Frederic W. Cook & Co., Inc.

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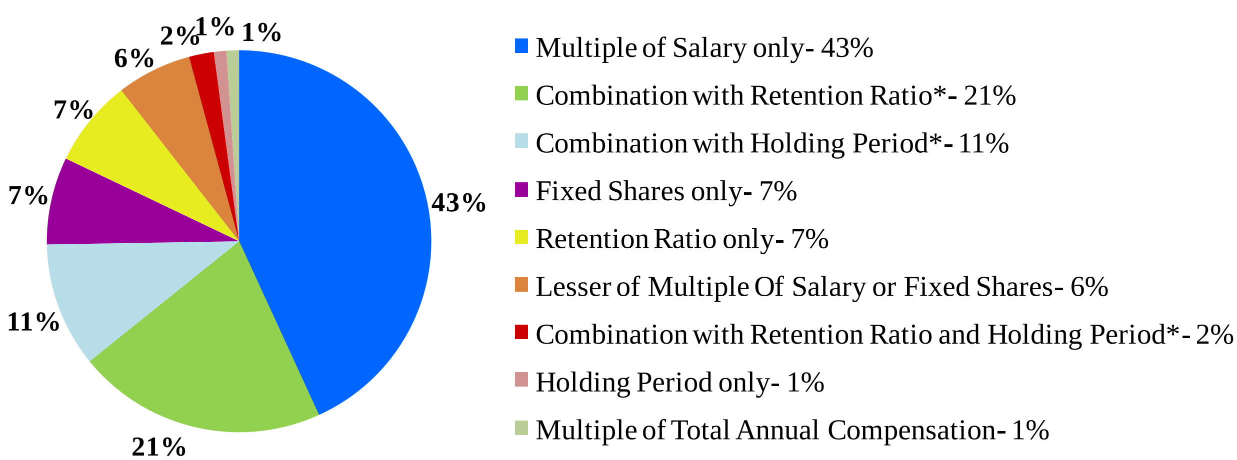
Executive Stock Ownership Policies – Trends and Developments

Stock ownership policies for executives have become virtually universal among large companies. Although the most prevalent approach continues to be the traditional multiple-of-salary guideline, use of retention ratios in combination with traditional guidelines continues to gain prevalence. Holding periods, whether in combination with traditional guidelines or stand-alone, are less prevalent, but institutional investor advisory groups, such as ISS, are encouraging companies to adopt them. Hold *beyond* retirement policies have not yet been widely embraced, but this type of ownership policy could emerge as a corporate governance "best practice."

Frederic W. Cook & Co., Inc. researched executive stock ownership policies at the 100 largest companies, by market capitalization, listed in the S&P 500 as of February 28, 2010 (the "Top 100"). Ninety-five percent of these companies have policies in place. These policies typically require executives to achieve pre-determined stock ownership levels within a specified time period, with the goal that executives build a significant equity stake in the company they manage to provide focus on long-term shareholder value creation. Requiring executives to hold a significant portion of their net worth in company equity is also believed to mitigate excessive risk-taking that propels short-term gains at the expense of long-term value creation.

<u>Exhibit A</u> illustrates the prevalence of various types of stock ownership policies among the companies in the Top 100 that disclose formal ownership guidelines for executives.

<u>Exhibit A</u>: Prevalence of Types of Stock Ownership Policies



**Combination guideline combines a traditional guideline (e.g. multiple of salary) with either a retention ratio or holding period. Prevalence percentages do not add to 100% due to rounding.*

Traditional Approaches

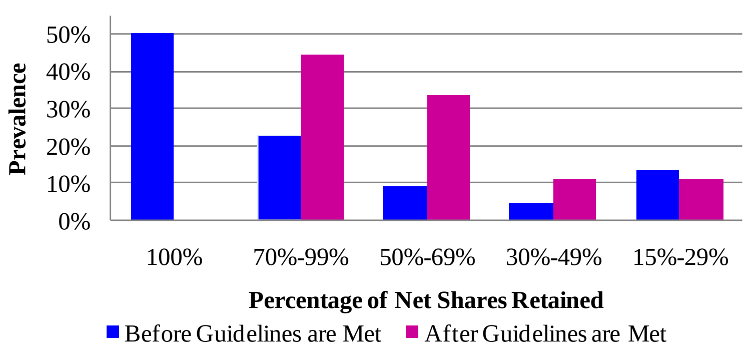
The most common approach to ownership guidelines is a multiple of salary approach, which requires executives to hold a defined dollar value of stock that grows in line with salary increases. Among the Top 100 companies who employ a multiple of salary approach, the median multiple for the CEO is 5X, and the median for other proxy-named executive officers is 3X. A multiple of salary approach is easy to communicate but more difficult for executives to maintain, particularly when a company's share price is volatile. In an attempt to mitigate the impact of stock price volatility, some companies have adopted fixed-share, rather than fixed-value, guidelines.

