Compensation Disclosure
- CD&A Impacts



Public Companies

- **July 31 - House Bill (Corporate and Financial institution Compensation Fairness Act of 2009) approved by the House of Representatives**

- Introduced by Rep. Barney Frank
- Supports Say on Pay
- Proposes Increased Compensation Committee Independence
- Proposes Provisions Relating to Financial Institutions



All Financial Institutions

- **September - Senate Meets on House Bill and SEC Comment Period Ends**

- Final regulations to come this fall/winter



■ **October 22 – Federal Reserve Proposes New Regulations and Oversight of Financial Institution Compensation Practices**

- Unprecedented federal influence on compensation plan design
- Substantial expansion of Board/Compensation Committee role
- Encourages balanced risk-taking incentives
- Requires effective controls and risk management
- Comment period through November 27, 2009

Who's impacted?



All Banks supervised by Federal Reserve

■ **October 22 – Special Master for TARP (Kenneth Feinberg) released determinations for compensation packages for 7 exceptional assistance firms**



7 Exceptional Assistance Firms

■ **October 26 – RiskMetrics Releases Draft Policy Updates for Comment**

- Final Policy to be issued in November



All Public Companies



Regardless of specific details to come from the various regulatory proposals, there are several themes that are emerging:

- **Board Accountability and Corporate Governance**
- **Risk Management and Assessment of Pay Programs**
- **Pay for Performance Alignment**
- **Focus on Long-Term Performance**
- **Increased Disclosure and Visibility**
- **Increased Influence of Shareholders**

Overall increased scrutiny, disclosure and regulation of executive and employee compensation practices and board governance



Announcements in June have Paved the Way for Current Legislation

- **Pay for Performance: Incentives should be tied directly to performance that supports long-term value creation for shareholders**
 - They should be tied to a wide range of internal and external metrics, not just stock price
- **Risk Time Horizons: Compensation should incorporate the time horizon of risks**
 - Executives should be paid based on creation of long-term value
 - Longer stock holding period is the most effective way of addressing this
 - Longer-term plans may obviate the need for specific clawbacks
 - Matching risks and compensation incentives is appropriate not just for the top 5, but also those involved in designing, selling and packaging financial instruments
- **Risk Management: Compensation practices should be aligned with sound risk management**
 - Committees should conduct and publish risk assessments of pay packages to ensure that they do not encourage imprudent risk-taking. Results should be made public



- **Golden Parachutes and Supplemental Retirement Packages: Companies should re-examine whether these vehicles are adequately aligned with shareholders' interests and promote meaningful performance**
 - Consider if executives are rewarded if shareholders are losing value
- **Transparency and Accountability should be promoted. Treasury to work with Congress to pass legislation on two specific topics for all public companies**
 - Say on Pay: SEC would require a non-binding annual say-on-pay vote
 - Independent Compensation Committees: Would require Compensation Committees to operate even more independently than currently required



Summary of Proposed SEC Disclosure Requirements – Seven “Enhancements” to Reporting



- **Released July 10, 2009; Comment period ended September 14, 2009**
- **Final rules expected to be effective for any annual meeting that occurs after December 15, 2009 (unless changes are significant)**
 - However, SEC has a long list of open issues/requests for comment
- **Final guidance expected before year end**
- **Discussion of risk management and compensation**
 - New CD&A section will discuss whether the company’s individual components or overall compensation policies for **executives and employees** create incentives that encourage unnecessary risk which would jeopardize the economic viability of the Company ... and how the Company manages that risk
 - Some examples which would warrant Committee attention include:
 - » a business unit that carries a significant portion of the company’s overall risk profile
 - » a business unit with a compensation structure significantly different than other units
 - » a business unit that is significantly more profitable than others within the Company
 - » a business unit where compensation expense is a significant portion of the revenues generated
 - » a compensation program that varies significantly from the Company’s overall risk and reward structure, such as when a bonus is payable upon the accomplishment of a task where the income and risk from that task extends over a significantly longer period



Summary of Proposed SEC Disclosure Requirements – Seven “Enhancements” to Reporting (cont’d)



- **Reporting of equity awards using grant date value**
 - Compensation tables will reflect full grant date fair value for grants made during the year, rather than accounting accrual during the year (which may relate to current and prior grants)
- **Additional Compensation Consultant disclosures, including fees**
 - If consultant (or any affiliate) played a role in determining or recommending executive and director compensation **and also** provided additional services to the Company, must disclose:
 - » Nature and extent of all additional services provided
 - » Aggregate fees paid for executive or director compensation services
 - » Aggregate fees paid for other services
 - » Whether the decision to engage the consultant for other services was made, recommended, screened or reviewed by management
 - » Whether the Board or compensation committee approved all services provided
- **Director and Director Nominee disclosure:**
 - Specific experience, qualifications, attributes or skills that qualify the person for service on the Board or a specific committee, including the person’s risk assessment skills or other expertise
 - If material, disclosure should cover more than the past 5 years
 - Any public company directorships held at any time during the past 5 years (not just current directorships)
 - Any legal proceedings in which the director or nominee was involved during the prior 10 years (not just 5 years)



Summary of Proposed SEC Disclosure Requirements – Seven “Enhancements” to Reporting (cont’d)



- **Company leadership structure: Chairman, CEO, Lead Director**
 - Describe the leadership structure and explain why it is appropriate given the Company’s specific characteristics
 - If the same person is CEO and Chairman, discuss whether there is a lead independent director and their specific role
 - Disclose the Board’s role in risk management and the effect that this involvement has on the company’s leadership structure
- **Voting results reported on Form 8-K (rather than 10-Q or 10-K)**
 - Requirement to file results of a shareholder vote within 4 business days
- **Various revisions to proxy solicitation process**



Corporate and Financial Institution Compensation Fairness Act of 2009 (most recent House bill)



- **Introduced by Rep. Barney Frank; Passed House July 31, 2009**
- **Three Major Provisions:**
 - Require **Say on Pay** (i.e. annual, non-binding advisory shareholder vote on pay)
 - Increased Standards Related to **Compensation Committee Independence** at all Public Companies
 - Additional provisions intended to **discourage excessive risks** (for all financial institutions)
- **Proposed Effective Dates**

Requirement	Applicability
Say on Pay/Golden Parachute Approval	Proxies filed on or after six months from the date of rule publication with the practical impact of mandatory Say on Pay likely in 2011
Compensation Committee Independence	Nine months after Act's passage
Disclosure Regarding Independence	For proxies filed one year or more after the Act's passage
Study of Consultant Independence	SEC to complete within two years of Act's passage
Disclosure and Prohibition of Incentives (for financial institutions only)	Federal regulators to issue guidance within nine month's of Act's passage
Financial Incentive Compensation Incentive Study	Comptroller General to compete within one year of Act's passage



■ Say on Pay Shareholder Votes

- Requires an annual, nonbinding (advisory) shareholder vote on executive compensation for all* public companies
 - » Approval would be for compensation as disclosed in Compensation Committee Report, CD&A, tables and support materials for Named Executive Officers (“NEOs”)
 - » Does not create additional liability to directors
- Requires separate advisory vote on golden parachutes during a merger or acquisition
 - » Disclosure of amounts to be received by NEOs as result of Change-In-Control transaction
- Effective Dates: Say on Pay/Golden Parachute Approval would be in effect for proxies filed on or after six months from SEC rule publication (likely to be 2011 proxy season)

■ Disclosure of Institutional Shareholder Votes

- Any institutional investment manager owning at least \$100 million of equity at some point during the preceding 12 months must annually report any vote it cast on an executive compensation or parachute arrangement, unless such vote would be publicly reported elsewhere

