

Long-Term Value Creation In an Era of Compensation Criticism

Council of Institutional Investors

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Overarching Themes

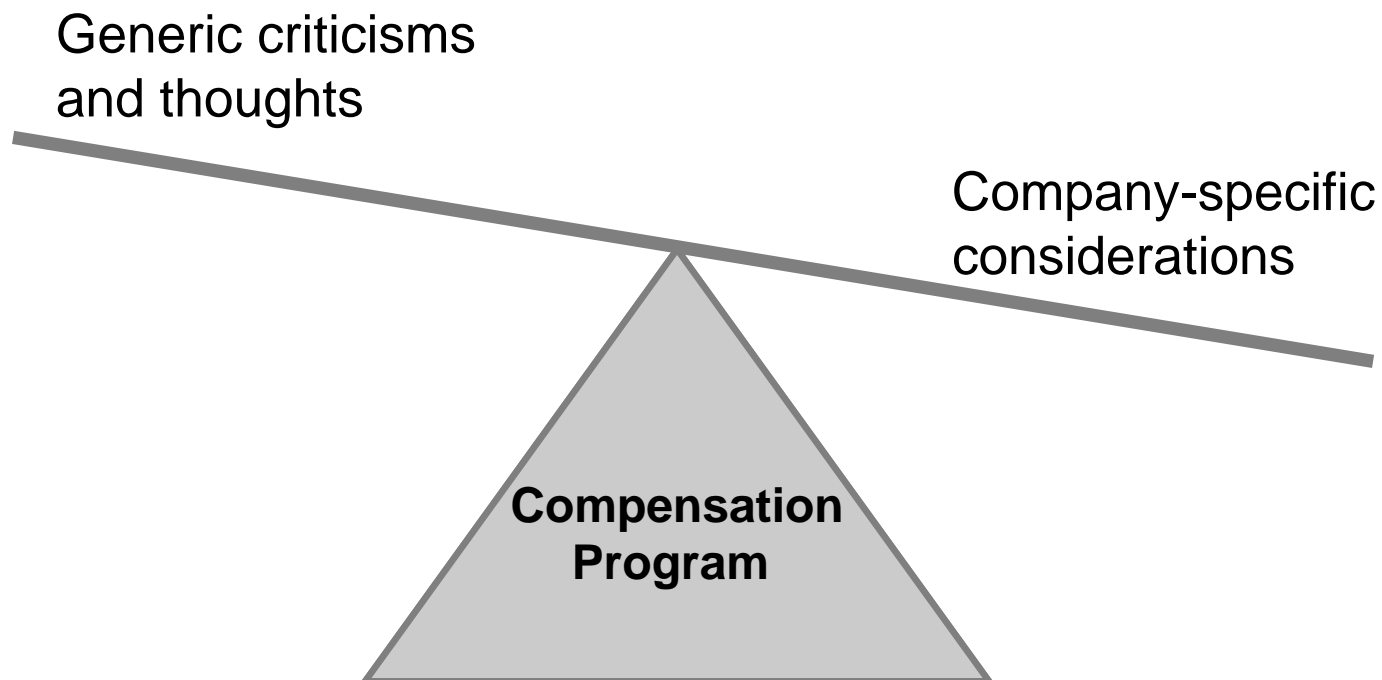
- Underlying issue is enormous income disparity between executives and the average citizen in the context of diminished current and future opportunities
 - Fairness redefined
 - Political agendas
- Significant amount of misguided information on appropriate compensation practices (often well intentioned) in the last five years and it will only continue
 - Consultants
 - Governance experts
 - Executives
 - Politicians

What are Some Common Criticisms?

- Link to stock price encourages risk-taking
- “Pay for performance” largely flawed
- Need more emphasis on peer groups for compensation decisions
- Executives earn many multiples of the average employee; compensation is unregulated
- Not enough ability to clawback pay
- Too many one-sided contracts/agreements
- “Say on pay” would force Boards to act for shareholders
- Board and management should have separate, independent consultants

Inevitable Balancing Act

- Important to balance generic criticism with company-specific facts to arrive at workable programs



Common Compensation Issues

- Compensation Committees challenged
- Role of incentives under pressure
- Overemphasis of accounting metrics in incentive programs
- Uncertainty around role of stock ownership
- Appropriate use of compensation data
- Political correctness

∴ Balance inherent inconsistencies and sloppiness of the capitalistic system with the consistencies of a bureaucratic, regulated approach

Law of Unintended Consequences

- Moving away from competitive determinations of compensation
- Continuing spouting of opinions from well-intentioned observers
- Changing the attractiveness of industries and the dynamics of turnarounds and start-ups
- “Say on pay” untried
- Decreasing global competitiveness

∴ Implicitly, it is better to have a more evenly-split pie than a bigger pie. CEOs paid less and shareholders perhaps make less

Where Should Compensation Go?

- A test of fundamental principles rather than a period of enlightenment
 - Put stake in the ground in favor of competitive compensation systems
 - Continue to aggressively push sound practices
 - Incentives should be a force for good, not evil
 - Heavy equity ownership is the elixir of sound programs
 - Must continue to agonize about performance metrics