



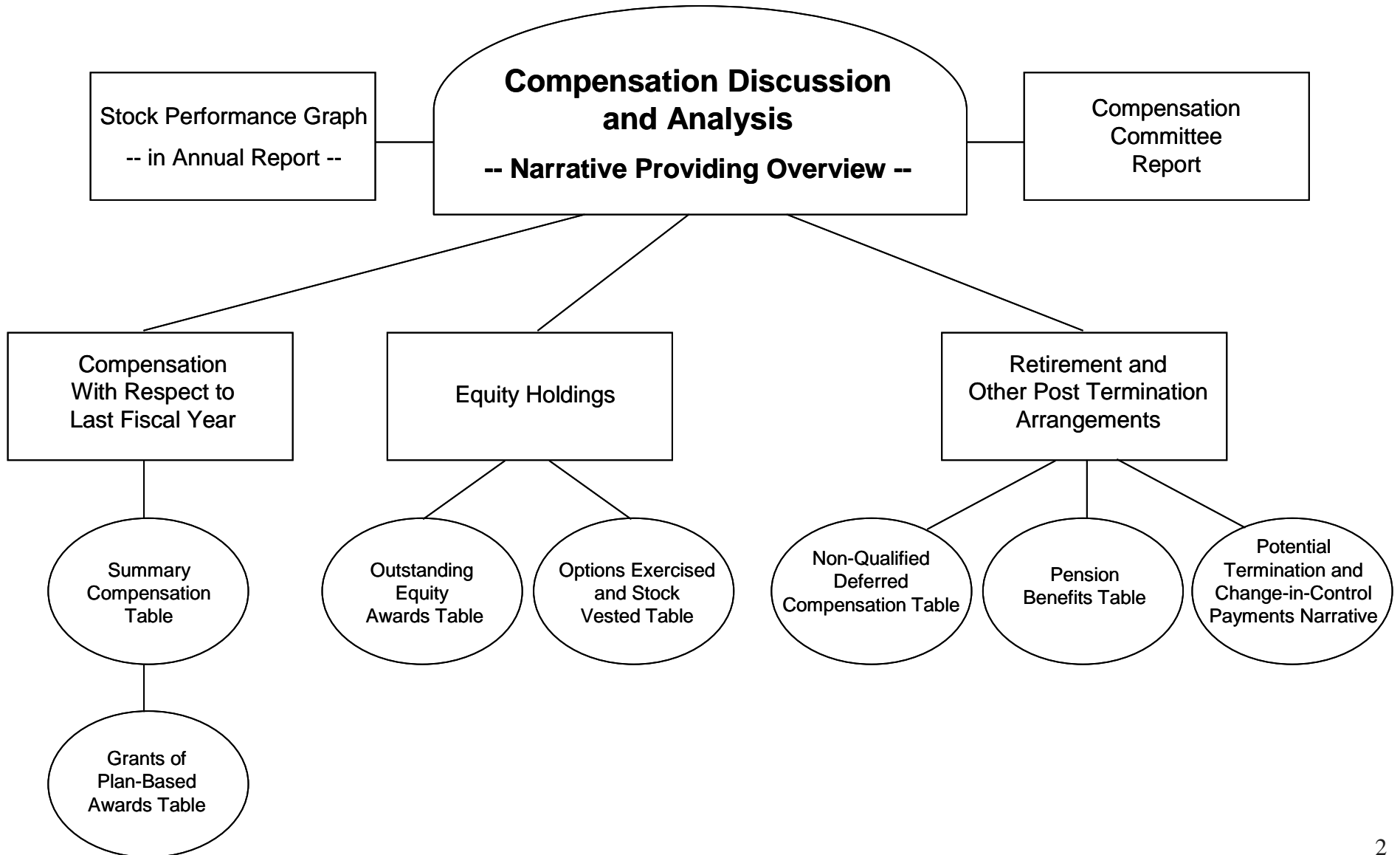
**ABA Joint Committee
on Employee Benefits**

***Trends in Executive and
Director Compensation***

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Frederic W. Cook & Co., Inc.
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Disclosure at a Glance





Board and Compensation Committee Concerns

- Avoiding criticism/enhancing reputation
- High standards of care and due diligence
- Obtaining objective input
- Linking incentives to corporate strategy
- Assessing *total* compensation
- Avoiding surprises
- Shaping the debate on CEO pay for performance



Hot Buttons

- Proving that pay is linked with performance
- Disclosure of change-in-control and severance costs
- And the “total” column for the first time
- Justification of perquisites, especially the company plane
- SERPs
- CalPERS “clawback” letters
 - Demanding a policy for recapturing bonus and incentive payments based on fraudulent activity or financials that are restated for which executives are found personally responsible



Notable Quotes

“So, at Berkshire, let’s start with what is legal, but always go on what we would feel comfortable about being printed on the front page of our local paper, and *never* proceed forward simply on the basis of the fact that other people are doing it.”

Warren Buffet

“Is there any higher goal at all for management than serving the stockholders openly and honestly? Is “competitiveness” even a meaningful word, compared with honesty and integrity in serving the owners of the company? What can “competitiveness” mean in this context?”

Ben Stein



Big Picture

Visible executive compensation trends...

1. Pay-level growth has moderated and disparities between companies are narrowing
2. Equity compensation is again being concentrated among key employees
3. Stock option use is declining but not disappearing
4. Use of time-based restricted stock and performance-based long-term plans is increasing
5. Share utilization and overhang is declining
6. Share conservation techniques are gaining importance
7. Voluntary deferred compensation is less flexible but still popular



Big Picture

Visible trends (cont'd)...

8. Disclosure is clearer, more immediate, and soon-to-be truly transparent
9. Pension-fund investors and organized labor are gaining influence through the ballot box; influence is real
10. Board compensation committees are spending more time on compensation issues, are better informed, and are stronger
11. Growing concern about proxy advisory services and their level of influence (conflict with consulting practices, accountability and black box approach)
12. Business-press coverage has intensified with better disclosure, is overwhelmingly negative, and often misinformed



What Are the Primary Challenges in Today's Market?

1. Option expensing creates two forms of financial inefficiency
 - A. Gap between “fair value” cost and “perceived value” among employees
 - B. Fixed expense creates possibility that cost exceeds value delivered
2. Investor pressure to constrain potential share dilution
 - Overhang levels growing as result of flat or depressed share prices
 - NYSE and Nasdaq listing standards require shareholder approval to replenish exhausted stock plan
3. General recognition that there is more to “performance” than short-term stock price appreciation



What Are the Key Principles & Challenges in Paying for Performance?

Key Principles

1. Limit non-variable components
 - Salary, perks
2. Emphasize variable elements
 - Payout and costs tied to results
3. Maintain accountability for failures
 - Avoid resets
4. Tie opportunity to both operational and stock price results
5. Encourage executive ownership

Key Challenges

1. Discourage “entitlement” mindset
2. Defining success
3. Selecting metrics
4. Setting target goals
5. Defining “market competitive”
6. Keeping it simple



What Are Companies Doing?

1. Leaving annual incentive plans relatively unchanged
2. Replacing all or a portion of historic stock option opportunity with “full-value” equity awards
 - Restricted Stock – shares of stock that vest based solely on continued service
 - Performance Shares – shares of stock that vest based on performance over a specified period of time
 - Performance Units – cash awards that vest based on performance over a specified period of time



What Are Companies Doing?

3. Modifying options to reduce cost or enhance financial efficiency
 - Shorter terms and post-employment exercisability
 - “Performance” options to reduce cost or enable expense reversal
 - But honestly, more talk than reality
4. Reducing aggregate LTI grant levels and economic costs
 - Lower award levels; reduced participation
5. Reevaluating all contractual and change-in-control policies
6. Thinking about governance and best practices in all of their deliberations



