A Perspective on Executive Compensation After Dodd-Frank

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Executive Compensation Agenda

- **Market trends**
- Emerging balanced long-term incentive portfolio
- Dodd-Frank, Governance, Proxy Advisory Perspective

Regulatory environment continues on

Dodd Frank

Reasonableness

409A

FASB/ IASB

SEC Proxy Disclosure

Stock Option Backdating

Sarbanes-Oxley

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Executive Compensation Trends

Median National Executive Total Salary Increases by Year

Actual 2009	Actual 2010	Projected 2011	Actual 2011	Projected 2012
2.0%	2.7%	3.0%	3.0%	3.0%

2011/2012 Compensation Philosophy for Officers/Executives

To Pay Below the Market	To Pay At the Market	To Pay Above the Market	No Formal Compensation Philosophy
2%	77%	14%	7%

World@Work 2011/2012 Salary Budget Survey

Key Equity Trends

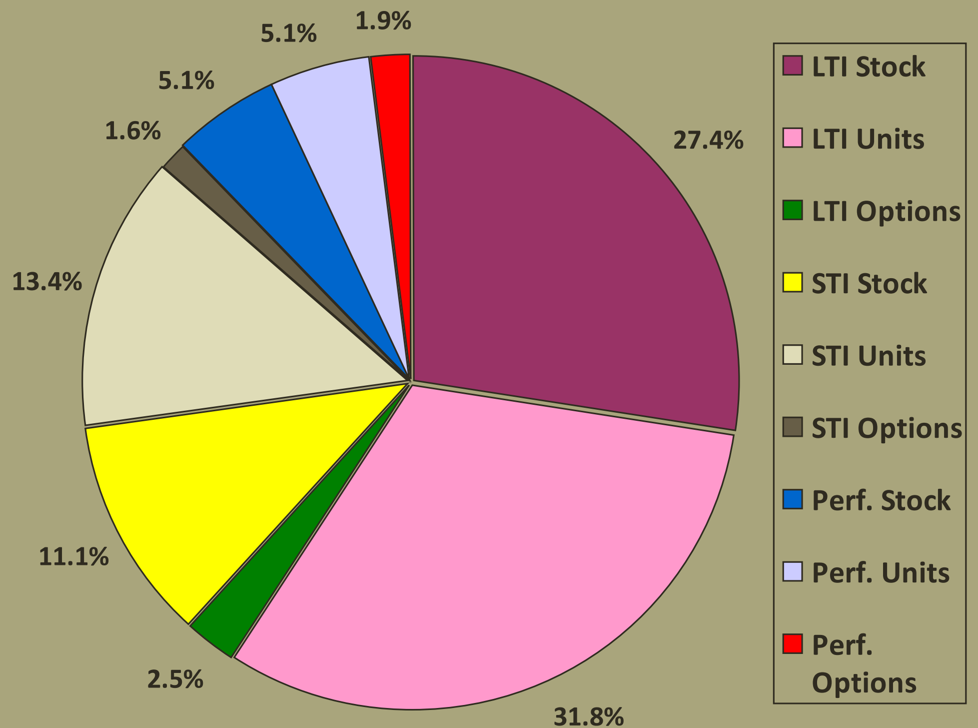
Over the past 5 years, we have seen a continued migration from use of stock options to use of restricted stock as well as a burgeoning increase in performance equity vehicles

Component	Trend	Comment
Stock Options	↓	5 year trend: 11% *decrease*
Restricted Stock	↑	5 year trend: 20% *increase*
Performance Shares	↑	3 year trend: 12% *increase*
Additional Share Requests	↑	5 year trend: 37% *increase*
Equity Grant Ratio for NEO's	↑	5 year trend: 26% increase (From 14% to 18%)
Total Overhang Rates	↓	5 year trend: 8% decrease(From 12% to 11%)
Burn Rate	↑	5 year trend: 14% increase (From 1.32% to 1.5%)