Retention Ratios in Combination with Traditional Approaches

When stock ownership guidelines were first implemented, most companies set forth a time period, usually five years, in which the executives were expected to achieve the required ownership level. Many companies using this traditional approach failed to consider what will happen if an executive does not own the required amount of stock at the end of the five-year time period. For example, will executives be required to purchase stock on the open market, or will the company pay in the form of stock compensation what would normally be paid in cash?

One approach for complying with the guidelines that continues to gain prevalence is the use of retention ratios in combination with traditional ownership requirements. When using a retention ratio approach, executives are required to retain a certain percentage of "net profit shares" (i.e., shares remaining after payment of any exercise price and taxes owed at the exercise of options, vesting of restricted stock/restricted stock units, or earnout of performance shares) until they meet the required ownership level. **Exhibit B** compares the percentage of net shares that must be retained before and/or after ownership guidelines are met by the executive, among the Top 100 companies that use retention ratios, either stand-alone or in combination with another type of ownership policy.

Exhibit B: Percentage of Shares Retained Before/After Guidelines are Met

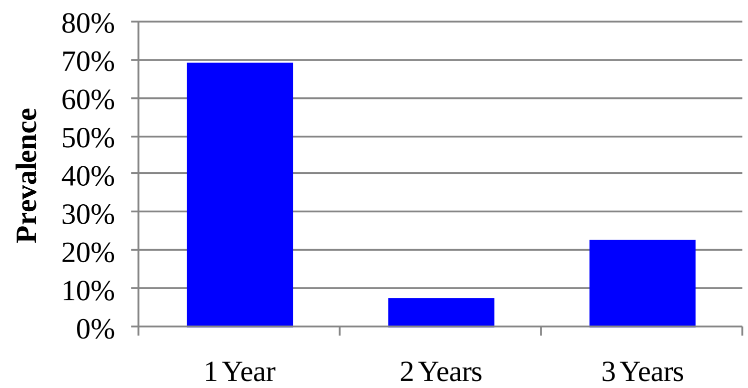


The benefit of using a retention ratio in combination with a traditional multiple-of-salary or fixed-share guideline is that companies need not set a period of time by which the required ownership levels must be achieved. Rather, the existing equity compensation program, in combination with the retention requirement, facilitates achievement of the required ownership level.

Holding Periods

An alternative approach to a retention ratio is a holding period. Both retention ratios and holding periods require executives to hold a percentage of net profit shares resulting from equity-based long-term incentives. We differentiate between retention ratios and holding periods based on the period of time executives are required to hold the net profit shares. Retention ratios are enforced for an indefinite period of time (e.g., the executive's career or until multiple of salary guidelines are met). Holding periods are enforced for a specific period of time (e.g., one year after exercise of options). As shown in **Exhibit C**, among the Top 100 companies that use holding periods, a one-year holding period was most prevalent at 69%.

Exhibit C: Number of Years Required for Holding Period



Advocates of holding periods believe such policies further encourage a long-term focus, create tighter alignment between executive and shareholder interests, and strengthen the executives' commitment to the long-term health of the company. For example, a requirement for executives to hold net profit shares for one year after option exercise mitigates the risk that an executive could profit from a short-term change in stock price at the expense of long-term sustainable shareholder value.

Hold *Beyond* Retirement Policies

Most ownership policies require compliance for as long as the executive serves in his/her position, i.e., until he or she retires or otherwise terminates employment. However, some corporate governance advisory groups advocate policies that require executives to hold equity for a certain period of time *beyond* retirement or other termination of employment. By requiring executives to hold stock for a period of time after retirement or other termination, executives cannot quit and sell shares and, therefore, continue to be accountable for the results of long-term strategic decisions made during their careers.

Four companies in the Top 100 have such policies in place.

- ExxonMobil – For restricted stock grants, 50% vests after five years and 50% vests on *the later of* ten years after grant or retirement. Vesting does not accelerate upon retirement, and therefore, executives are typically required to hold stock for many years after retirement.

- PepsiCo – Executive officers who terminate or retire from PepsiCo are required to continue to hold 100% of the shares needed to meet the applicable ownership requirement for at least six months after termination/retirement and are required to continue to hold 50% of the shares needed to meet the ownership requirement for at least one year after termination/retirement.

- Time Warner – Executive officers are required to hold at least 75% of net-after-tax profit shares from option exercises for at least twelve months after exercise (or, if the executive is no longer employed by the Company, for at least twelve months after termination of employment).