* Potential exceptions for smaller reporting issuers



- **Stricter Independence Standards for Compensation Committee Members**
 - Committee members cannot accept any consulting, advisory, or other fees outside of pay received for Board service
- **Authority of Committee Relating to Compensation Consultants, Counsel and Advisors**
 - Committee to retains sole authority (but not the obligation) to hire, compensate and oversee independent compensation consultants, counsel and other advisors
- **Compensation Consultants, Disclosure and Funding**
 - Any compensation consultant retained by the Committee must be independent within standards to be established by the SEC
 - Proxy filing must disclose whether the Committee retained and obtained the advice of a compensation consultant meeting SEC independence standards. The Act does not include earlier draft language requiring additional disclosure as to why a Committee chose not to hire an independent consultant
- **Study and Review**
 - SEC will conduct a two-year study examining the use of independent consultants by Committees
- **Effective Dates**
 - Independence standards must be met within 9 months after Act's passage, or risk stock exchange delisting. Disclosure regarding independence would be in effect for proxies filed on or after one year from Act's passage



■ **Applicability**

- Applies to “covered financial institutions,” defined as any depository institution, registered broker-dealers, credit unions, investment advisors, Fannie Mae, Freddie Mac and other institutions identified by the Federal Regulator

■ **Required Disclosure of Incentive Programs**

- Must sufficiently disclose to the Federal Regulator the structure of all incentive-based compensation arrangements sufficient to determine whether they are aligned with sound risk management, account for the time horizon of risk, and meet other criteria to discourage overly risky behavior

■ **Prohibition on Certain Incentive Arrangements**

- Federal Regulator will issue regulations prohibiting any incentive arrangements or features determined to encourage risks that could threaten the safety and soundness of the company or have serious adverse effects on economic conditions or financial stability (limited grandfathering of arrangements in place when Act is passed)

■ **Exceptions/Clarifications**

- Covered financial institutions with assets of less than \$1B are exempt
- Companies are not required to report compensation provided to any individual employee
- Disclosure is not required if a company does not have incentive-based payment arrangements

■ **Study and Effective Date**

- Comptroller General to study the relationship between compensation structures and excessive risk taking, focusing on 2007-08. Regulations to be completed within nine months of Act’s passage by various federal regulators



- **Proposed New Regulatory Guidance Announced October 22, 2009**
 - 30 Day Comment Period
- **Objective**
 - To ensure incentive compensation policies do not encourage excessive risk taking and are consistent with the safety and soundness of the institution
- **Initiating 2 Supervisory Actions**
 - 28 Large Complex Banking Organizations (LCBO) – more comprehensive review and analysis
 - Other Community/Regional Banking Organization – part of normal supervisory review
- **Covered Individuals/Plans - Broader than SEC and TARP covered individuals**
 - **Senior Executives** or others responsible for oversight of organizations' firm wide activities or material business lines
 - **Individual employees** (including non executives), whose activities may expose the institution to material amounts of risk (e.g. traders) and
 - **Groups of employees** who in the aggregate may expose the institution to material amounts of risk, even if no individual employee is likely to expose the bank to material risk (e.g. loan officers as a group)



■ **Balanced Risk Taking Initiatives**

- Review the full range and the time horizon of risk to ensure proper balance
- Fix unbalanced arrangements
 - » Risk adjustment of awards
 - » Deferral of payments
 - » Longer performance periods
 - » Reduced sensitivity to short term performance
- Review golden parachute arrangements and termination/CIC agreements.

■ **Effective Controls and Risk Management**

- Policies, procedures, and roles to be involved in reviews
- Frequent reviews, reporting and adjustments
- Substance of reviews

■ **Strong Corporate Governance**

- Board Involvement (or Compensation/Other Committee) should be actively involved
- Board Composition and Resources (independent Committee and advisors)
- Disclosure (proxy)
- Tailored Governance Programs (size of bank; roles)



Pay Czar Announces Decisions



On October 22, 2009, Special Master for TARP (Kenneth Feinberg) released determinations for compensation packages for 7 exceptional assistance firms. Decisions reflect the following principles

- **Pay practices should align compensation with long-term value creation and financial security**
 - Reject cash bonuses paid on short-term performance and restructure cash guarantees into stock
- **Significant reduction in total compensation**
 - Average cash compensation down more than 90%, with approved cash salary limited to \$500,000 for more than 90% of covered employees
 - Average total compensation down by more than 50%
 - Exceptions where necessary to retain talent and protect taxpayer interests
- **Salary increases should be paid in company stock and held over the long-term**
 - Stock immediately vested, only to be sold in 1/3 installments beginning in 2011 or early when TARP is repaid
- **Incentive compensation should be paid in the form of long-term restricted stock and be contingent on performance and on TARP repayment**
 - Require executives to meet performance goals set by Special Master and certified by Compensation Committee. Any incentives granted paid only in stock requires three years of service and can be cashed in only when TARP is repaid
- **Immediate reform of practices not aligned with shareholder and taxpayer interests**
 - Limits “other” compensation and perquisites and no further accruals under SERP or severance plans



RiskMetrics is requesting feedback on two 2010 potential policy changes

■ **Pay for Performance**

- Current test:
 - » A one- and three-year total shareholder return in the bottom half of the industry group coupled with an increase in CEO total direct compensation causes a potential pay for performance disconnect
- Proposed modifications, companies will also have potential pay for performance problems if:
 - » They have unchanged or marginally decreasing CEO pay with below-industry median one- and three-year total shareholder return, and
 - » If a potential problem exists, RiskMetrics will review the alignment of CEO total direct compensation and total shareholder return over five years

■ **RiskMetrics Questions**

- Is a five-year pay alignment a useful factor in assessing pay for performance?
- What additional factors, if any, should be included in an examination of longer-term pay alignment?



RiskMetrics' list of poor pay practices will include practices that may incentivize inappropriate risk-taking

■ RiskMetrics will assess

- Guaranteed bonuses
- Single performance metric used for short and long-term incentive plans
- High severance and / or pay opportunities relative to industry peers
- Mega annual equity grants
- Disproportionate level of SERPs

■ They will consider factors that may mitigate risk

- Clawbacks
- Stockownership/holding requirements

■ RiskMetrics Questions

- Are there specific pay practices which are particularly risky and deserve more scrutiny?
- Are there additional mitigating practices or factors which should be considered?