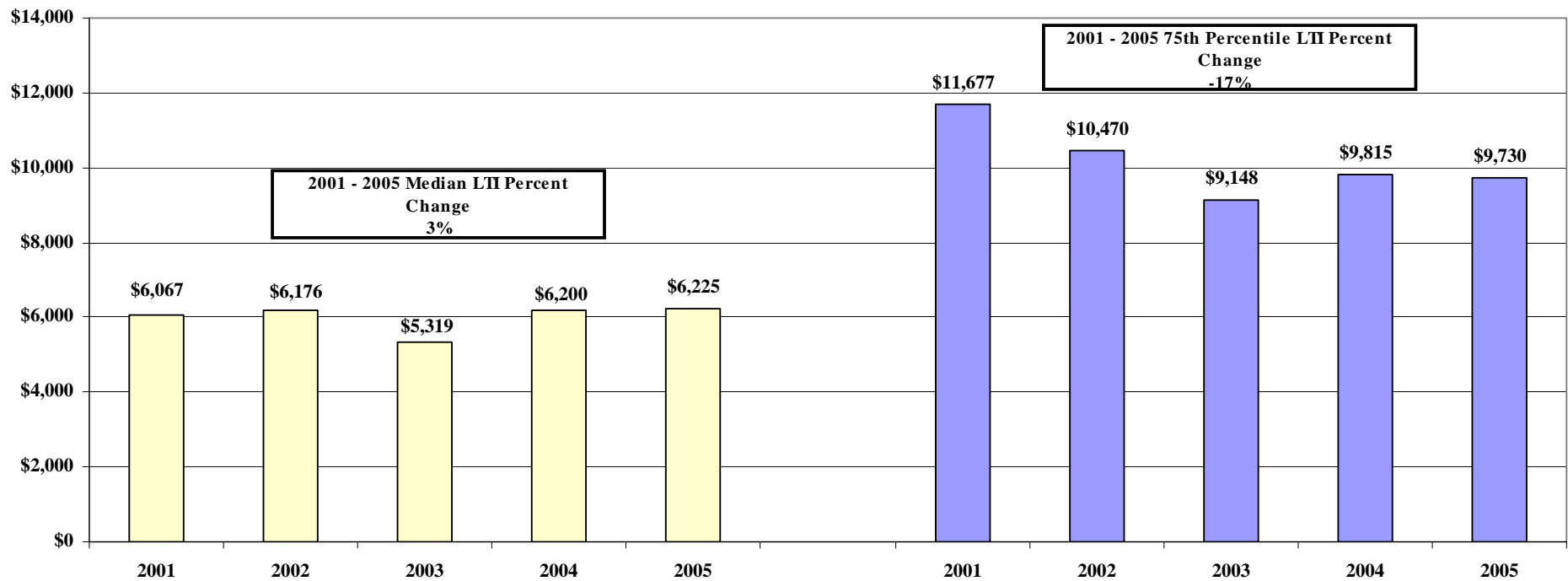
Executive Compensation Levels and Mix

Status quo...

- Median salaries are up modestly (3-4.5%)
- Meanwhile, 2006 target bonuses are increasing for senior executives (i.e., more performance risk and leverage in short-term plans)
- Long-term grant values are flat at median and down moderately at the 75th percentile, based on constant valuation
 - Smaller grants (i.e., down 10-25%) and more selectivity below the executive level
- Median total direct compensation is flat to up slightly

Executive Compensation Levels and Mix

CEO LTI value, 2001 – 2005 (\$000) . . .





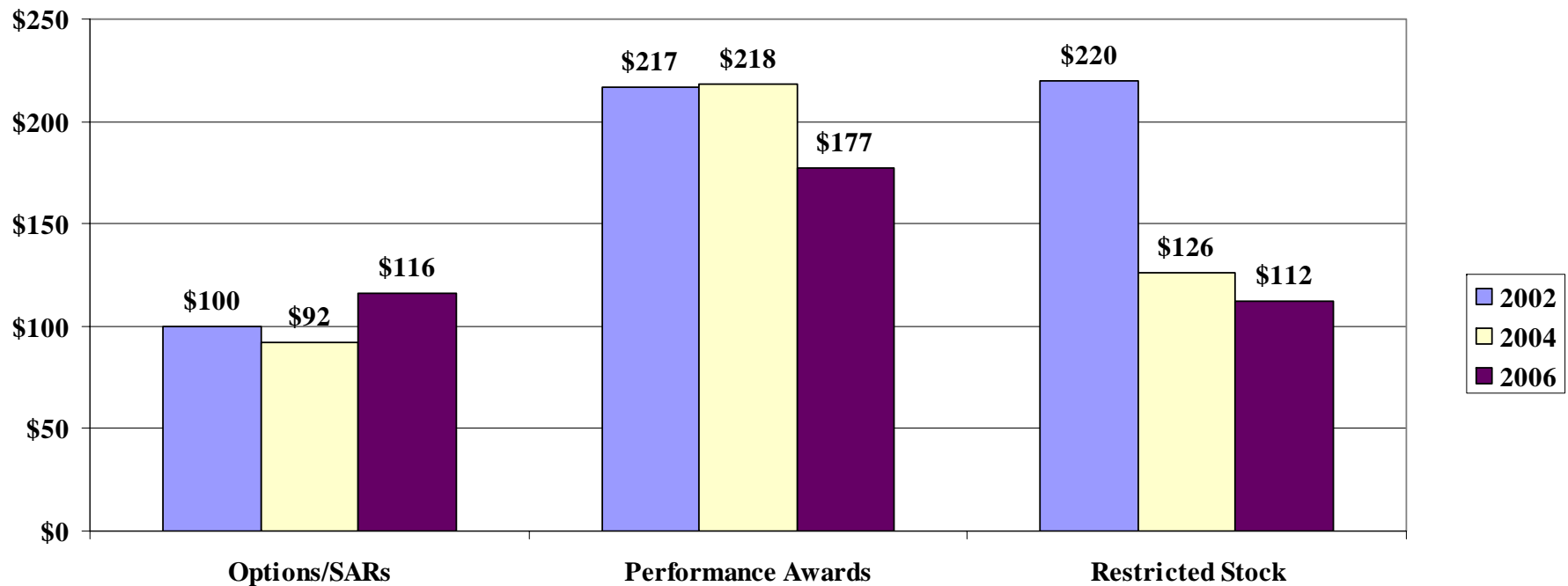
Executive Compensation Relationships

Relatively constant amongst a company's top five executives for the past three years . . .

	<i>% of CEO</i>	
	<i>Base Salary</i>	<i>Total Cash</i>
2 nd Highest Paid Executive	62%	48%
3 rd Highest Paid Executive	52%	43%
4 th Highest Paid Executive	49%	35%
5 th Highest Paid Executive	46%	34%

Executive Compensation Delivery

Medium entry level base salary for LTI participation (\$000)...

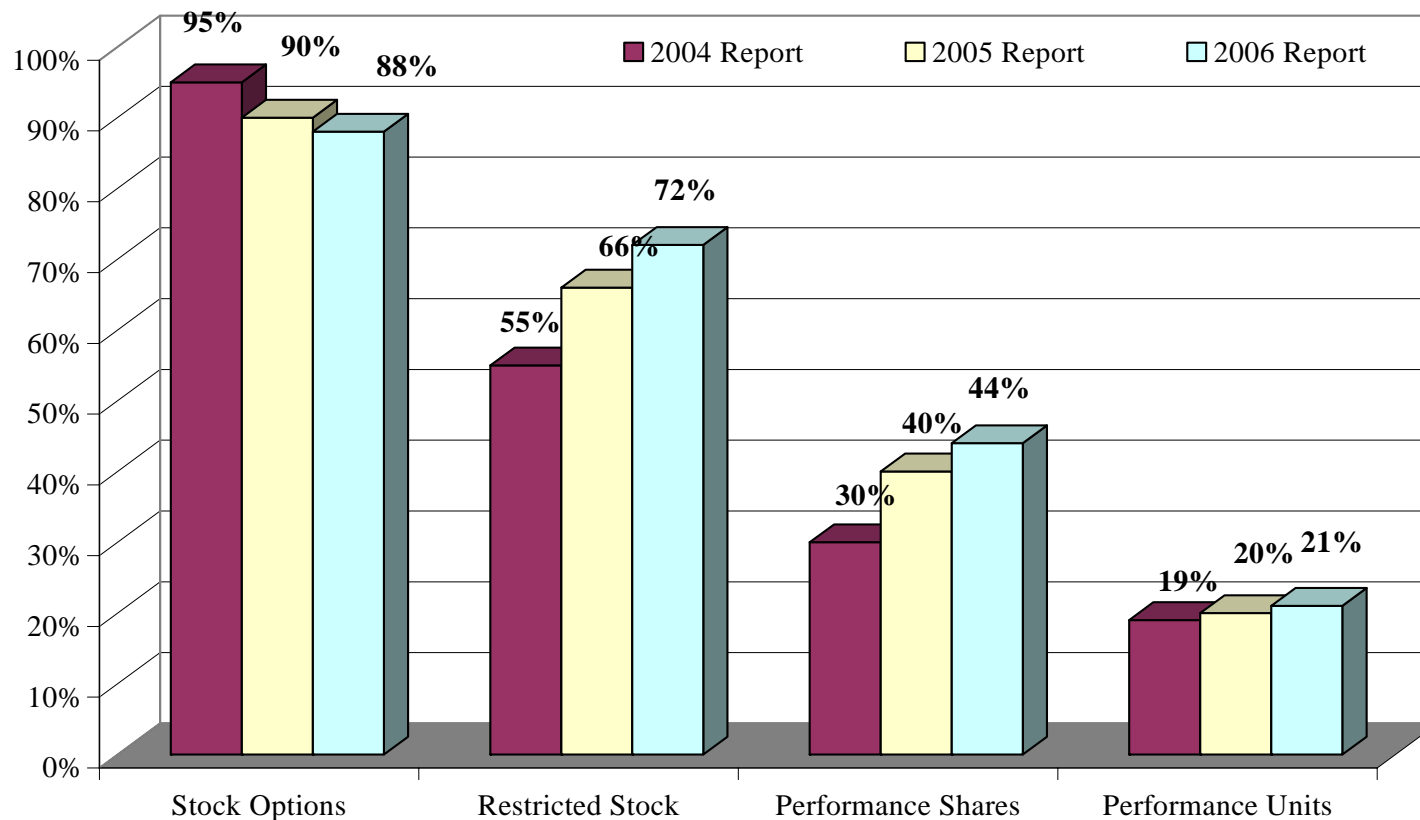


Executive Compensation Delivery

Shift in grant practices continue...