- Wells Fargo – Executive officers are required to hold at least 50% of net-after-tax profit shares from option exercises or restricted stock vesting until the one-year anniversary of retirement.

Although hold beyond retirement policies are not widely used, recent federal legislation mandating "Say on Pay" and other compensation governance reforms could encourage more companies to modify their stock ownership policies to include a post-termination holding period. In addition, this type of ownership policy could emerge as a corporate governance "best practice."

ISS GRId

In March 2010, Institutional Shareholder Services (ISS) introduced Governance Risk Indicators ("GRId") as a tool for institutional investors to assess the level of governance-related risk at current or prospective portfolio companies. Three of the 28 scoring items in GRId's compensation category relate to executive stock ownership guidelines.

- *Is the CEO subject to stock ownership guidelines?* GRId scoring is as follows:

  — "Robust": at least 6X base salary (+3 points)
  — "Standard": 3X to less than 6X base salary (0 points)
  — "Substandard": less than 3X base salary (-3 points)
  — No guideline/not disclosed (-5 points)

If a company does not use a multiple-of-salary approach, ISS will convert the disclosed guideline into a value, based on the share price at the time of evaluation. Although 5X is the most common multiple of salary for CEOs, the ISS definition of "robust" ownership guidelines may push companies to move toward 6X in order to receive the highest GRId score on this item.

- *What is the holding period for stock options for executives?*
- *What is the holding period for restricted shares for executives?*

In order to receive points for these two items, the holding period must apply to a "meaningful portion" of net profit shares, which is defined as 50% or more in the GRId documentation. In addition, the holding period must apply even after required stock ownership levels have been met. Scoring depends on the duration of the holding period as follows:

— Until end of employment or beyond (+5 points)
— Greater than or equal to two years (+3 points)
— Less than two years (between 0 and +3 points, based on linear interpolation between 0 and 2 years)
— No holding period/no disclosure (-3 points)

Based on our research, holding periods are far less prevalent than other types of ownership guidelines. However, implementing holding period requirements that apply even after traditional multiple-of-salary guidelines have been achieved may become more prevalent as a result of the GRId scoring system.

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This letter was authored by Logan Carr and Cimi Silverberg, with research assistance from other Frederic W. Cook & Co. consultants. Questions and/or comments should be directed to Ms. Carr in our New York office at lmcarr@fwcook.com or (212) 299-3713, or to Ms. Silverberg in our Chicago office at cbsilverberg@fwcook.com or (312) 894-0073. This letter and other published materials are available on our website, www.fwcook.com.

Companies in Research Sample

3M	ConocoPhillips	Hewlett-Packard	Pfizer
Abbott Laboratories	Corning	Home Depot	Phillip Morris International
Altria Group	Costco Wholesale	Honeywell International	PNC Financial Services
Amazon.com	CVS Caremark	IBM	Procter & Gamble
American Express	Dell	Intel	Prudential Financial
Amgen	Devon Energy	Johnson & Johnson	Qualcomm
Anadarko Petroleum	DIRECTV	JPMorgan Chase	Schlumberger
Apache	Dow Chemical	Kimberly-Clark	Southern
Apple	DuPont	Kraft Foods	Target
AT&T	eBay	Lockheed Martin	Texas Instruments
Bank of America	Eli Lilly	Lowe's	Time Warner
Bank of New York Mellon	EMC	Mastercard	Travelers
Baxter International	Emerson Electric	McDonald's	Union Pacific
Berkshire Hathaway	Exelon	Medco Heatlh Solutions	United Parcel Service
Boeing	Express Scripts	Medtronic	United Technologies
Bristol-Myers Squibb	Exxon Mobil	Merck	UnitedHealth Group
Carnival	FedEx	MetLife	US Bancorp
Caterpillar	Ford Motor	Microsoft	Verizon Communications
Celgene	Freeport-McMoRan	Monsanto	Visa
Chevron	General Dynamics	Morgan Stanley	Walgreen
Cisco Systems	General Electric	News Corp	Wal-Mart Stores
Citigroup	Gilead Sciences	Nike	Walt Disney
Coca-Cola	Goldman Sachs Group	Occidental Petroleum	WellPoint
Colgate-Palmolive	Google	Oracle	Wells Fargo
Comcast	Halliburton	PepsiCo	XTO Energy

Summary Financial Data of Research Sample

	Revenues ($ Millions)	Market Capitalization as of 6/30/10 ($ Millions)	Net Income ($ Millions)
75th Percentile	$61,401	$80,681	$5,080
Average	48,942	64,681	4,090
Median	30,594	39,215	2,671
25th Percentile	16,577	27,429	1,720