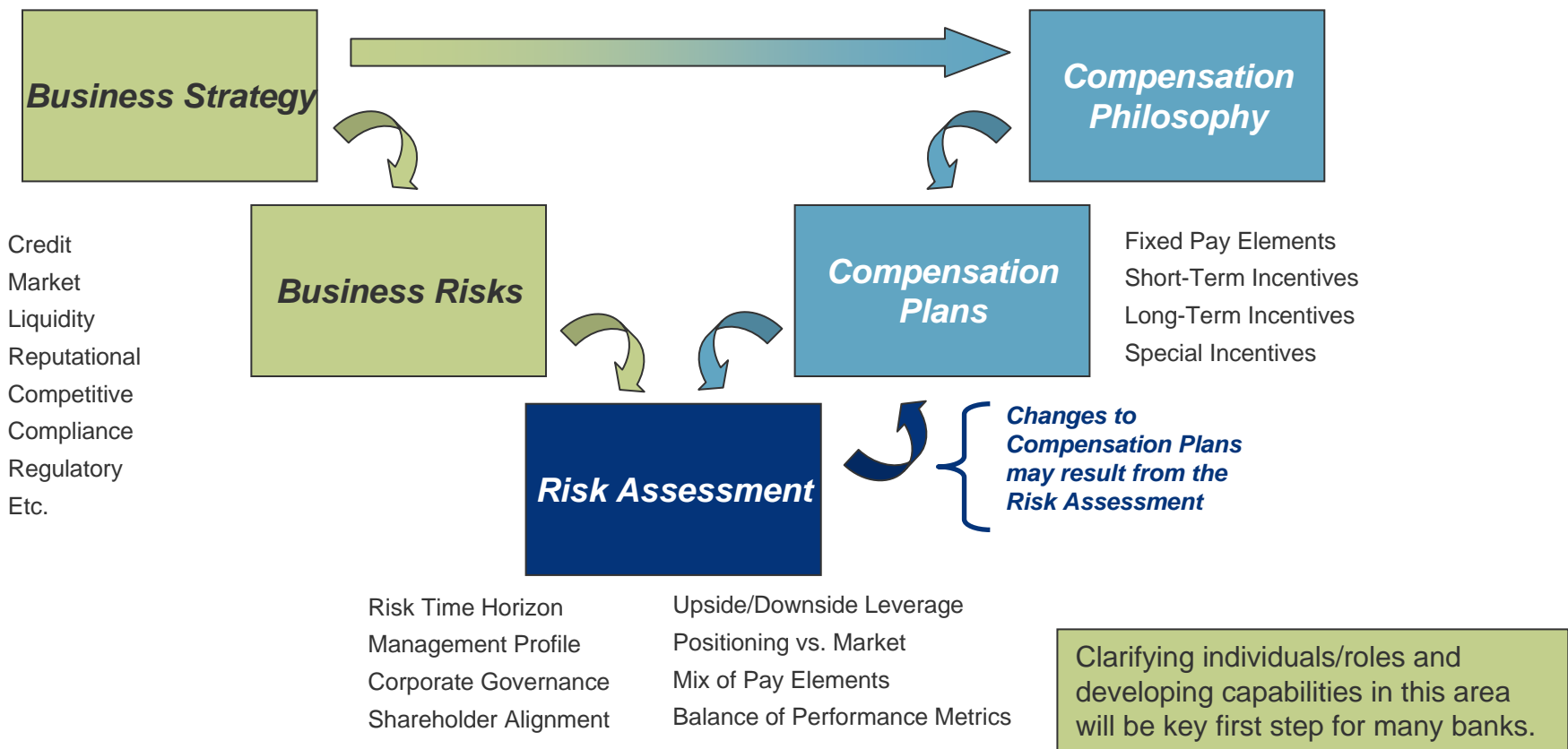


Compensation “Best” Practices Should Embrace

- **Risk Management**
 - Ensure compensation programs do not motivate unnecessary or excessive risk taking (all employees, not just executives)
 - Implement controls, process, design features to mitigate risk taking
- **Long-Term Horizon of Performance and Rewards**
 - Reward based on the long-term value and soundness of the institution
 - Review mix, leverage and design features to ensure a long-term view of performance
- **Pay for Performance**
 - Ultimately ensure pay and performance are aligned
 - Use appropriate balance of performance measures
 - Reward short and long-term performance in appropriate balance
- **Limited Focus on Perquisites and Benefits**



- Understanding of the business strategy and risks should be the starting point for assessment
- Knowledge of compensation plans is also needed to evaluate the risk-reward interaction





- **Companies are in business to take risks, and executives need to be encouraged to take *appropriate* risks**
- **But not all risks are acceptable; some risks should not be unduly rewarded**
- **Appropriate protections and controls are needed, both within the compensation program and throughout business processes (investment criteria, risk oversight, etc.)**
- **Business risks may be evaluated using several factors**
 - Type of risk: strategic, operational, financial, competitive, regulatory, etc.
 - Nature of risk: ongoing vs. event-driven; internally vs. externally driven; etc.
 - Potential exposure/impact if the business risk occurs
 - Time horizon for impact
 - Quality of the existing controls and whether it is possible to implement additional controls
- **Compensation Committees should take care that compensation plans**
 - Are designed with an understanding of key business risks
 - Do not have design flaws that motivate unnecessary and excessive risk-taking



- **What are the company's business risks?**
- **Which risks could most threaten the company's value?**
- **What is the probability that the business risk will occur?**
- **Over what time horizon should business risk be measured?**
- **What controls are currently in place to mitigate risk?**
- **What controls should be put in place to better protect the company from excessive risk taking?**
- **Which risks are connected (directly or indirectly) to incentive compensation?**



- **Do incentive plan metrics reflect the company's business strategy?**
- **Is there an appropriate balance and mix of performance metrics?**
- **Is the leverage (upside and downside) appropriate?**
- **How much focus is placed on short-term performance? Is it appropriately reflecting the time horizon of the risk taken?**
- **Is there appropriate focus on long-term performance? How is long-term defined?**
- **Is there a balance of performance measures?**
- **Are there protections/controls in place to avoid excessive risk taking? Who is involved in assessing risk and monitoring compensation?**
- **Do the payouts align with shareholder interests?**
- **Do executives hold an appropriate amount of pay in stock (i.e. aligned with shareholders)?**
- **Do the payouts align with market practice?**



Typically Acceptable:

- **Defined range of incentive awards (e.g. 50% - 200% of target)**
- **Majority of incentive compensation weighted toward long-term, equity-based incentives**
- **Long-term incentive/equity vesting schedules that are three years or more**
- **Meaningful stock ownership and retention guidelines**

May Be Questionable:

- **Small variations in performance that result in large variations in pay**
- **Heavily lopsided reward opportunity, e.g., uncapped upside or guaranteed minimum payouts**
- **Quarterly bonus payments without “true-up” if full year results fall short**
- **Immediate (or quick) vesting of equity-based incentives**
- **Overloading on stock options through mega grants**



- **Compensation practices should be adjusted to**
 - Consider risk horizon and timeframe of results/rewards
 - Place more focus on longer term, sustainable performance
 - » Adjust the “mix” of total compensation to focus more on long-term performance; enhance long-term incentive timeframes/vesting
 - Ensure reward periods match the timeframe required to determine whether a decision/action was successful
 - » If not, change design features to allow for better alignment
- **Short-term incentive techniques**
 - Holdbacks/deferrals – portion of annual award contingent on sustained future performance
 - Payment in stock – pay part (or above target) payouts in stock
 - Shifting mix to long-term
- **Long-term incentive techniques**
 - Extended vesting of awards (i.e. longer periods)
 - Performance vesting of restricted stock
 - Stock ownership and retention guidelines
 - Hold until or past retirement requirements



- **Ensuring PFP is a complex balancing act**
 - Economic environment
 - Influences out of control of management (e.g. stock price, rates)
 - Optics and perceptions - media/public/shareholders
 - Disclosure limitations
 - Regulatory mandates
 - Piecemeal view
 - Contradicts risk mitigation (i.e. no risk pay is the opposite of pay for performance!)

- **BALANCE is the key to effective pay for performance**
 - Short-term and long-term
 - Absolute and relative
 - Financial, operational, strategic
 - Bank, team and individual
 - Formula and discretionary
 - You want ALL of these in aggregate – not in each plan

- **Review performance in aggregate and over a longer period of time (stress test) and understand potential range of outcomes for performance and pay**



- **Stay Informed**
 - The best starting point is education and information; understand what may be coming, implications and what changes may be appropriate going forward
- **Develop Processes, Define Roles**
 - Establish process for assessing incentive plan risk and ongoing reviews/compliance
 - Review governance practices in light of pending legislation (independence, process, disclosure)
 - Clarify roles of management, Compensation Committee, Board
- **Review Compensation Program and Incentive Plans**
 - Review total compensation programs and incentive plans in particular to ensure they do not motivate and reward inappropriate risk taking
 - Ensure compensation focuses on driving sustained, long-term performance that supports your unique business goals and strategies
 - Ensure performance is measured using a balanced portfolio of performance measures
 - Ensure total compensation program is clearly aligned with both company business strategy and interests of shareholders
- **Prepare for Future – Disclosure and Regulatory Reviews**
 - Begin evaluating last year's proxy statement and CD&A to assess areas where additional/better/different disclosure may be required
 - Begin to set up risk assessment processes, structures, controls



