

# The Current Environment

ENGAGED DIRECTORS.  
EFFECTIVE BOARDS.



## Top Issues from the 2009 NACD Governance Survey

Financial oversight moved up four places in 2009. Risk oversight placed 6<sup>th</sup> in terms of importance, up eight spots since 2008.

1. Strategic Planning

55.9%

2. Corporate Performance

54.6%

3. Financial Oversight

47.4%

4. CEO Evaluation

47.0%

5. CEO Succession

44.6%

## An Improving Market, an Uncertain Future

- Recovery looms, legislation also
  - Signs of an improving market
  - A cascade of legislation affecting corporate governance
  - Populist atmosphere in the Beltway
- Executive compensation under scrutiny

## Executive Compensation in the Spotlight

- New scrutiny on bank executives regarding pay practices
- New compensation oversight practices
  - Treasury Department, Special Master for TARP Executive Compensation Kenneth Feinberg
  - The Federal Reserve

## The Treasury's Compensation Determinations

- Base salaries
  - Cash is capped at \$500,000, remaining base salary to be paid in company stock

- Stock is immediately vested

However...

- Stock may only be sold in 1/3 installments beginning in 2011, unless TARP is repaid earlier

## The Treasury's Compensation Determinations (cont'd)

- Incentive Compensation
  - Paid in restricted stock
    - Requires achievement of objective goals set in consultation with the Special Master
      - Achievement of goals must be certified by each company's compensation committee
    - Incentive awards paid only if employee stays with company for 3 years
    - Award will not be paid unless company repays its TARP obligations

## The Treasury's Compensation Determinations (cont'd)

- Additional restrictions
  - Perquisites capped at \$25,000
  - Golden parachutes
    - Restrictions extended beyond top 5 employees to top 20 employees
  - SERPs
    - Additional accruals prohibited

## The Federal Reserve

- The Federal Reserve is initiating two programs to review pay practices of both large and smaller banking organizations
  - Review of 28 large, complex banking organizations
  - Also, review practices at community/regional banks
- Bank regulators will review each firm's pay practices to determine “consistency with the principles for risk-appropriate incentive compensation”
- Banks set their own compensation, but give the Federal Reserve veto power over pay practices

## The Federal Reserve's Review Process

- Large banking organizations must provide information on:
  - The structure of the organization's current incentive comp.
  - Processes the organization uses to oversee comp. arrangements
  - Plans for improving the risk-sensitivity of comp. arrangements and related risk management controls and corporate governance practices.
- Community and regional banking organizations
  - The Fed will review comp. arrangements as part of the risk management review process during the regular risk-focused examination process

## The Federal Reserve's Pay Principles

- Incentive compensation arrangements at banks should:
  - Provide employees incentives that do not encourage excessive risk-taking beyond company's ability to manage risk
  - Be compatible with effective controls and risk management
  - Be supported by strong corporate governance, including active and effective oversight by the ***organization's board of directors***
    - Boards should oversee incentive comp. arrangements
    - Boards should monitor performance, regularly review comp. design
    - Composition & resources of board should permit effective oversight
    - Disclosure practices should support safe and sound comp.

## Hitting Bottom?

- Have we hit the Great Recession's bottom?
- Job losses eased
- The Dow's amazing recovery
- Negative housing market trends may be moderating
  - Housing prices in the US climbed 5% in Q2

**Recovery looms, but...**

## A Cascade of Legislation and Regulations

- Shareholder Bill of Rights Act of 2009 (Schumer)
- Shareholder Empowerment Act (Peters)
- Compensation Fairness Act (Frank)
- Investor Protection Act (Treasury)
- Corporate Governance Reform Act (Ellison)
- Cap Executive Pay Act (McCaskill)
- Excessive Pay Shareholder Approval Act (Durbin)
- Stock Option Deduction Act (Levin)
- Various regulations from the SEC