Equilar 2011 Equity Trends

Hot Topic
Performance-Based Equity

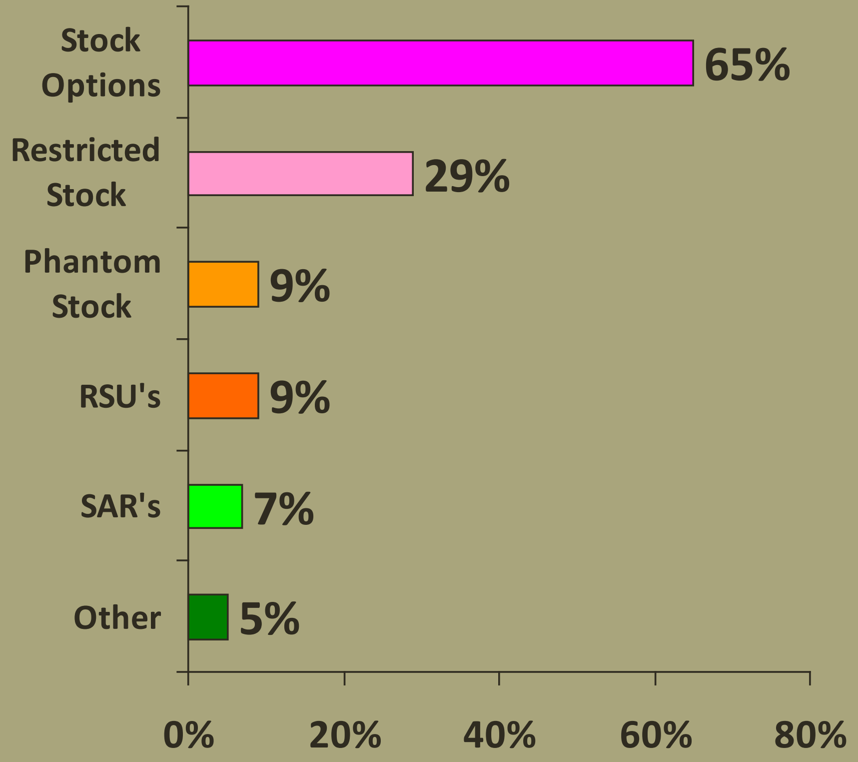
- Performance-based equity awards to executives are becoming more popular
- Most awards (over 60%) are granted with a long-term performance period
- Nearly 50% of surveyed companies awarded performance shares in 2010
- The chart provides the prevalence of various performance-based equity vehicles awarded



Equilar 2011 Equity Trends

Equity for Executives in Private Companies

- Stock Options are the most prevalent form of equity granted to the C Suite in privately held companies, followed by restricted stock
- Most private companies do not require officers to purchase company stock
- Performance conditions are not typically required for vesting equity awards



NCEO Equity Granting Practices in Closely Held Companies

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"Compensation programs are a management system that need constant attention to drive strategy."

"Perfect storm" for appropriate pay and design

- Accounting changes breed flexibility
- Good governance means
  - Diligent process
  - Pay for strategy
  - Transparency
- Recession . . . Rebound . . . Motivation . . . Retention
  - Where are we going? What are we paying for?

Old incentive practices
Pre-ASC 718 and Recession

- Annual bonuses for Profit and Revenue
- Appreciation-Only Long-Term Incentives
- Supplemental Executive Retirement

Everything is fair game – long-term performance drives design

- Diverse range of alternatives – **accounting changes breed flexibility**
- Design driven by where company is and wants to go
  - **Business stage**: Start-up, growth, maturing, declining
  - **Long-term strategic goals**: Sell in mid-term? Create company "built to last?" Turnaround?
  - **Purpose for LTIP**: Recruitment/retention? Mid-term performance? Culture of ownership? Integration? Line of sight?
  - **Affordability**: Cash flow, dilution, **and** unwanted turnover

Everything is fair game – long-term performance drives design

- **Find the right balance**
  - Stock Options/SARs: appreciation only
  - Restricted Stock/RSUs/Phantom Stock: full-value
  - Performance Shares/Awards: outcome-based awards
    - Pay for longer-term outcomes, either in shares or cash

Emerging Pay for Performance Model

Performance Shares/Awards

Annual Incentive	Stock Options / Stock Appreciation Rights	Restricted Stock / Restricted Stock Units/ Phantom Stock

Short-Term Focus

Long-Term Focus

Performance share/award plans

- Performance goal either absolute or relative
  - Absolute = performance improvement
  - Relative = performance against peers
- Performance measured at participant “line of sight”
  - Corporate performance
  - Divisional performance

***No absolute rules of game, simply what we are “reinforcing and rewarding.”**

Sample performance share plan

Units Granted:	2000
Threshold Value:	$0.00
Maximum Value:	$300,000.00
If Stock at $20 at End:	15,000 Shares

Performance Unit Value

Avg EBITDA Growth 2009-2012					
	7.2% or >	$0.00	$112.50	$125.00	$150.00
Avg EBITDA Growth	7.0%	$0.00	$87.50	$100.00	$125.00
2009-2012	6.8%	$0.00	$62.50	$75.00	$100.00
	< 6.8%	$0.00	$0.00	$0.00	$0.00
		< 6%	6.0%	7.0%	8.0% or >

Avg Revenue Growth 2009 - 2012

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It's all relative – TSR Plans are the Pay for Performance Trend

- The number of companies considering or adopting performance shares continue to increase.
- The majority of plans measure financial performance over a three-year period.
- However, difficulty in setting long-term goals and indirect link to shareholder value creation have prompted companies to explore alternative ways to measure performance.
- One of the measures receiving significant attention is relative total shareholder return.