Expectations for 2009 & 2010

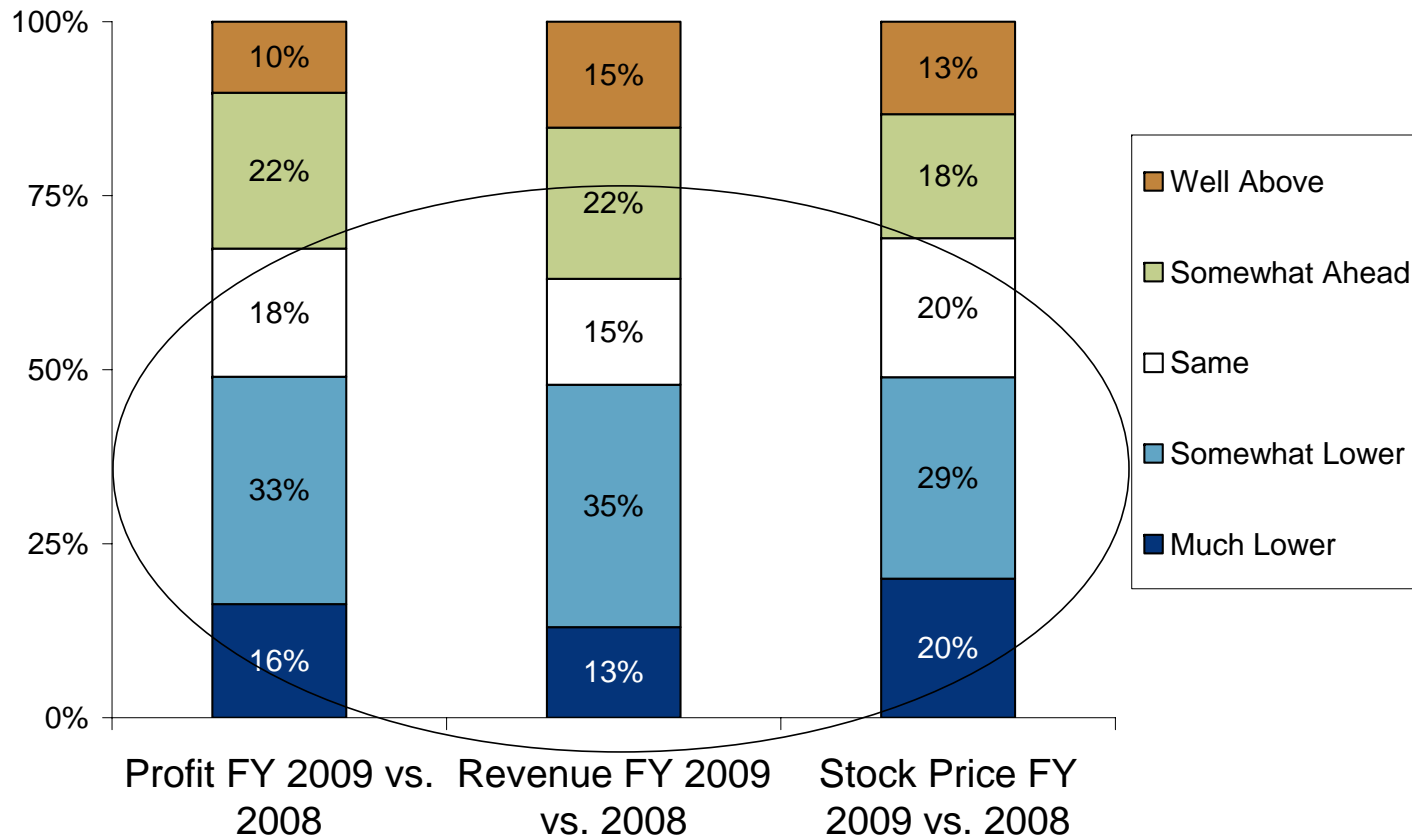


Expectations for 2009 and 2010 – September Poll – Financial Services Companies



- More than 50% of surveyed financial service companies now expect performance to be the same or lower than 2008

2009 Expected Performance vs. 2008



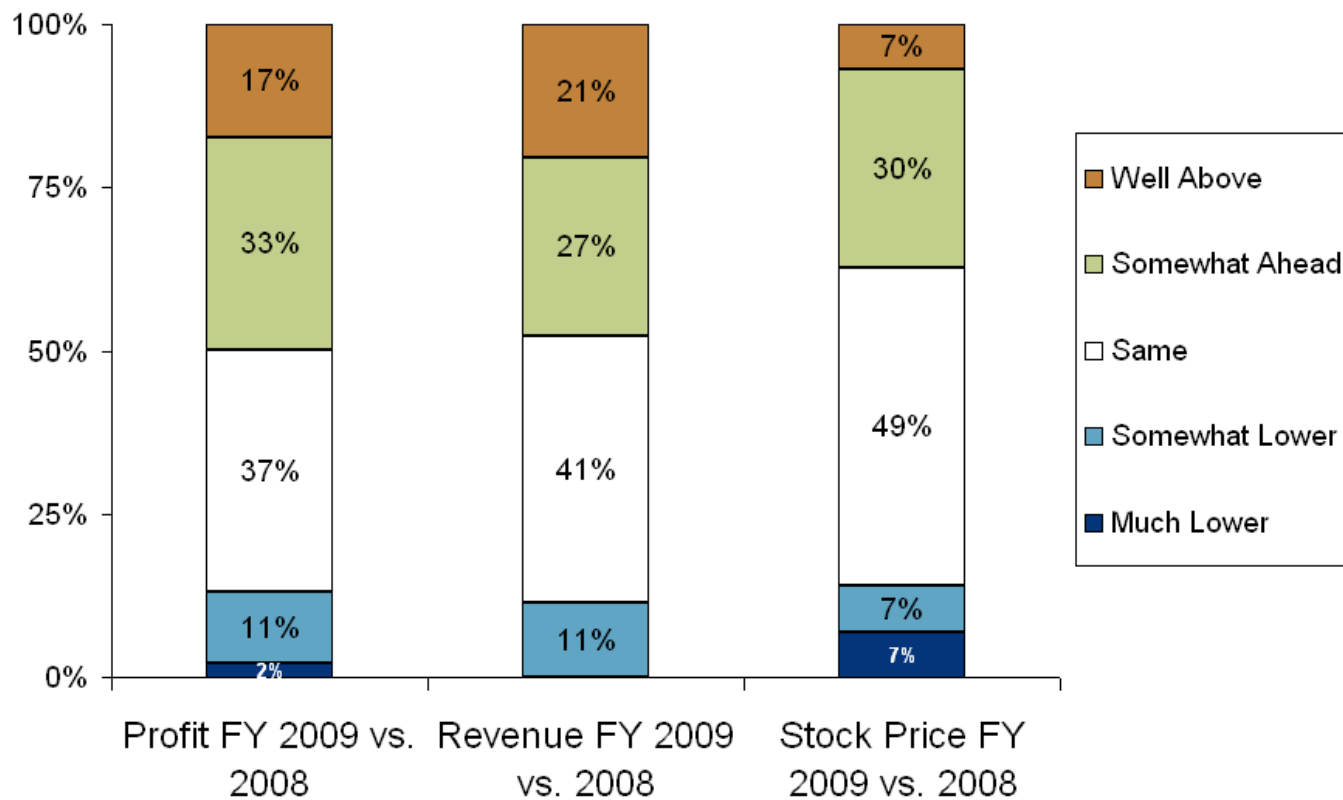


Expectations for 2009 and 2010 – September Poll – Financial Services Companies



- However, more than 75% expect performance to be the same or better than their peers