# The Current Environment

	Proxy Access	Risk Committee	Say-on-Pay	Majority Vote	Independent Board Chair	Mandatory CRO	Limits on Compensation	Independent Compensation Committee
Shareholder Bill of Rights	✓	✓	✓	✓	✓			
Compensation Fairness Act			✓					✓
Cap Executive Pay Act							✓	
Shareholder Empowerment Act	✓		✓	✓	✓			✓
Excessive Pay Shareholder Act							✓	
Corp. Governance Reform Act		✓	✓		✓	✓		✓

# The Current Environment

	Introduced by	Major Action	Expected Debate	Expected Passage
<b>Shareholder Bill of Rights</b>	Sen. Schumer		Q1 2010	Q1 2010?
<b>Compensation Fairness Act</b>	Rep. Frank	Passed House	Nov/Dec 2009	Q1 2010?
<b>Cap Executive Pay Act</b>	Sen. McCaskill			N/A
<b>Shareholder Empowerment Act</b>	Rep. Peters			N/A
<b>Excessive Pay Shareholder Act</b>	Sen. Durbin			N/A
<b>Corp. Governance Reform Act</b>	Rep. Ellison			N/A

## Possible Legislative Proposals

- Say-on-pay
- Proxy access
- Use of independent comp. advisors
- No classified boards
- Limits on compensation
- Restrictions on severance pay
- Independent comp. committees
- Use of chief risk officers
- Clawbacks of unearned compensation
- Limits on deductions for stock option compensation

## Additional SEC Regulations and Proposals

- Current Regulations
  - Elimination of broker discretionary voting (NYSE rule 452)
- Proposals
  - Increased disclosure for the following:
    - Overall compensation policies and impact on risk-taking
    - Stock and option awards for executives
    - Director and nominee qualifications
    - Company leadership structure
    - Board's role in the risk management process
  - Proxy access

## Still on the SEC agenda

- Increased regulation of market professionals and intermediaries
  - Register hedge fund advisers and hedge funds
  - Increased disclosure around asset-backed securities
  - Increased disclosure from credit rating agencies
  - Restrictions on money market funds
  - Increased information regarding municipal securities
- “Proxy plumbing”
  - NOBO/OBO rules
  - Over and empty voting

## Possible Rating Agency Reforms from the SEC

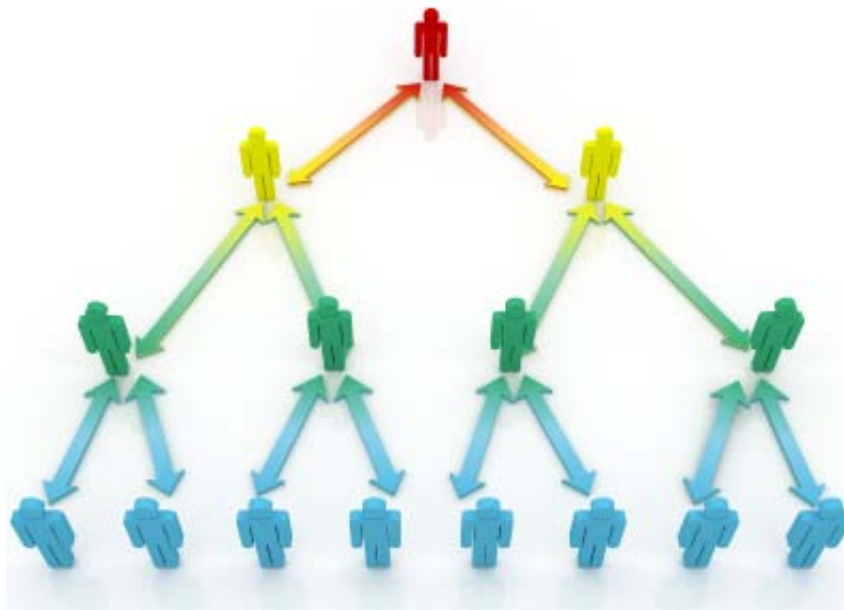
- Greater information concerning ratings histories
- Stronger compliance programs and enhanced disclosure
- Require disclosure of information including what a credit rating covers
- Remove exemption for NRSROs from being treated as experts