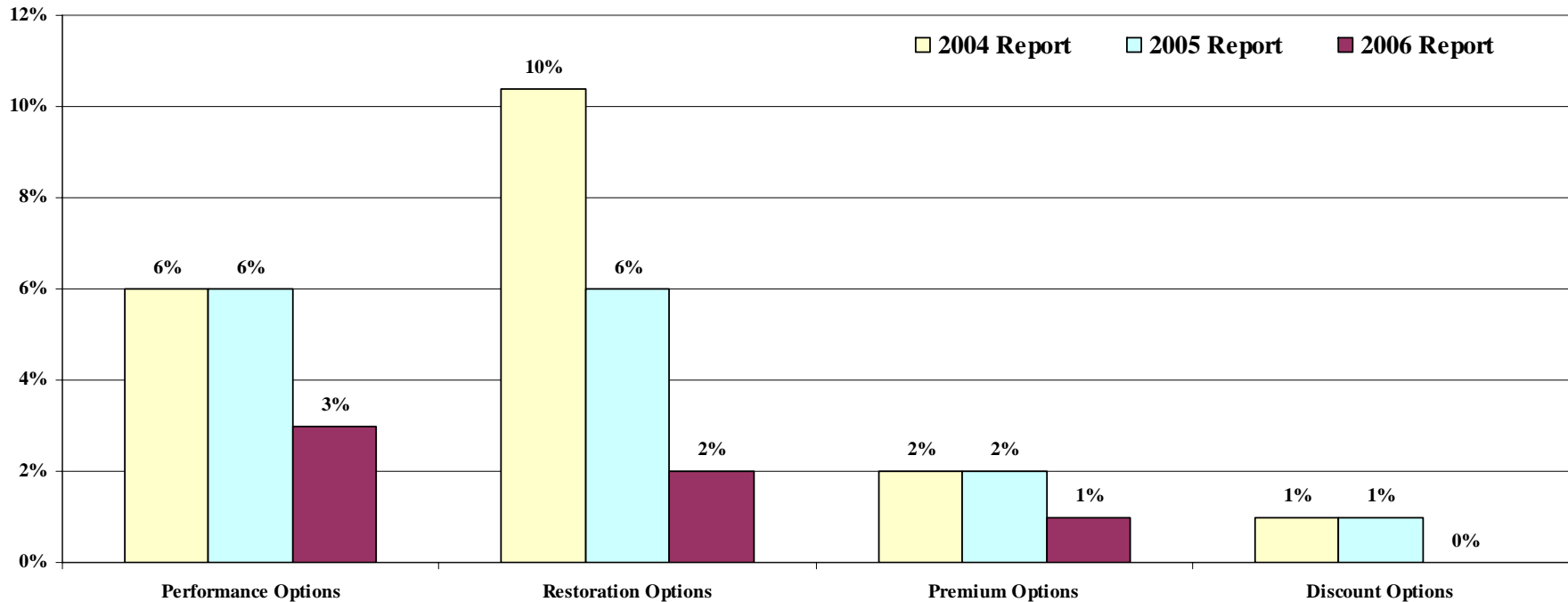
- But stock options are not dead – they still have a place

Executive Long-Term Incentive Grant Type Usage—Percent of Top 250 Companies



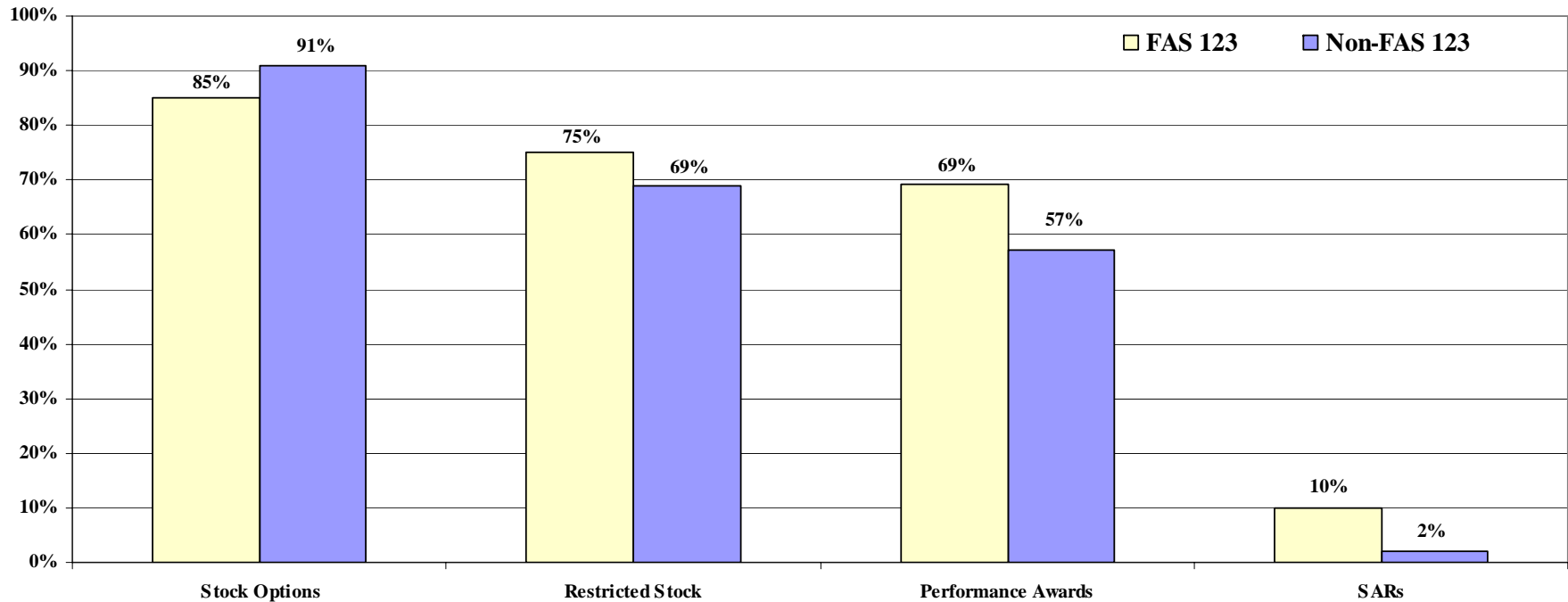
Executive Compensation Delivery

Executive stock option features – percent of Top 250 companies...



Executive Compensation Delivery

Grant type usage at FAS 123 companies versus Non-FAS companies...





Executive Compensation Delivery

Shift in long-term value from options...

- Long-term mix is now strategic, not competitively driven

Large-Cap Top-5 Grant Value Mix

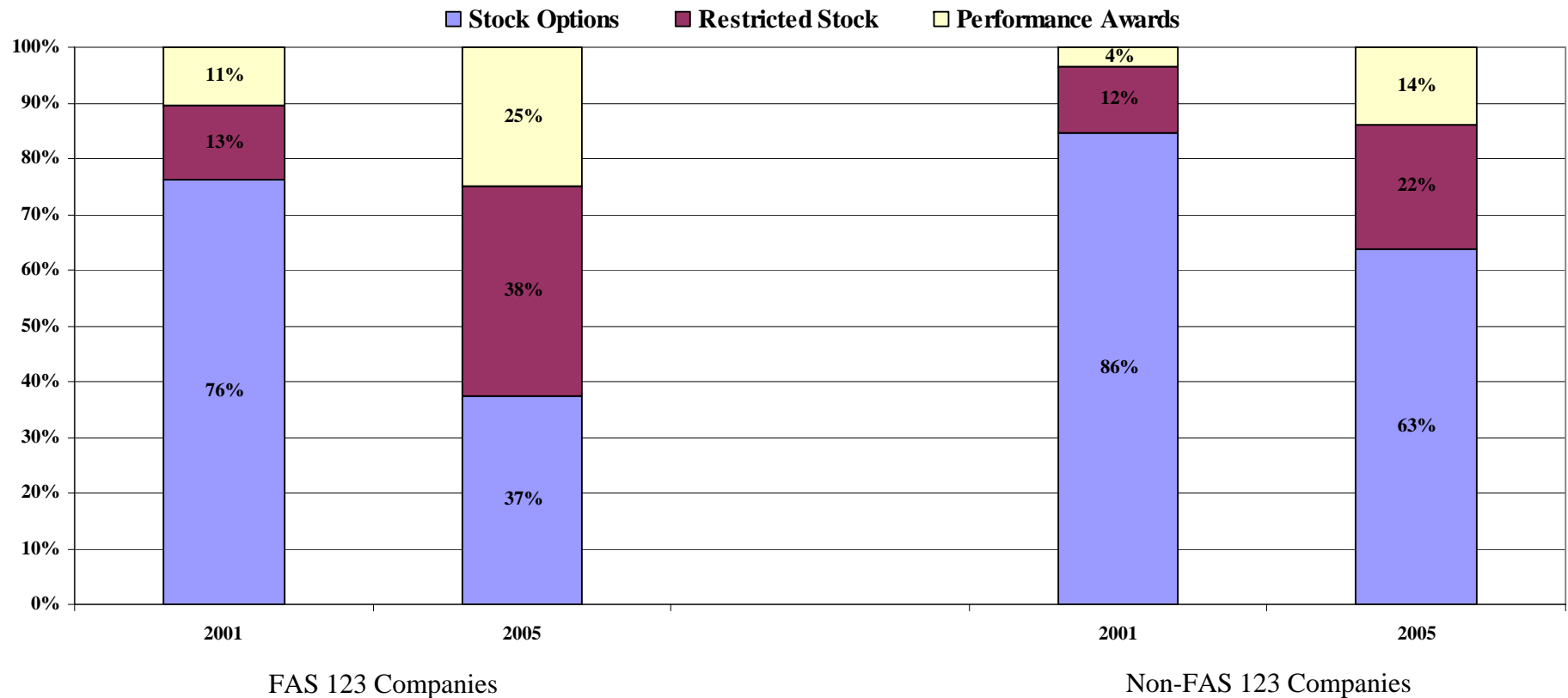
	<i>Options</i>	<i>Performance Stock/Cash</i>	<i>Restricted Stock</i>
2002	80%	15%	5%
2005	50%	20%	30%

- Time-based restricted stock is the biggest gainer

Executive Compensation Delivery

Looking at the CEO mix amongst the Top 250...

