DJIA	NASDAQ	S&P 500	10 yr Note	Gold (Dec)	Oil (Dec)	FTSE 100
12,016.55	2,686.17	1,255.83	2.00%	1,797.20	95.71	5,510.82
▲ +33.31	▲ +0.02	▲ +2.60	▼ -0.04	▲ +41.10	▲ +1.45	▼ -16.34
+0.28%	+0.00%	+0.21%	-1.96%	+2.34%	+1.54%	-0.30%

Executive Compensation: Reforms Are Slowly Gaining

By Sheryl Nance-Nash Posted 9:20AM 02/26/10 Economy, Goldman Sachs , Boeing, American Express

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If you want to stir up a hornet's nest, just mutter two words: executive compensation.

From the White House to Wall Street to Every Street USA, who gets paid how much is a topic of heated debate. Earlier this week came the announcement that Wall Street employees saw their bonuses increase by 17% to a collective $20.3 billion in 2009: During an economic downturn, a disparity in pay like that gets extra attention.

The furor isn't likely to fade anytime soon. New Securities and Exchange Commission disclosure rules kick in at the end of the month. They require public companies to disclose risks arising from their compensation policies and practices for both executives and nonexecutive officers, to the extent these risks are reasonably likely to have a material adverse effect.

The pressure is on. Corporations want to keep top performers happy; boards are being taken to task by shareholders for their lack of restraint on pay; and companies that were recipients of TARP money have Obama pay czar Ken Feinberg waving a big stick. It's ugly out there in pay-land.

Tying Bonuses to Long-Term Performance

RiskMetrics Group highlights some of the problematic pay practices: multiyear guarantees for salary increases, nonperformance-based bonuses and equity compensation; including additional years of unworked services that result in significant additional benefits without sufficient justification; including long-term equity awards in pension calculations; perquisites for former and/or retired executives; extraordinary relocation benefits (including home buyouts) for current executives; change-in-control payments exceeding three times base salary and target bonus; tax reimbursements related to executive perquisites or other payments, such as personal use of corporate aircraft and executive life insurance, among others.

Already, though, some change has come. Goldman Sachs reversed its compensation structure after public outcry. "The higher-level executives were given mostly stock compensation as opposed to cash, and presumably this calmed some of the public outrage without necessarily making Goldman Sachs less competitive at lower executive levels," says Fred Lipman, co-author of *Executive Compensation Best Practices*, and a partner with the law firm of Blank Rome.

Some companies are now tying bonuses to longer-term performance. Shell for example, had its pay voted down by shareholders. In reaction, the company put in place an innovative program whereby bonuses are tied to both share performance and other criteria, such as production and cash-flow increases, says Michael McGrath, author of the new book *Business Decisions! How to Be More Decisive While Reducing Risk in Today's Economy*. He says the new system at Shell doesn't necessarily reduced executive bonuses, but it shifts some incentives toward a five-year horizon.

"If an executive accepts half his bonus in shares, they may be matched in part or whole after three years, depending on how well Shell performs compared to competitors such as Exxon and BP. The shares must then be held two more years before they can be sold," says McGrath.

Reexamining the Whole Compensation Philosophy

Many organizations are responding to the political pressure to not pay excessive bonuses by increasing base pay, says Ed Rataj, managing director of compensation at CBIZ Human Capital Services. One financial services company recently increased base pay by as much as 50% for some employees as a way to keep compensation levels competitive in an environment that would frown upon the payment of bonuses.

So how is the compensation landscape redefining itself? Todd Gershkowitz, senior vice president of Farient Advisors, an executive compensation consulting firm, describes what he sees. He says companies are looking at several factors:

- **Risk evaluation:** Evaluating the relationship between compensation and excessive risk taking behavior;
- **Transparency:** Taking steps to restore shareholder trust through transparency, demonstrated reasonableness, and adherence to good governance guidelines;
- **Alignment:** Determining how to deliver demonstrable alignment between performance and pay, with a particular focus on the mix of pay, the choice of performance metrics, and the goal-setting process around those metrics;
- **Incentives:** Redesigning long-term incentive programs given shifting perceptions of the value of equity (stock options in particular), and;
- **Communication:** Engaging in more proactive, direct, open and two-way communication with shareholders about compensation philosophy and plan design.

There's also a movement toward instituting clawback policies that require management to return compensation that's later found to have been based on inaccurate financial results. Another emerging best practice is the use of stock-retention policies, which require top managers to maintain significant stock holdings until or through retirement, which helps them maintain an alignment of interest with shareholders, explains Laura Thatcher, leader of law firm Alston & Bird's executive compensation practice.

Movement in the Right Direction

Peruse some corporate proxy materials, and you'll find evidence of real change. "The proxy materials for Boeing (BA) and American Express (AXP) are two good examples of companies where they have completely revamped their executive compensation system within the last two years," says David Howard, counsel with the Business & Tax Group of law firm Hoge Fenton Jones & Appel.

"They detail their new compensation formulas for their directors, CEO and named executive officers," says Howard. "Bonuses are out. At-risk compensation is in. There are short-term performance measures, intermediate measures and long-term measures. They have compensation plans that seem to be tied to performance. They require the top executives to participate in the ownership and have their compensation in excess of basic compensation be at-risk with meaningful performance based standards. This is where most companies will want to be."

What's already becoming clear, says Rose Marie Orens, senior partner with Compensation Advisory Partners, is that "performance-based programs will be more prevalent after the last two-year hiatus."

Among the unexpected beneficiaries of all this compensation turmoil are charities. "One of the interesting techniques out there right now is offering additional compensation for the CEO's charity of choice. That's a win-win for all," says Mitchell Rosenberg, an organizational psychologist with consulting firm M.M. Rosenberg & Associates.

But do the steps being taken go far enough? Paul Sorbera, president of Alliance Consulting, would argue that they could be going too far. "My concern is that in putting pressure on these firms' pay policies, top performers are at risk of being hired away by foreign firms. That's bad business and bad politics."

However, in many quarters experts say all the changes are movement in the right direction. Yet plenty of work remains to be done.

Transparency and Independence

"The compensation committee of the board needs to be made up of active, informed experts who are not indebted to the firm's internal power structure. This is tricky at best to accomplish, but it should be given every priority," says Diane Swanson, professor of management and chair of the Business Ethics Education Initiative at Kansas State University.

Not to be left out of the repair process is human resources departments. "They need to undertake periodic benchmarking of compensation across the industry. This will help to ensure that, while the compensation plan is being appropriately managed with respect to risk, it is also satisfying the objective of attracting and retaining talent at the company," says Karen DeToro, a senior manager at Deloitte Consulting.

Managers of large institutional funds need to continue to track executive pay in terms of financial performance and publish the results, says Swanson. "They need to follow up by considering this information in their investment choices. This practice speaks loudly to Wall Street," she adds.

Then too, more "say for pay" resolutions need to be adopted by corporations so that shareholders are fully informed about executive pay decisions and have the opportunity to voice their opinions and have input into the decision making. "The more transparency the better," says Swanson. "Since shareholders technically own the corporation, they have the right to know how their money is spent."

And if corporations don't get with the program, she says, "they risk a breach of trust with society and a backlash that includes more government oversight."