2009 Expected Performance vs. Peers



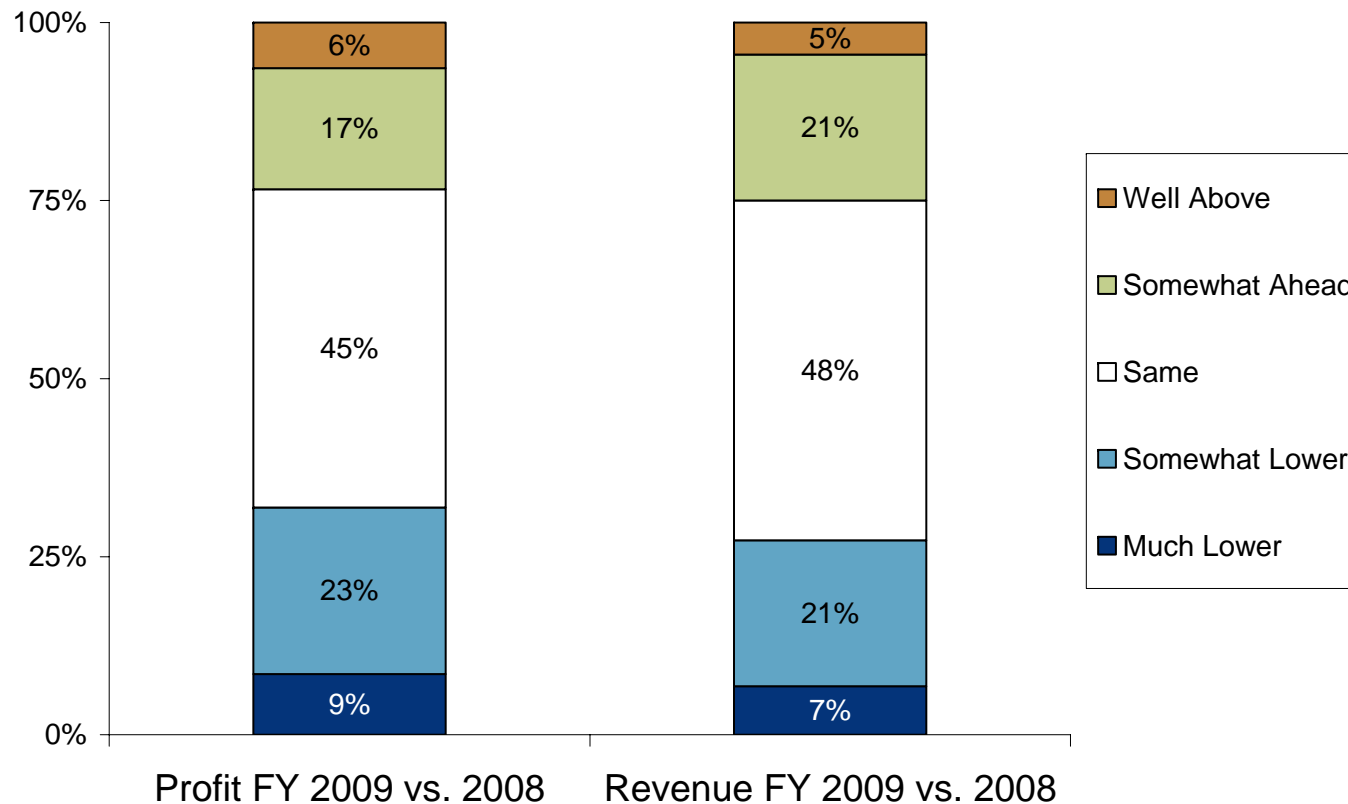


Expectations for 2009 and 2010 – September Poll – Financial Services Companies



- More than 65% of companies expect performance to be the same or better than budget

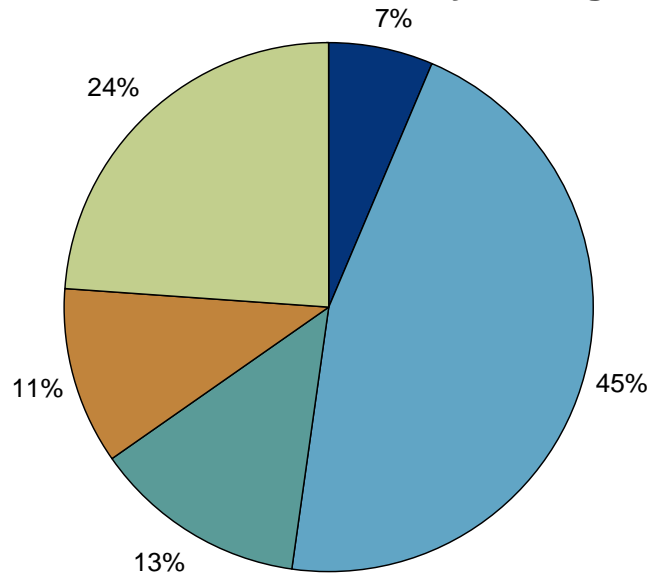
2009 Expected Performance vs. Budget



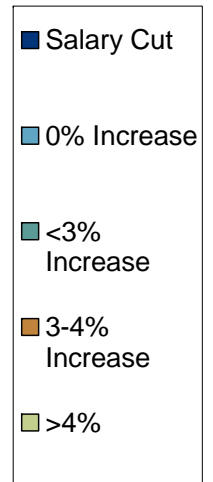
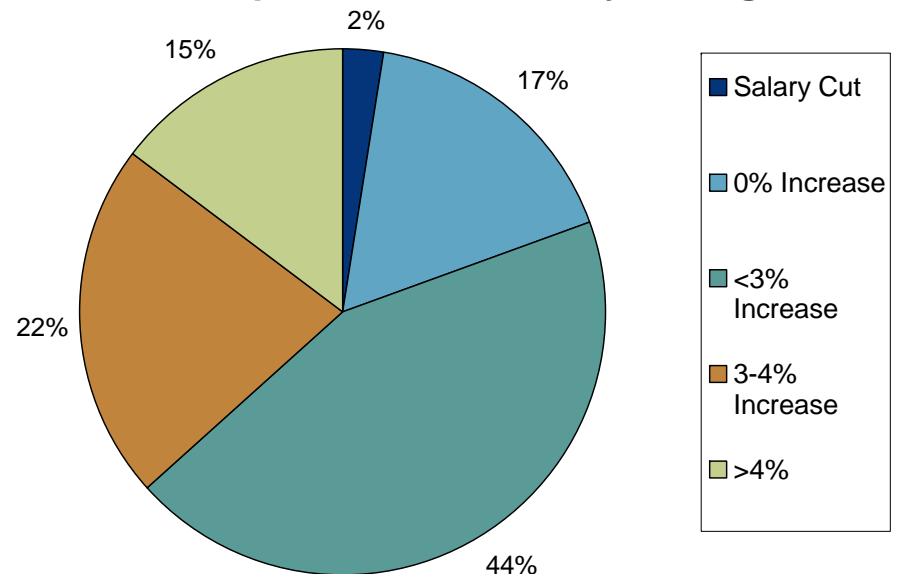


- 52% of companies froze salaries or reduced salaries in FY 2009 as compared to 70% among general industry
- Future prospects look brighter, with 81% of companies considering salary increases and 15% expecting salary increases of over 4%

FY 2009 Executive Salary Changes



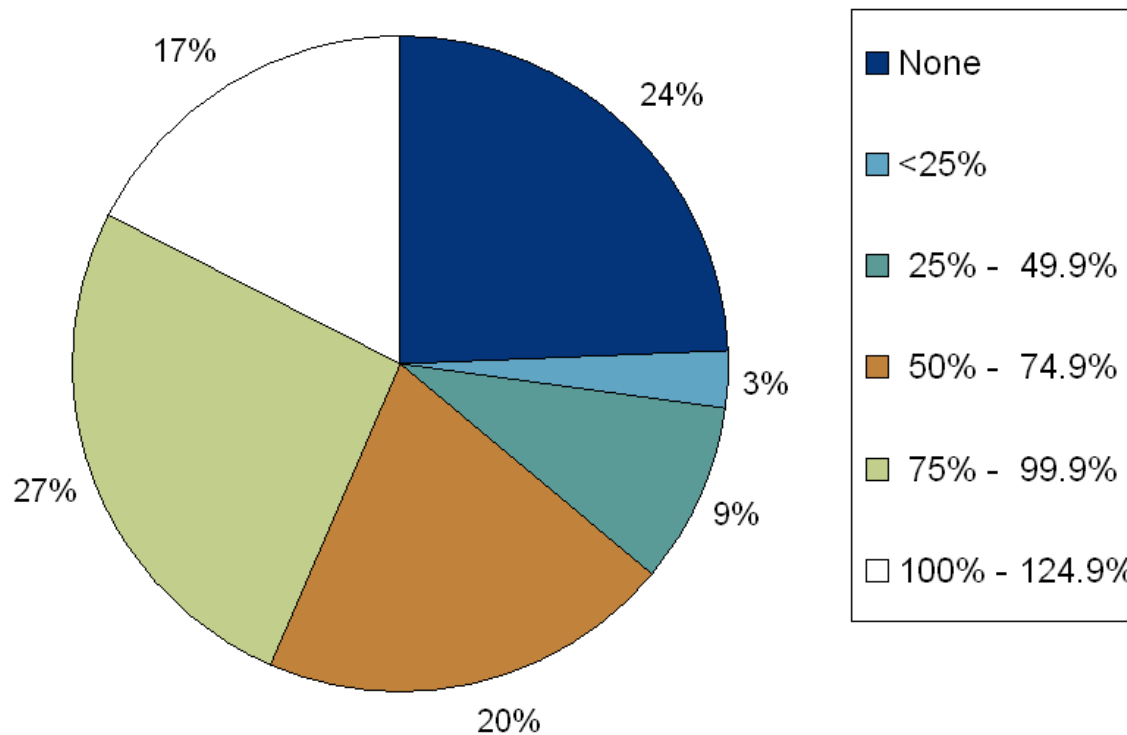
FY 2010 Expected Exec. Salary Changes





- Nearly 25% of companies expect to pay no or de minimis bonuses this year
- Only 17% anticipate paying at or above target