CEO Grant Type as a Percent of Total LTI Value, 2001 - 2005





Executive Compensation Delivery

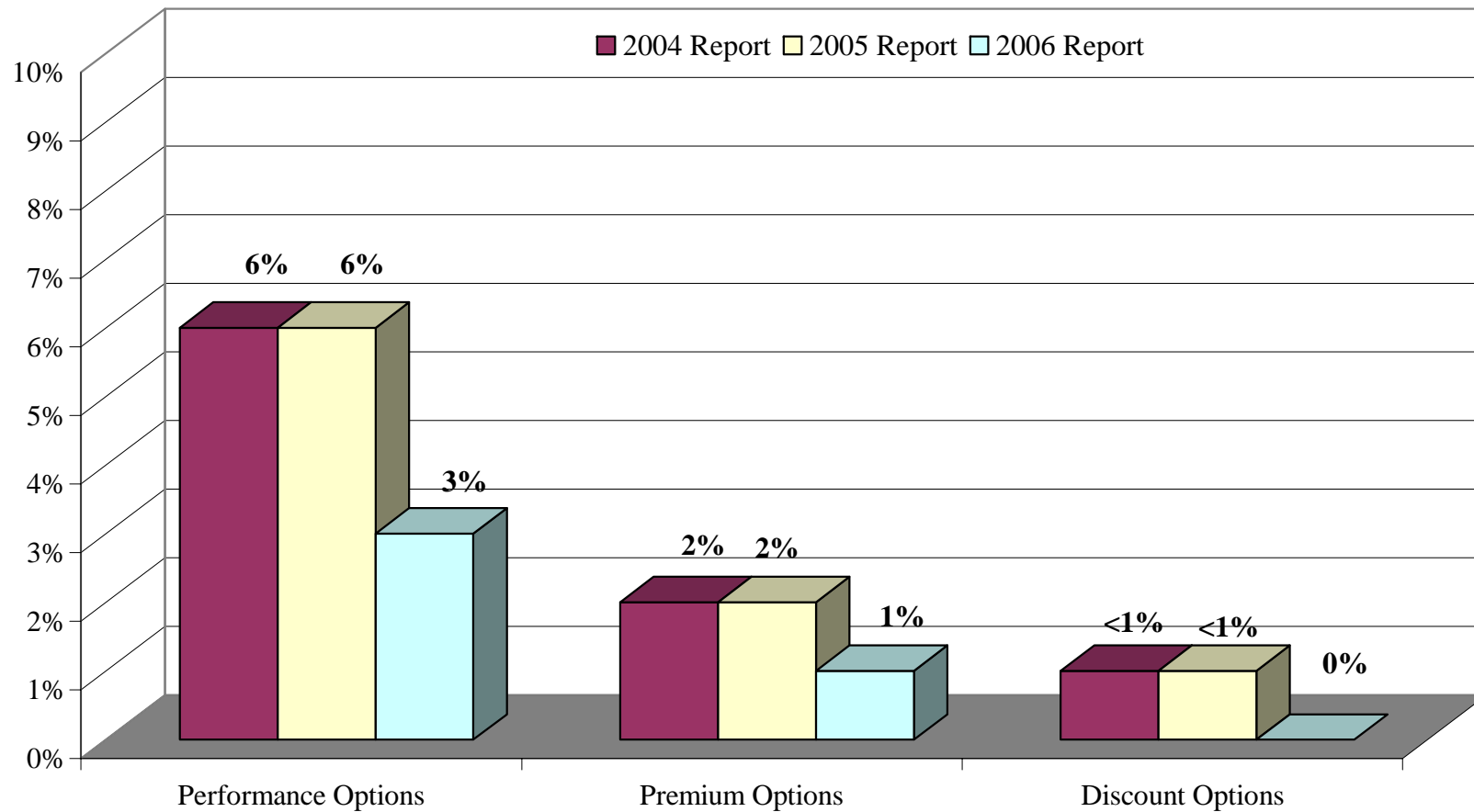
Option changes are subtle...

- Plain-vanilla structure remains the norm
 - 7-year terms sometimes replacing 10 years without additional shares
 - 10% vs. 82%
 - Post-retirement treatment often more limited
 - At-the-money strike price and simple time vesting still the norm
 - Double-trigger change-in-control acceleration replacing single-trigger in new severance arrangements
- Expect more stock-settled SARs to simplify exercises, save shares, and open new design possibilities

Executive Compensation Delivery

Looking at the numbers...

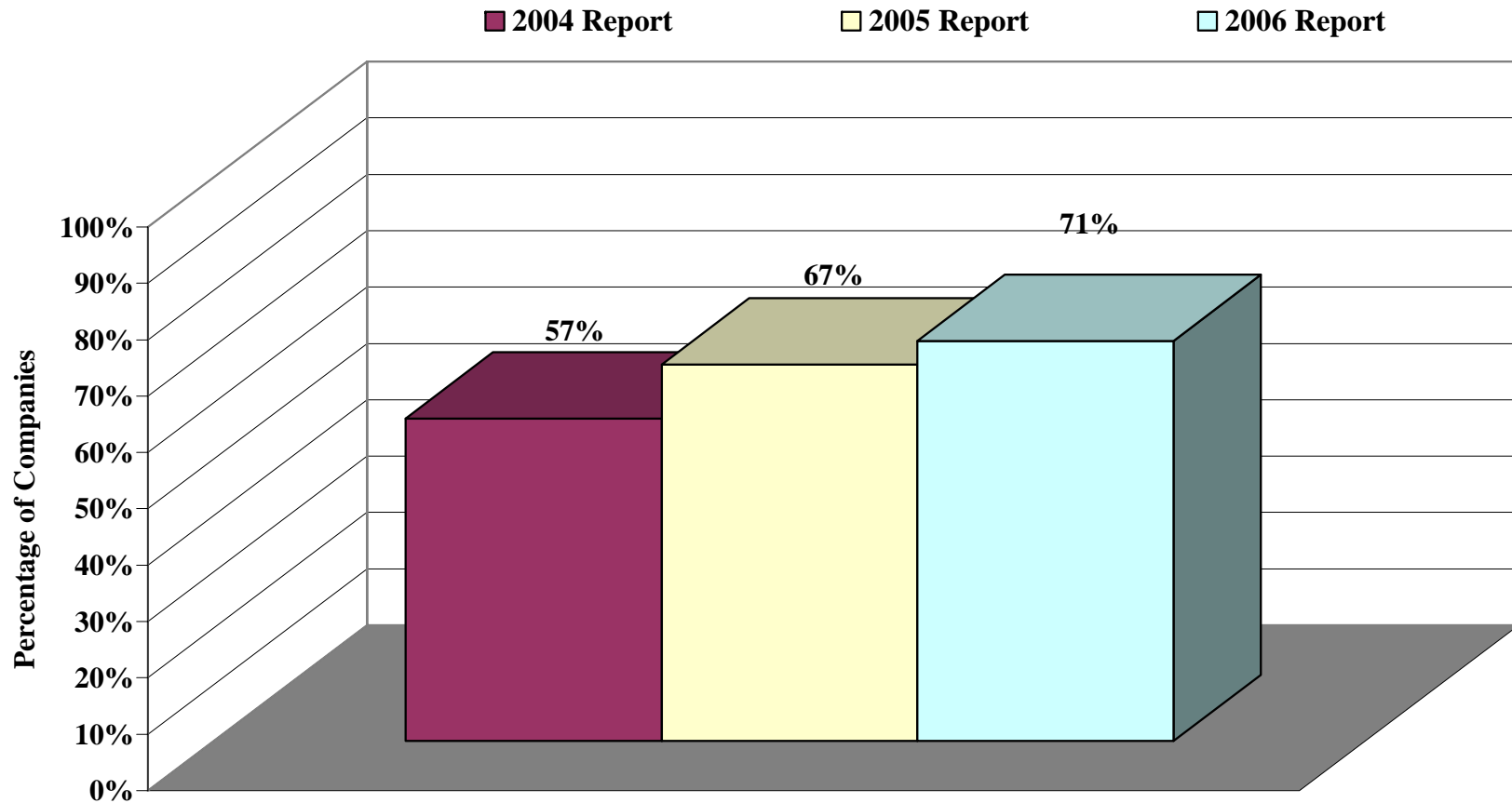
Executive Stock Option Features—Percent of Top 250 Companies



Executive Compensation Delivery

Stock Ownership guidelines becoming the norm...