Is TSR right for you?

Pros	Cons
• Market "sets" goal. • Maintains motivation in both good and poor performing years. • Compensation expense accrual is predictable and stable. • Pay and performance outcomes are transparent. • Unlike financial metrics, total shareholder return does not require adjustments for special or unusual items.	• Compensation expense accrual is not reversed. • Requires special valuation model to determine grant date fair value. • Payouts can occur if the company performs better than many poor performers ("best of the worst"). • Outcomes may be inconsistent with investor expectations.

Executive Compensation Agenda

- Trends
- Emerging balanced long-term incentive portfolio
- **Dodd-Frank, Governance, Proxy Advisory Perspective**

Dodd-Frank Wall Street Reform and Consumer Protection Act

- Enacted July 21, 2010
- Significant public company executive compensation reform and governance reforms
- Say-on-Pay, Say When on Pay and Say on Parachutes
- Compensation Disclosures
- Compensation Committee and Adviser Standards
- Clawbacks

Say-on-Pay, Say When on Pay, Say on Parachutes

- Shareholder advisory (non-binding) vote on executive compensation
- Advisory vote on frequency of Say-on-Pay vote
- Advisory vote on compensation in mergers and related transactions
- Requirements were first effective for 2011 annual meetings (2009 for TARP recipients)
- Smaller reporting companies were exempted for first two years
  - $75 million public float
  - **Advisory votes required for annual meetings starting January 23, 2013**
  - No CD&A requirement for such companies

Say-on-Pay Results

- **2011:** Overwhelming support (ISS 2011 U.S. Postseason Report)
  - Average shareholder support of 92%
  - Negative votes at only 38 Russell 3000 companies (1.6% of total)
  - Pay-for-performance cited most often as reason for negative votes
- **2012:** Very similar to 2011 (Semler Brossy Report 6/27/12)
  - 72% of companies with over 90% support
  - Negative votes at 51 companies so far
    - Citigroup: 93% support in 2011; 45% support in 2012
- **Sue-on-Pay:** shareholder lawsuits against 11 companies that have lost Say-on-Pay votes

Say-on-Pay Results

- No major shock waves
- Proxy advisory firms, ISS and Glass Lewis, have significant influence
  - Conference Board Report (March 2012) – study showed ISS influence of 17-21%
  - Trend – companies file supplemental proxy materials if there is a negative recommendation
- Jury is out on whether vote impacts level of compensation
- Communication is key, including proxy disclosure **and** engagement with shareholders

Proxy Disclosure Trends

- Focus on describing pay for performance (P4P)
- Companies will rethink adopting new compensation plans that are difficult or awkward to communicate
- CD&A executive summaries and proxy statement summaries
- New ways to communicate
  - Coca-Cola – color, graphics and plain language
  - Exxon Mobil – glossy mailing and video
  - More like political campaign pieces

Frequency Vote (Say When on Pay) Results

- Shareholders can vote among one, two and three year frequency
  - Company must state whether it will abide by shareholder preference
- Shareholders at nearly 80% of Russell 3000 companies supported annual frequency (ISS 2011 U.S. Postseason Report)
- At companies where the board recommended triennial frequency, the shareholders followed that recommendation 40% of the time but selected annual frequency 50% of the time

Compensation Disclosures

- New disclosure requirements not yet proposed by SEC
- Disclosure of pay vs. financial performance
  - Likely use of total shareholder return (TSR) as performance measure
- Pay equity disclosure – comparison of median annual compensation of employees vs. CEO
- Rule will create reporting burdens

Compensation Committee and Adviser Standards

- New SEC rules adopted June 20, 2012 – exchange listed companies
  - Proposed exchange rules by 9/25/12; final exchange rules by 6/27/13
- New independence standards for CC members
  - Similar to audit committee standards, Rule 10A-1
- CC will need to **consider** consultant and adviser independence
  - No requirement to **engage** independent advisors
  - Six factor test
  - Legal counsel (other than in-house) providing advice to CC
- Modest change to proxy disclosures – consultant conflicts

Clawback Policy

- SEC to direct exchanges – require clawback policy for listed companies
  - SEC rules not yet proposed; then exchanges must adopt standards
- Recovery of **incentive compensation** (including options) from **current and former officers** during the **three years** before a restatement, to extent compensation based on **erroneous financial data**
- Broader than SOX clawback
  - Issuer-enforced; applies to all officers/former officers (not just the CEO and CFO); no-fault
- Legal questions – employment and tax
- Policy questions – who else should be covered?

Questions?