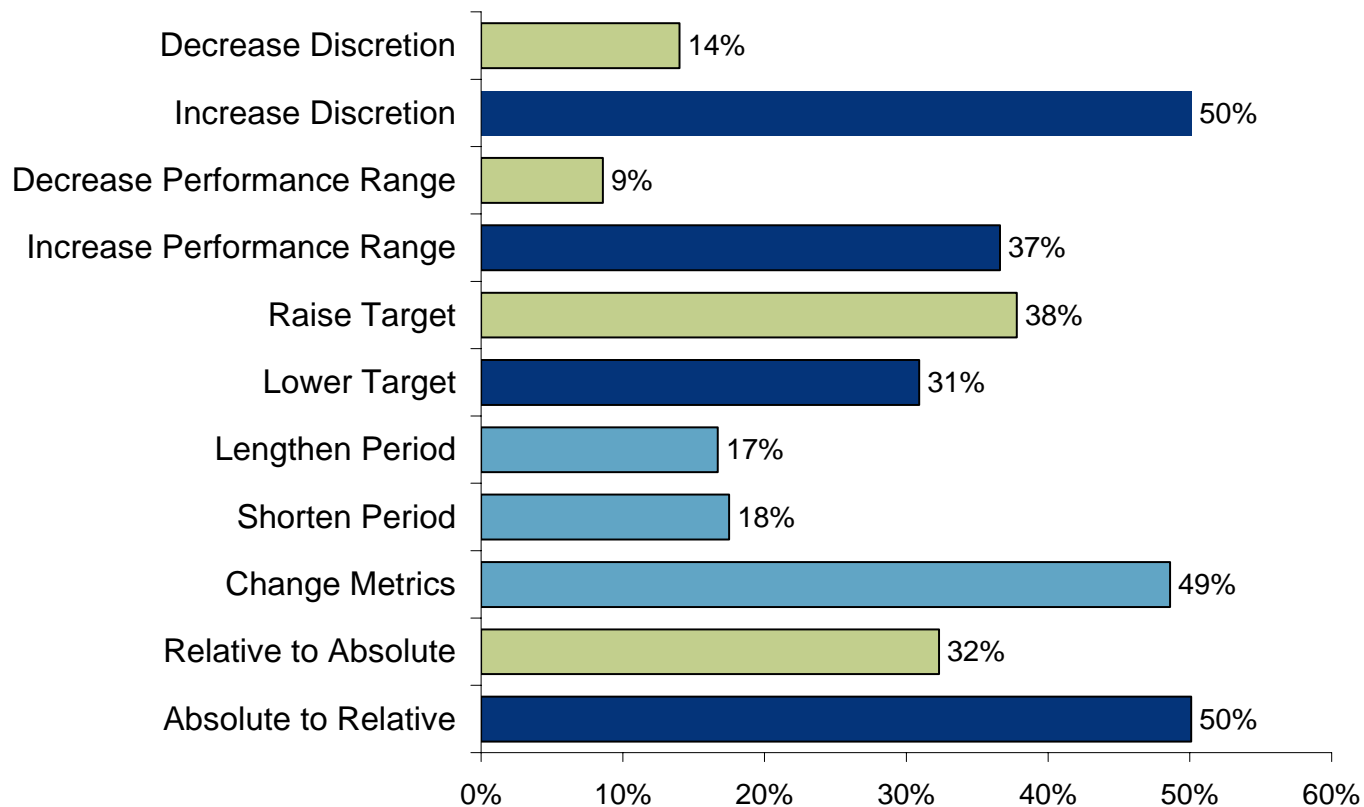
Expected FY 2009 Bonus vs. Target





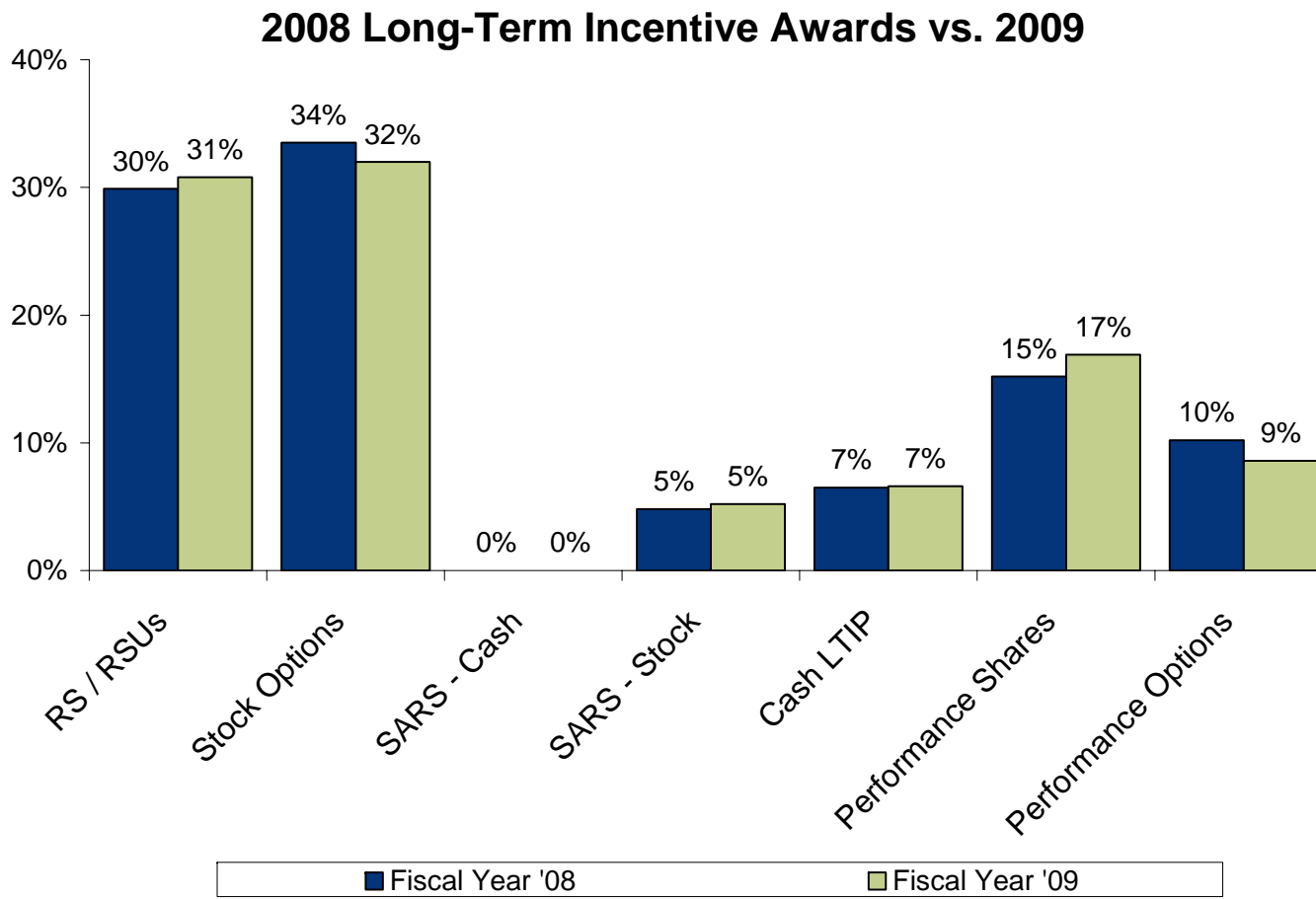
- A significant number of companies contemplated or modified plans in 2009 or expect to relook at incentive plan design in 2010