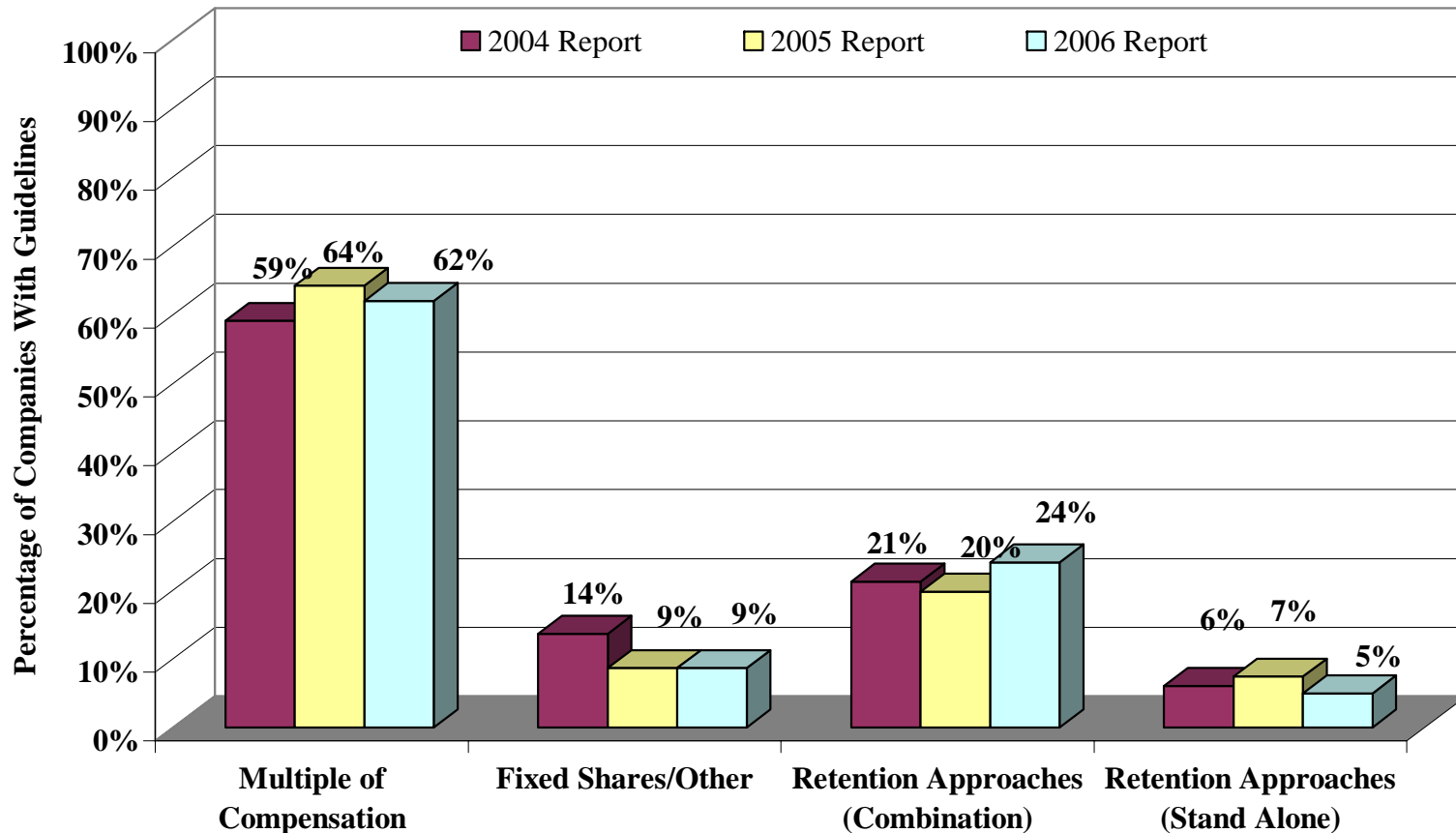
Prevalence of Executive Stock Ownership Guidelines



Executive Compensation Delivery

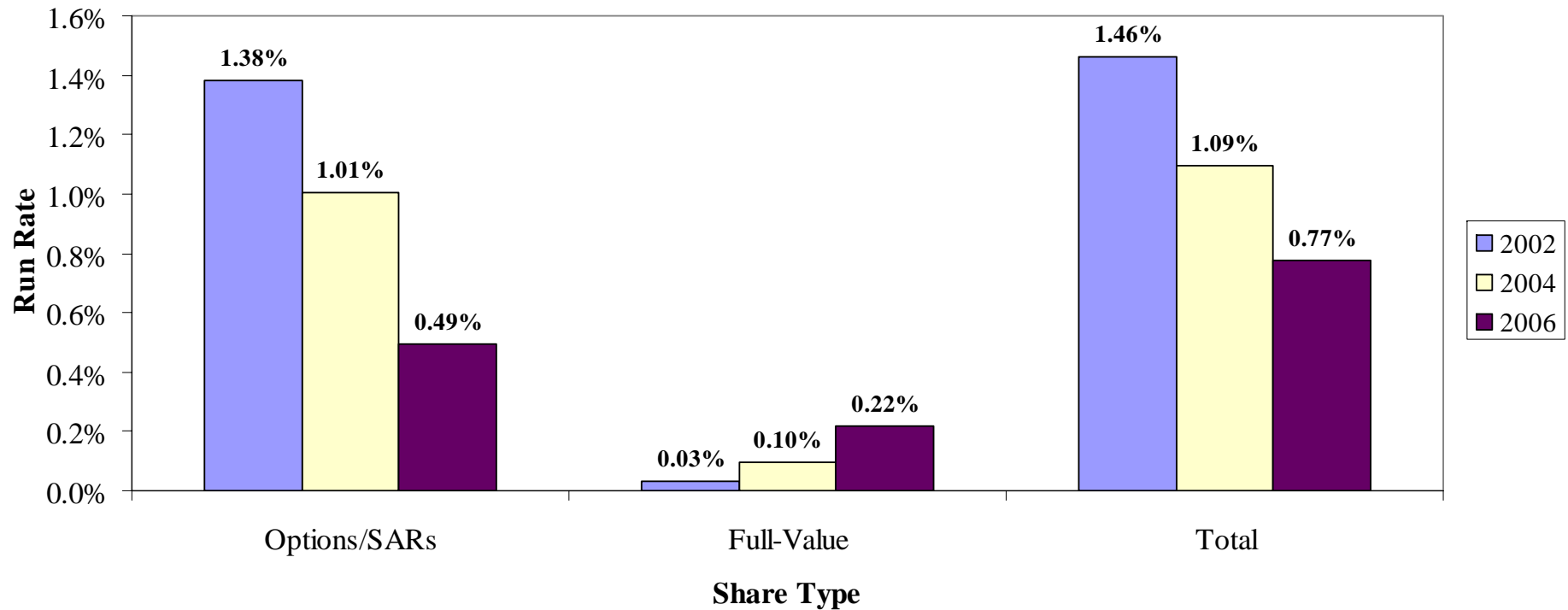
With retention approaches (our preferred) gaining a bit...