## Financial Stability Board (FSB)

- International financial regulators from the largest economies
- Creates standards to guide financial institutions in executive pay, capital requirements, hedge funds, and tax havens
- FSB may become a financial overseer of all G-20 economies
- Will likely have strong influence on U.S. regulation of exec. comp
- FSB wants compensation closely tied to corporate governance and risk management

## CEO Succession Planning

- Departures down for six straight months, small uptick in August
  - 101 CEOs left in August; 105 left in September\*
- CEO departures are down 17% from 2008 levels



\*Challenger, Gray, and Christmas, Inc.

# What Can Directors Do?

- Legislation and regulation is going to happen – **it is a matter of “when” not “if”**
- There is an opportunity to **lessen government intervention** if the director community shows it is doing its part.
- Boards can **minimize the negative implications** of new rules by taking proactive measures now.

## Leading the Way: Directors Strengthening Corporate Governance

### *NACD's Campaign to Restore Public and Investor Confidence*

- NACD's campaign is about helping **boards of directors actively lead** in the process of restoring confidence
- It calls upon every board and director to **review current corporate governance practices and to commit to ongoing board development**, using the *NACD Key Agreed Principles for the Governance of U.S. Publicly Traded Companies* as a framework

## 1. Download, Share & Schedule

- Add the Principles to the agenda of an upcoming nominating & governance committee meeting

## 2. Discuss and Review

- Compare your board's practices with the Principles using the worksheet in the Boardroom Discussion Guide – can your processes be aligned with the Principles for a greater competitive advantage?

## 3. Commit and Connect

- Commit to ongoing board development, and let NACD know when you've completed your review so we can demonstrate that collectively, directors are taking action

[www.nacdonline.org/directorchallenge](http://www.nacdonline.org/directorchallenge)

## The Key Agreed Principles

- Provide a consistent framework for reviewing governance practices
- Represent areas of consensus among board, shareholder and management organizations – boards can use them with *confidence*.
- Are intended to improve the quality of boardroom discussion and debate around the most critical areas of governance
- Support flexibility and reject “box-ticking”

# Why Participate in the Campaign?

## Improve Your Own Board's Effectiveness

- better board process and information flow
- increased strategic engagement
- clearer expectations among all parties in the governance process.

## An Alternative to Prescriptive Solutions

- You'll also be demonstrating to policymakers and shareholders that governance and oversight excellence must and will be led by directors themselves.

## A National Movement...

- 3000+ downloads of Campaign materials
- All members of Congress have received copies of NACD's Key Agreed Principles
- Home Depot, Aetna, UnitedHealth and other boards have adopted the NACD Key Agreed Principles
- 1B media impressions of the Campaign, including *WSJ*, *NYT*, *CNN*, *MSNBC*

# Time is of the Essence

- Your board can **minimize the negative implications** of new rules by taking proactive measures now.
- Boards that engage with the Principles will benefit from **improved effectiveness, better communication**, and more.

***We urge you to get involved in the  
Director's Challenge **today*****

- **The NACD Key Agreed Principles:** a framework, not a prescription
- **Discussion Guide:** in-boardroom discussion of the Principles
- **White Papers:** fresh thinking on executive compensation, risk oversight, corporate strategy and transparency
- **NACD's Board Advisory Services:** in-boardroom evaluations and education
- **Blue Ribbon Commission Reports:** deep dives into recommendations for specific topics

## Recommendations from the 2009 BRC Report on Risk Governance

- Encourage management to pursue risk as a means to generate sustainable corporate value or performance
- Ensure that full boards have primary responsibility for risk
- Establish acceptable levels of volatility for each business unit
- Understand the aggregate impact of risk exposure
- Make sure the board culture encourages dynamic interaction



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**Thank You**