Actions Contemplated in 2009 or 2010





- For 2009 relatively few companies modified their mix of equity



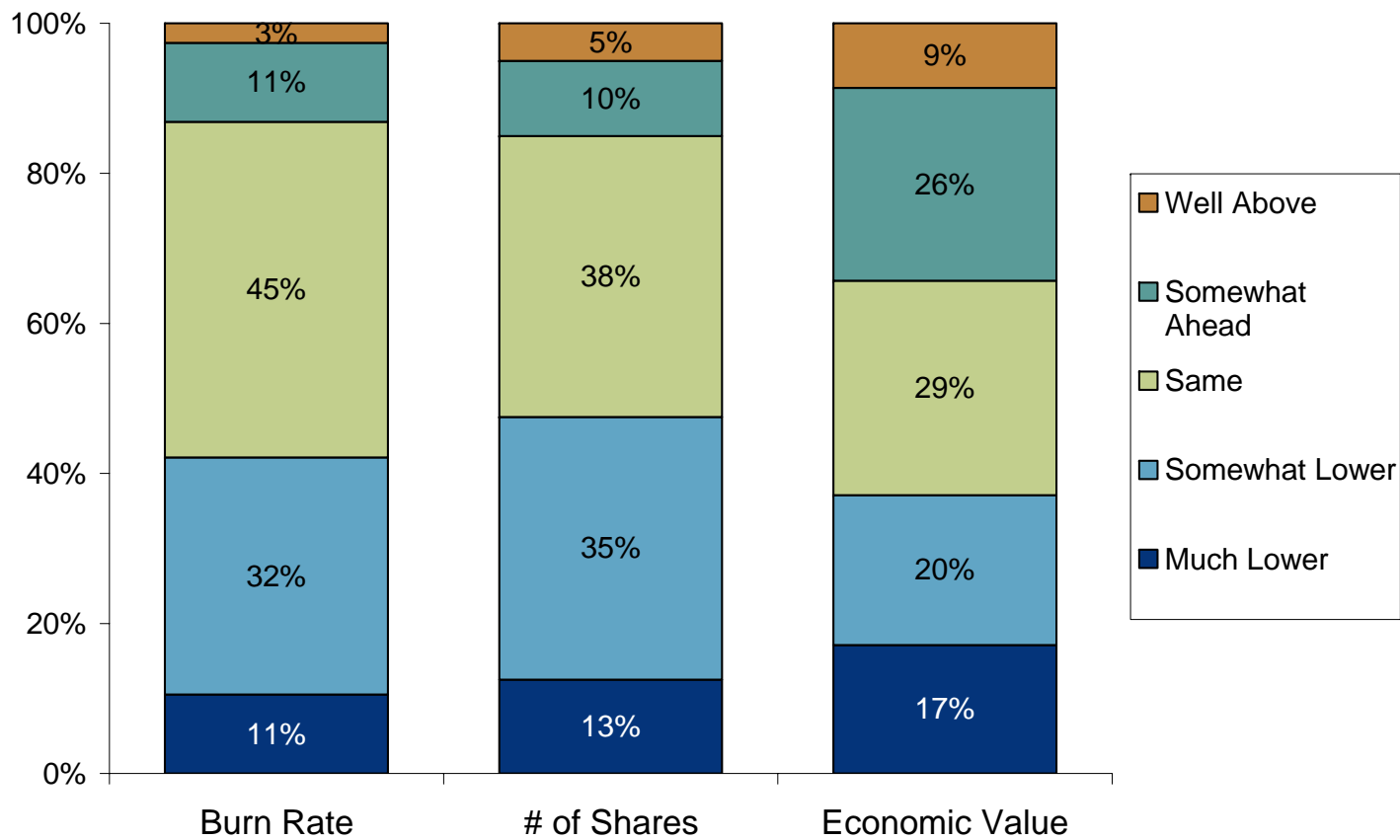


Long-Term Incentive Awards – Financial Services Companies



- Expectations for 2009 long-term incentive awards levels reflect continuity despite continued stock price weakness

2010 LTI Expectations



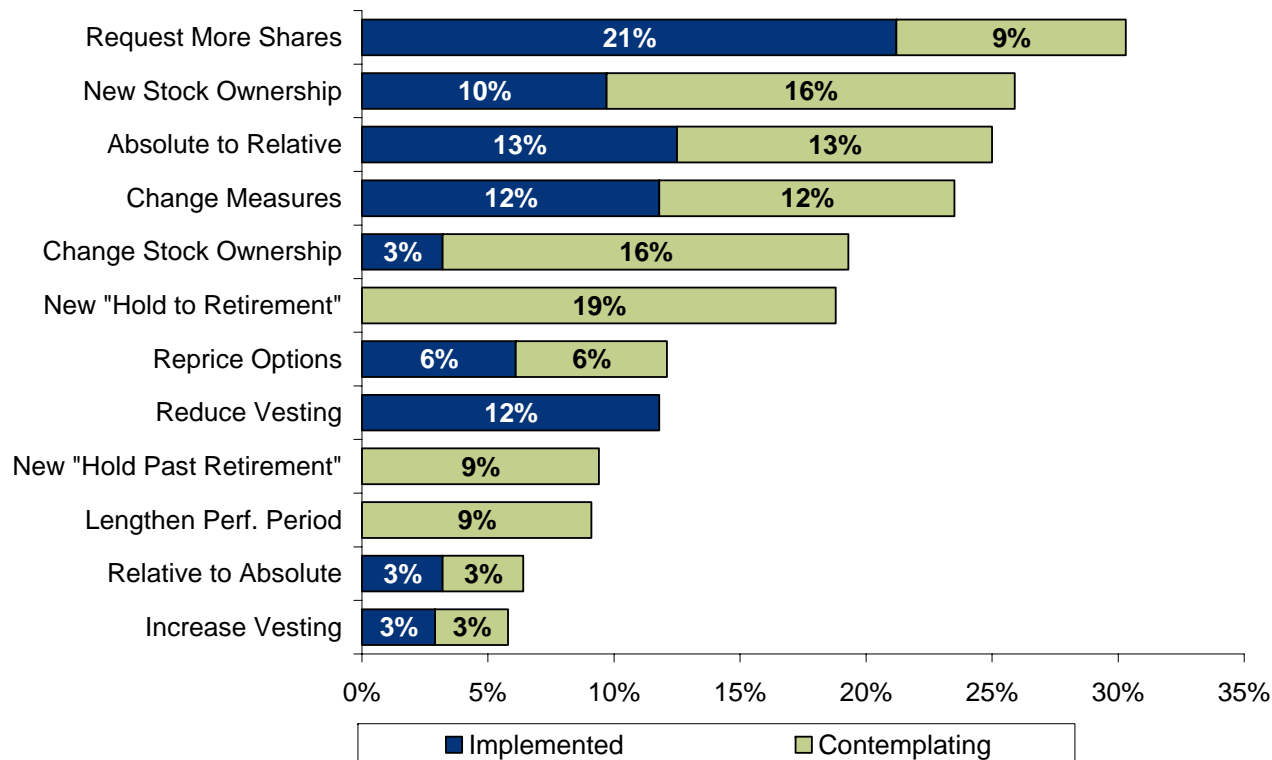


Long-Term Incentive Awards – Financial Services Companies



- Expectations of future long-term incentive awards plan design indicate moderate change
- Ownership guidelines continue to increase with refinement and companies are considering hold requirements