Types of Executive Stock Ownership Guidelines



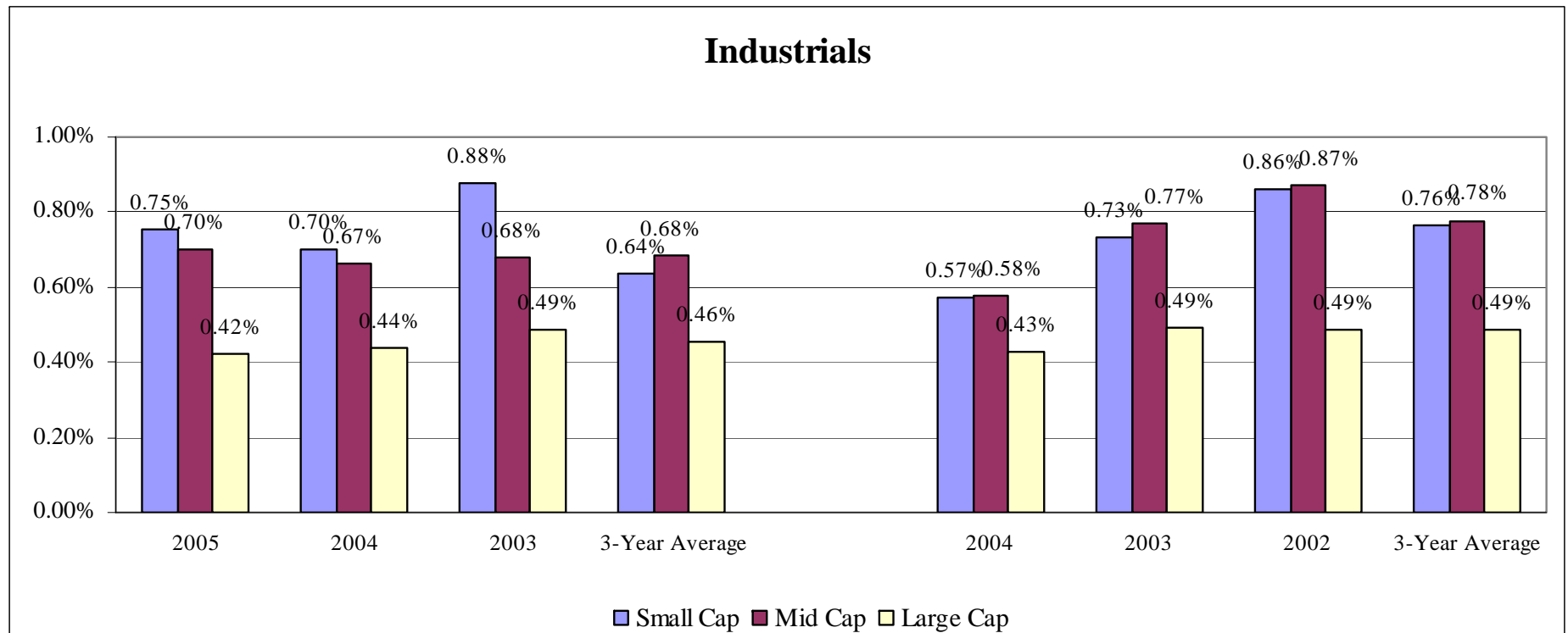
Executive Compensation Delivery

Burn rates continue to drop with shift to full value shares...



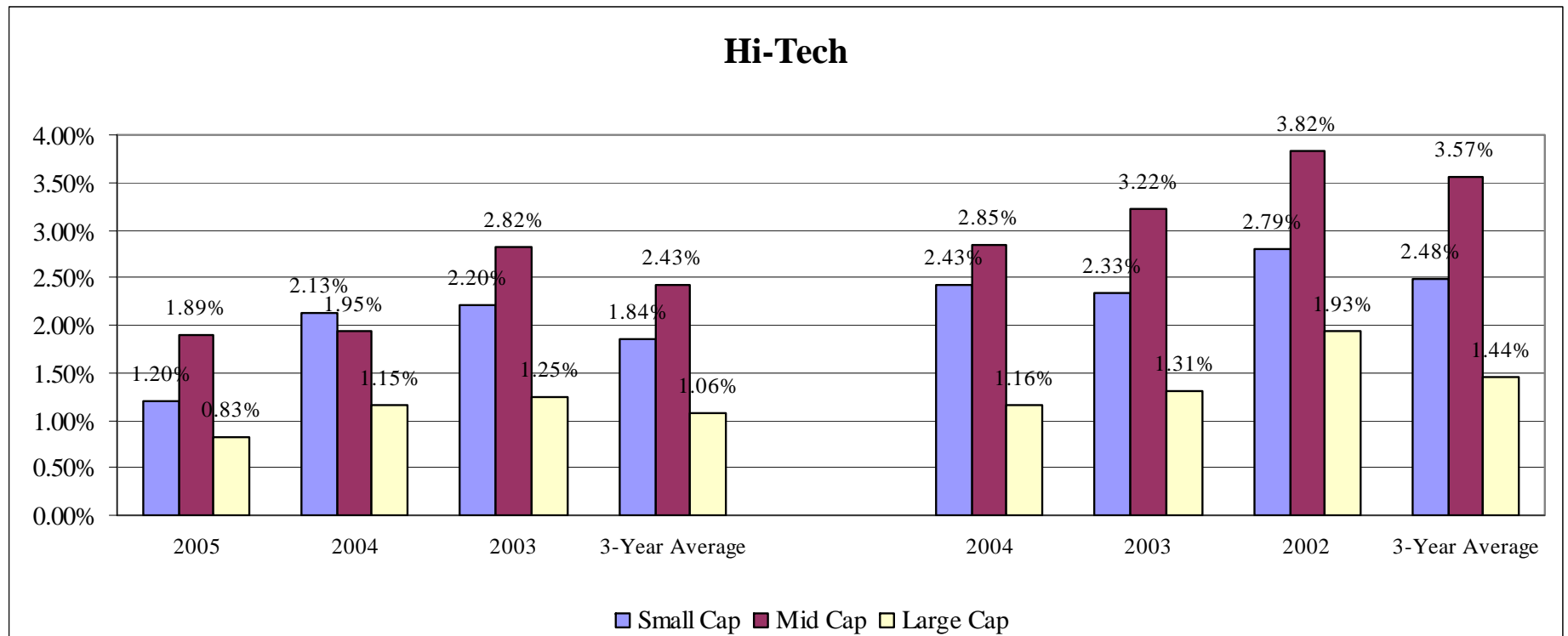
Executive Compensation Delivery

Value of grants (FVT - % of market cap) also dropping...



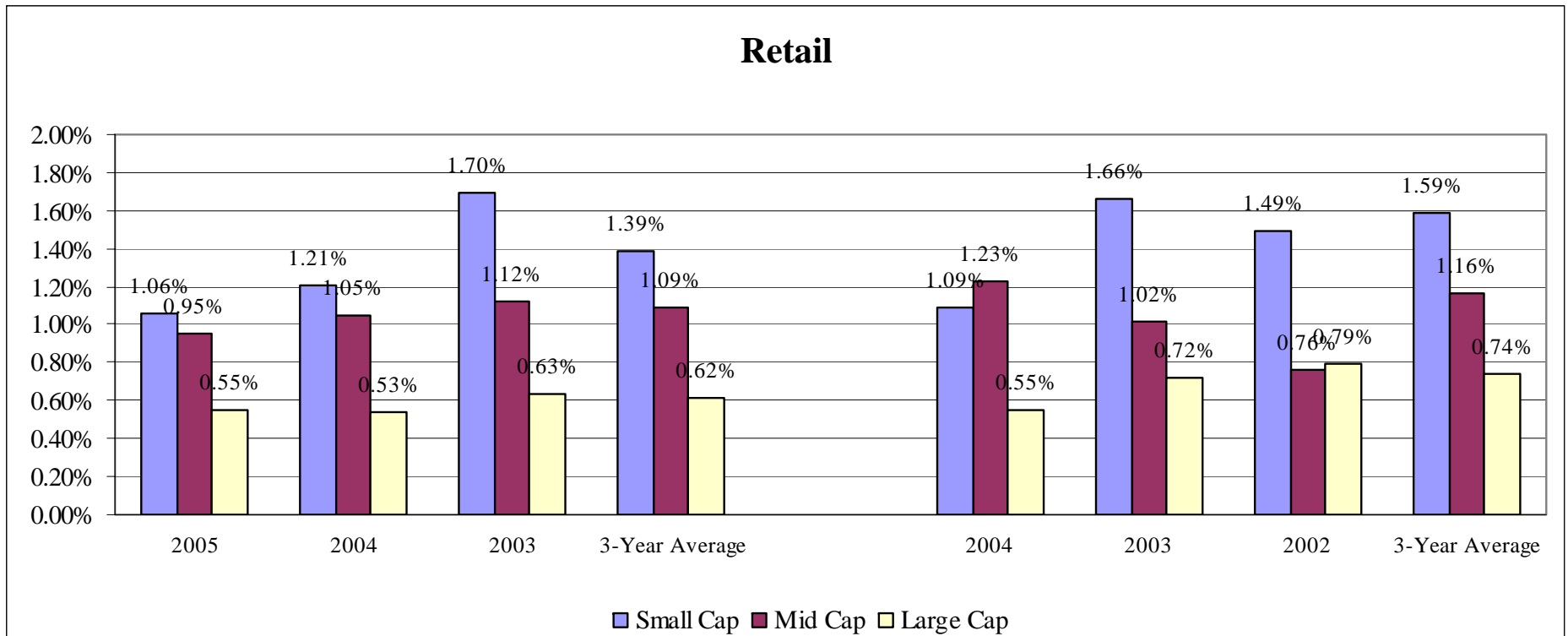
Executive Compensation Delivery

Value of grants (FVT - % of market cap) also dropping (cont'd)...



Executive Compensation Delivery

Value of grants (FVT - % of market cap) also dropping (cont'd)...





Emerging Trends

Changing programs in response to market environment...

- Companies are reviewing their change-in-control and severance programs for reasonableness
 - While typical severance is still 3 times salary and bonus for the CEO and 2-3 times for the next tier of executives, trend is to reduce the severance levels
 - Expect to see the new levels reflected in surveys in two-to-three years
- Continued pressure from shareholders to ensure that retiring executives do not also receive large severance payments



Emerging Trends

Changing programs (cont'd) ...

- “Valley provisions” (also referred to as “modified gross-ups”) are becoming more prevalent
 - If the executive’s potential payment only exceeds the 2.99 threshold by a small amount, cut back to less than 2.99 to avoid a large gross-up payment for just a small additional benefit
- But watch gross-ups disappear entirely



Emerging Trends

Recent CEO contracts...

1X	2X	2.5X	3.0X
Lucent	3M	Chevron (was 3X)	Allied Waste
	Baxter	Sara Lee	Aon
	Fiserv		Boeing
	Hewitt		ConAgra
	Hewlett-Packard (was 2.5X)		Mellon
	JPMorgan Chase (was 3X)		NCR
	Krispy Kreme		OfficeMax
	Pathmark		Safeco
	Siebel Systems		Saks



Emerging Trends

Changing programs (cont'd) ...

- New equity plans have “double-trigger” provisions at a CIC
 - Unvested equity only vest if terminated after a CIC (i.e., not upon CIC event alone)
 - Reduces cost of keeping acquired company executives and eliminates perceived inequity between old and new employees
 - Examples include: Gartner and Eastman Kodak
- Taking long-term incentives out of SERPs and severance:
 - Pfizer no longer covers long-term incentives in their retirement programs
- And reevaluating SERPs in their entirety



Emerging Trends

Changing programs (cont'd) ...

- Less-biased employment agreements
 - Broader definition of “Cause”
 - More narrow definition of “Good Reason” termination
 - Avoidance of double dipping (e.g., no severance payments beyond retirement date)
 - Inclusion of more restrictive covenants (e.g., inclusion of non-solicitation in addition to confidentiality, non-disparagement and non-compete clauses)



Emerging Trends

Changing programs (cont'd) ...

- Committee more involved in setting goals:
 - Previously reviewed goals set by Management
 - Now may change the types of goals and/or increase the required level of performance to align with what the Company needs to achieve to be successful
 - However, Committees are expressing frustration that performance (as written about by the press) is tied to only one measure – TSR, often over one year



Emerging Trends

Changing programs (cont'd) ...

- Adopting policies to clawback incentive compensation paid to guilty parties if payments based on fraudulent results or if go to a competitor

Financials

Bristol-Myers Squibb

Citigroup

Compass Minerals

GM

Hewlett-Packard

Interpublic Group

Competitors

AIG

IBM

First Horizon National

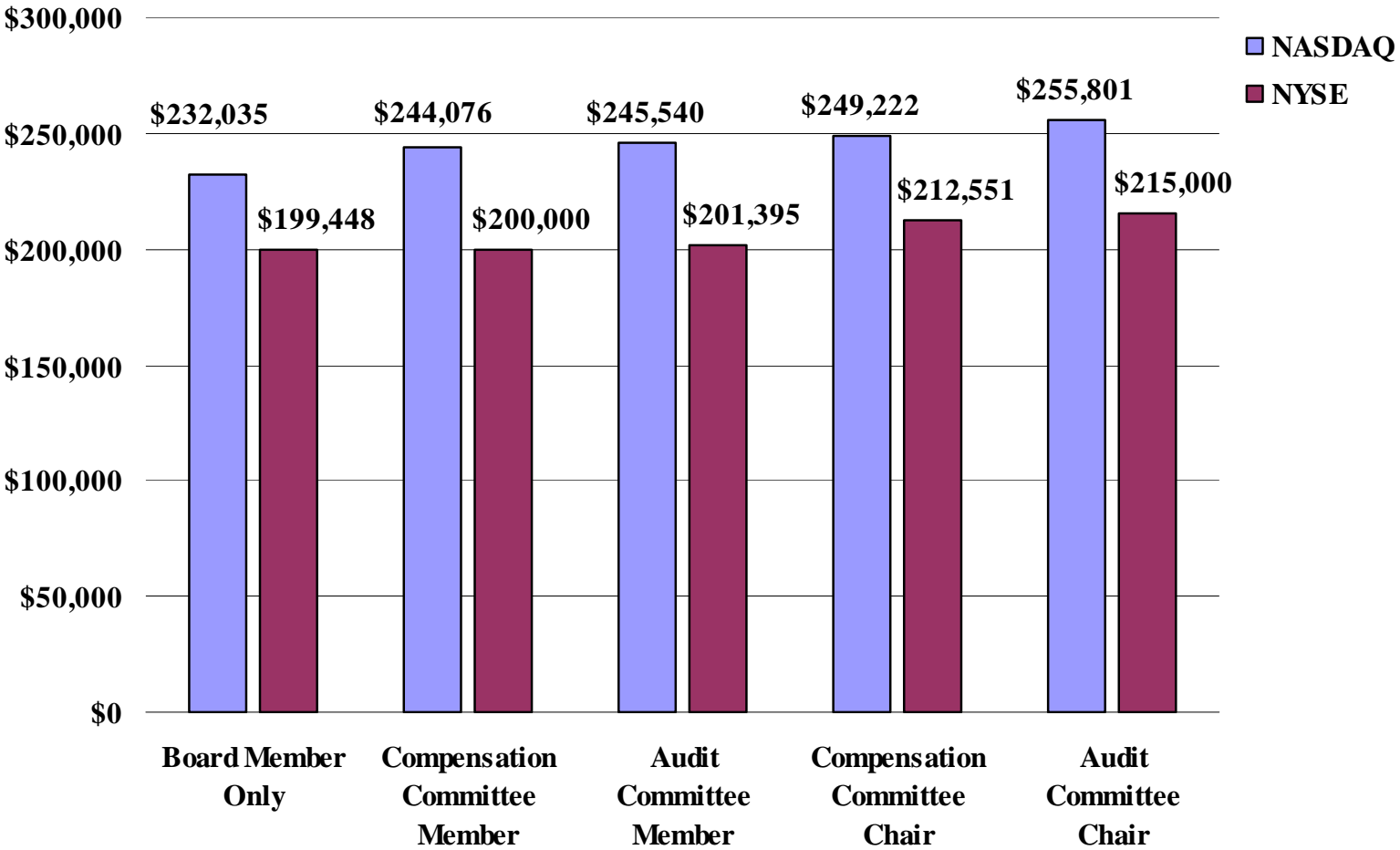
Invitrogen

Marsh & McLennan



Directors' Compensation

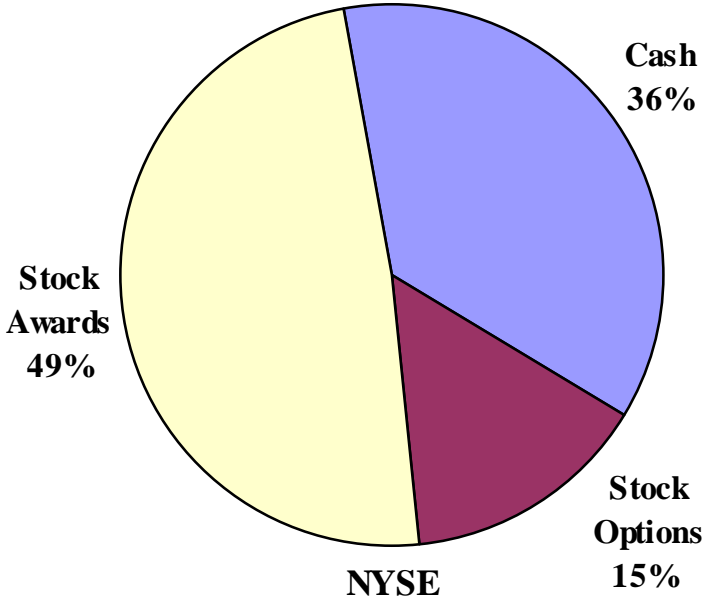
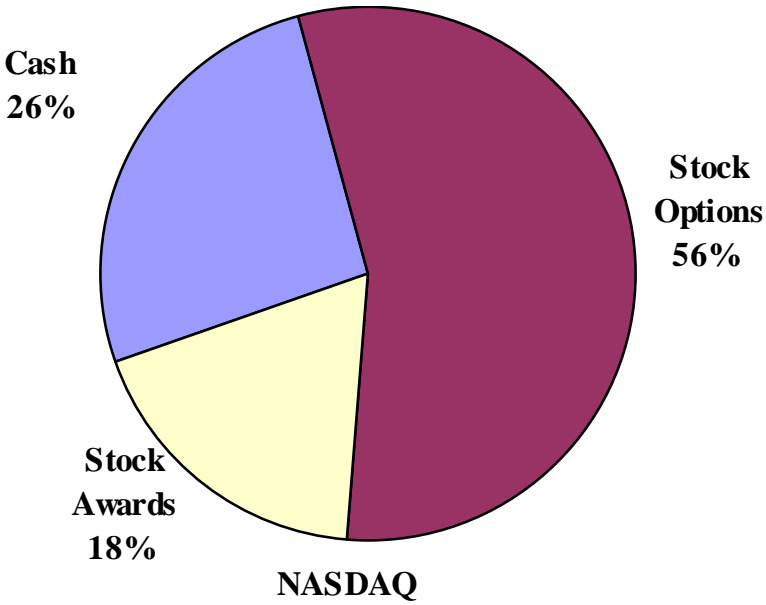
Don't forget them . . .