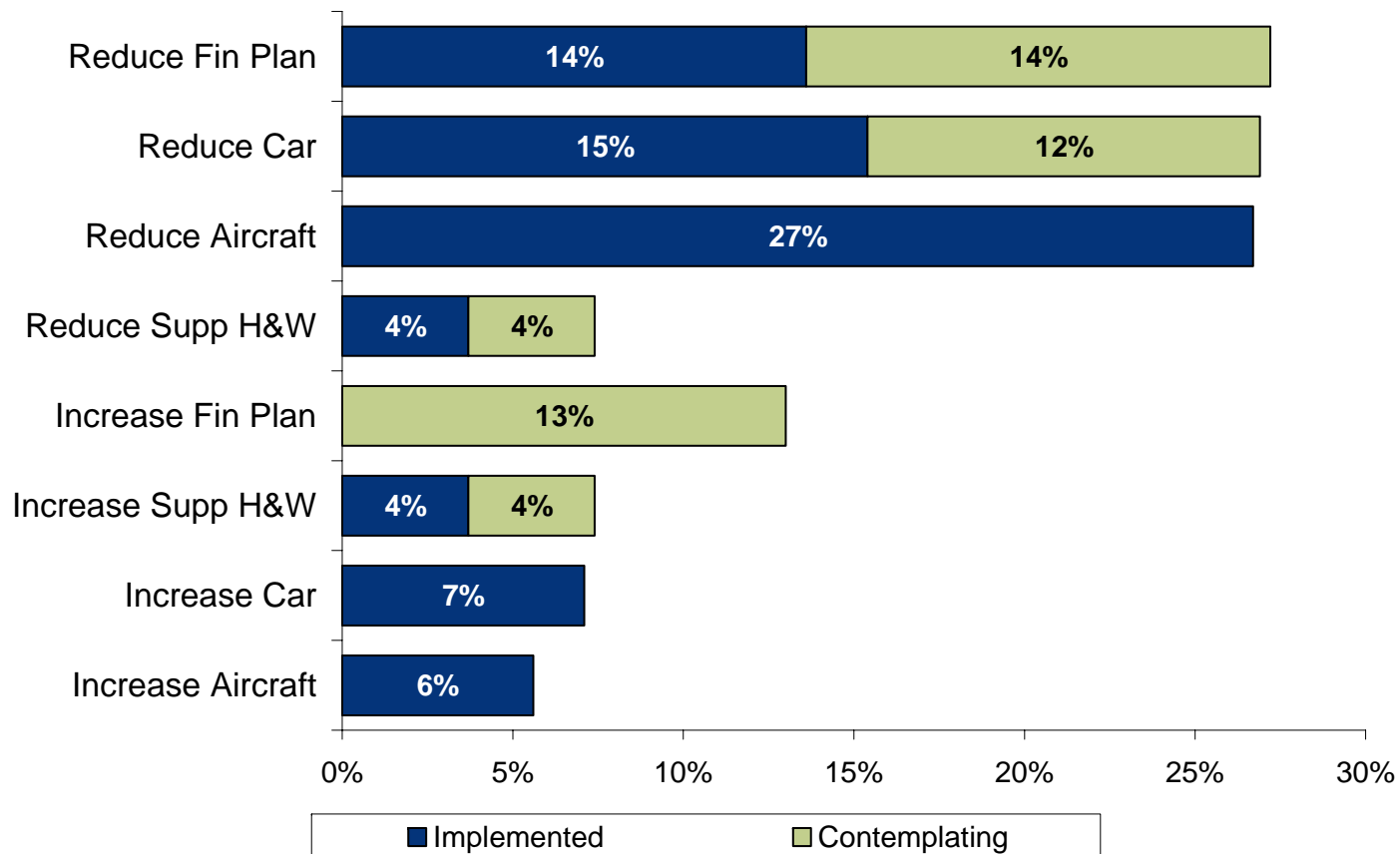
Implemented and Contemplated Changes to LTI / Ownership





- Companies continue to implement and contemplate reductions to perquisites

Implemented and Contemplated Changes to Perq's





Change in Control Provisions – Financial Services Companies



■ Change in Control Provisions

- Vast majority of companies do not expect to revise their CIC arrangements in 2010

» Change in Cash Severance*

	Increase	Decrease	Introduce
Will Likely	0%	3%	6%
Have Not Considered	94%	86%	91%

» Equity Acceleration Provisions*

	Move Double to Single	Introduce Double Trigger	Move Single to Double
Will Likely	0%	0%	0%
Have Not Considered	93%	92%	92%

» Excise Tax Modifications*

	Increase	Decrease
Will Likely	0%	0%
Have Not Considered	92%	72%

*Prevalence excludes those companies implementing changes in 2009 and those not likely to implement changes in 2010.

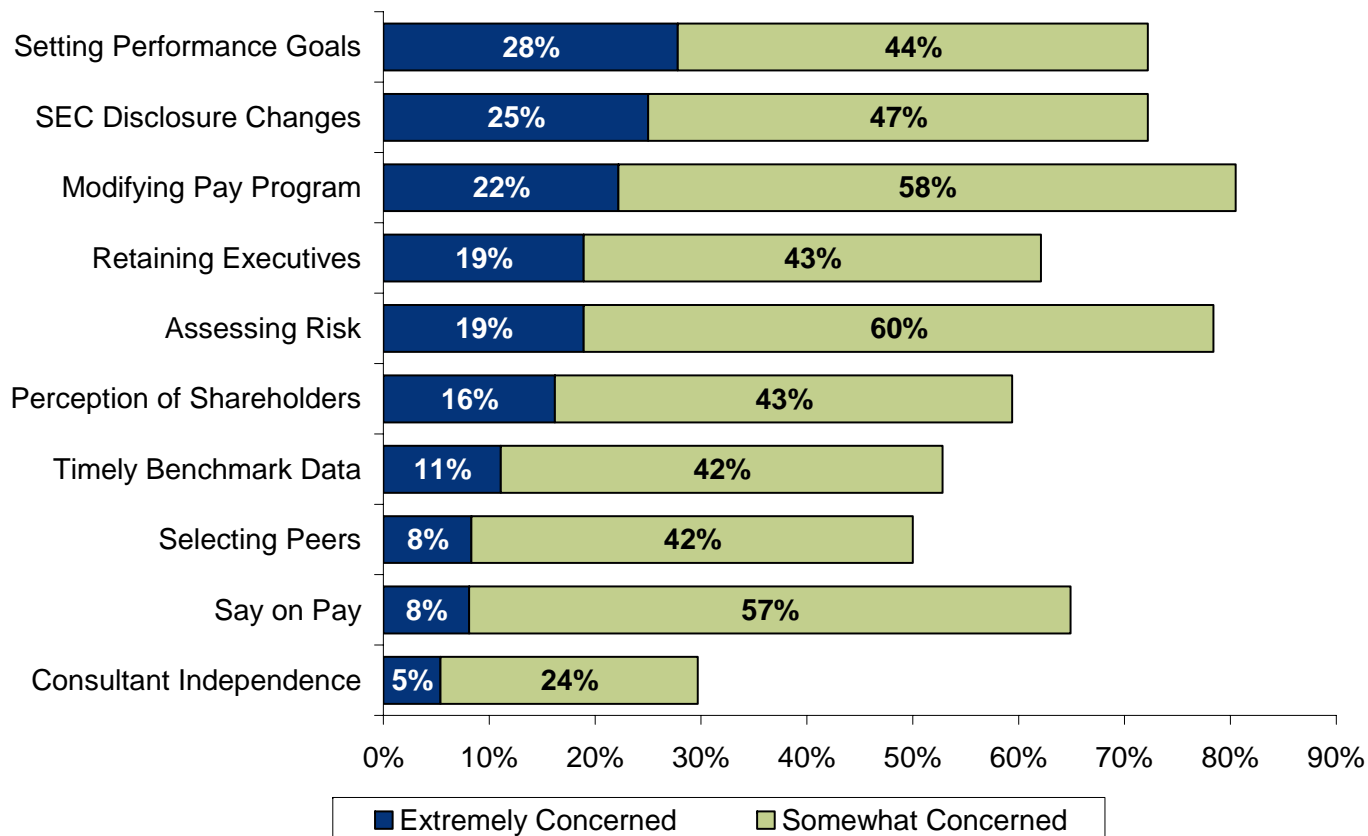


Management's Areas of Concern for 2010



- Concerns focus on risk assessment and goal setting, and pay plan flexibility
- Regulatory changes generally perceived as lower concern

Areas of Concern for Upcoming Year





QUESTIONS?

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