Directors' Compensation

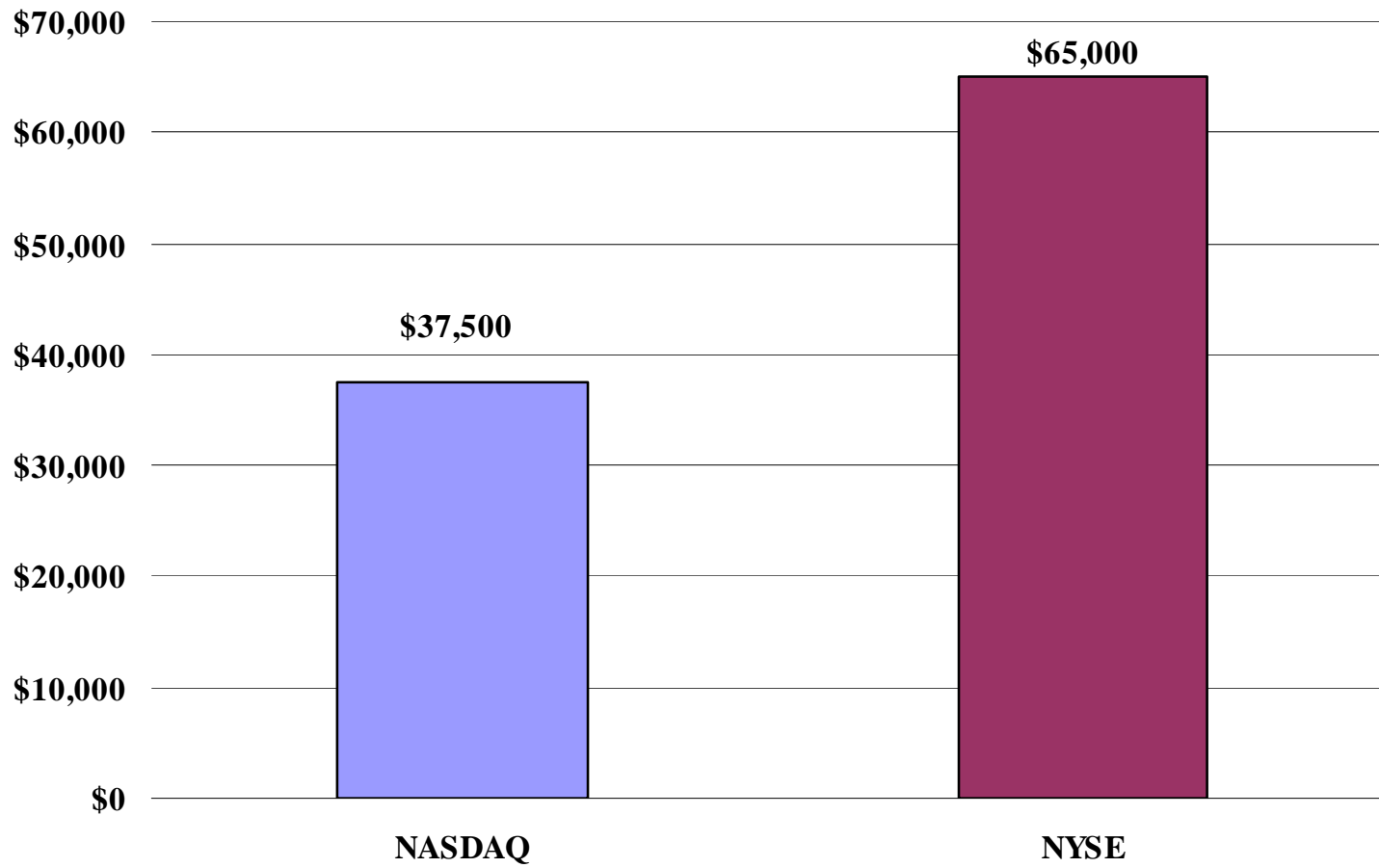
Stock options or restricted stock? . . .





Directors' Compensation

Board retainers . . .





Directors' Compensation

Committee members received . . .

	Percentage of Companies		Median Retainer / Fee	
	NASDAQ	NYSE	NASDAQ	NYSE
<i>Additional Retainers</i>				
Audit Committee	42%	31%	\$10,000	\$7,500
Compensation Committee	34%	14%	\$5,000	\$9,000
Nominating & Governance Committee	27%	12%	\$5,000	\$8,500
<i>Committee Meeting Fees (per meeting)</i>				
Audit Committee	46%	50%	\$1,500	\$1,500
Compensation Committee	45%	49%	\$1,500	\$1,500
Nominating & Governance Committee	43%	50%	\$1,500	\$1,500



Directors' Compensation

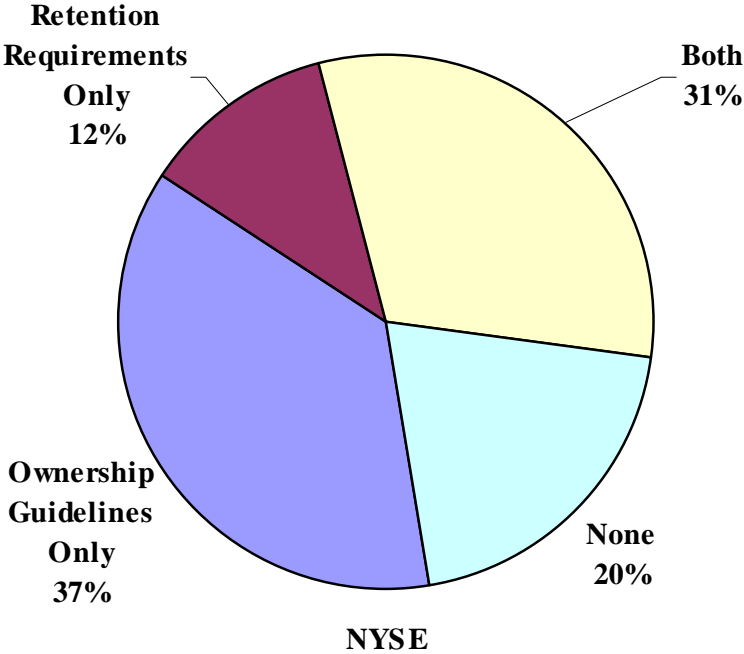
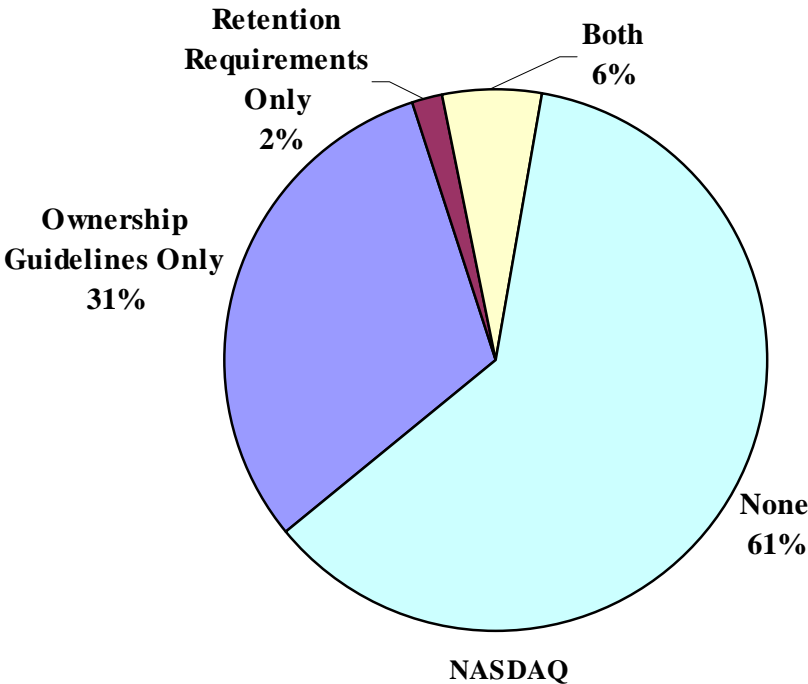
Additional fees for committee chairs . . .

	Percentage of Companies		Median Retainer / Fee	
	NASDAQ	NYSE	NASDAQ	NYSE
<i>Chair Additional Retainers</i>				
Audit Committee	77%	92%	\$11,040	\$15,000
Compensation Committee	68%	92%	\$9,000	\$10,000
Nominating & Governance Committee	59%	90%	\$5,894	\$10,000
<i>Chair Additional Meeting Fees (per meeting)</i>				
Audit Committee	24%	25%	\$2,500	\$500
Compensation Committee	5%	3%	\$1,000	\$500
Nominating & Governance Committee	4%	3%	\$750	\$500



Directors' Compensation

Director ownership guidelines . . .



Company Profile

Frederic W. Cook & Co., Inc. is an independent consulting firm specializing in executive and director compensation and related corporate governance matters. Formed in 1973, our firm has served more than 1,900 corporations, including 40 percent of the current Fortune 200 during the past two years, in a wide variety of industries from our offices in New York, Chicago, Los Angeles, and San Francisco. Our primary focus is on performance-based compensation programs that help companies attract and retain business leaders, motivate and reward them for improved performance, and align their interests with shareholders. Our range of consulting services includes:

- Annual Incentive Plans
- Change-in-Control and Severance
- Compensation Committee Advisor
- Competitive Assessment
- Corporate Governance Matters
- Corporate Transactions
- Directors' Remuneration
- Incentive Grants and Guidelines
- Long-term Incentive Design
- Ownership Programs
- Performance Measurement
- Recruitment/Retention Incentives
- Regulatory Services
- Restructuring Incentives
- Shareholder Voting Matters
- Specific Plan Reviews
- Strategic Incentives
- Total Compensation Reviews

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