



The Next Generation of Performance Plans? Fixing Governance Ups and Downs

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Agenda

- ❖ Why Performance Awards?
- ❖ Who Determines Governance Standards?
- ❖ The Governance Issues with Performance Plans
- ❖ The Solutions



Why Performance Awards?

- ❖ Another flat market
- ❖ Growth companies grew up
- ❖ Accounting rule changes “leveled the playing field”
- ❖ Volatility did not necessarily make options more valuable
- ❖ RSUs came to the rescue
- ❖ Pay without performance continued
- ❖ Global changes in governance mandated change (Say on Pay)
- ❖ Line of sight was lacking
- ❖ 162(m)



Who Determines Governance Standards?

Source	Examples
Independent Advisers	Institutional Shareholder Services, Governance Metrics International, Glass Lewis
Institutional Investors	Fidelity, Vanguard, Association of British Insurers, National Association of Pension Funds
Legislation	Sarbanes Oxley, Dodd-Frank, US Tax Code, UK Remuneration Code
Regulation	US Securities and Exchange Commission, NYSE, NASDAQ, LSE
Labor Unions	AFL-CIO, SEIU, United Auto Workers
Litigation	Disney, NYSE, Broadcom
Media	Wall Street Journal, USA Today, Financial Times, Bloomberg



The Governance Issues

- ❖ Lowball goals
- ❖ Valuation-based compensation numbers
- ❖ Annual incentive plans hiding in an “LTI”
- ❖ Relative TSR – timing of adoption
- ❖ Relative TSR – payout with negative absolute TSR
- ❖ Selection of peer group/index



The Governance Issues

- ❖ Financial performance measures that don't support value creation
- ❖ Non-GAAP measures
- ❖ Board/Committee discretion
- ❖ Interim milestone-based goals
- ❖ Vague subjective goals and activities



The Governance Issues

2011-2012

Exhibit C

Daily/Weekly:

- Check Smith Barney and Wells Fargo Daily; process ACH and any option exercises
- Enter Bank Book entries/Reconcile Bank Account
- Stock Administration
- Prepare and file Form 4s
- Process employee stock purchase each 6 months
- Upload files to Smith Barney - grants, tax withholding, vesting
- Update/Perform/Review Financial and IT internal controls testing and related documentation
- Supervise AP, Payroll, Fixed Assets
- Signing checks/processing wires
- Provide weekly cash forecast
- Provide weekly cash amount to transfer
- Script writing/Testing of system upgrades as needed
- Prepare/Submit Surveys
- Review of contracts

Monthly Close:

- Prepare and Input all entries and reconcile all accounts
- Prepare monthly reporting package - update monthly department expense breakdown/
project summary report/review headcount reports

Quarterly Reporting:

- Prepare financial statements and flux analysis/put together reporting binder
- Manage quarterly review with auditors
- Close meeting/memo
- Review/tie out of 10Q and earnings release
- Prepare/review quarterly site payments and related accrual



The Governance Issues

- ❖ Mid-cycle modifications to goals
- ❖ After-the fact-overrides
- ❖ Liberal termination provisions
- ❖ Liberal change-in-control provisions
- ❖ Unnecessary complexity



The Governance Issues

In **April 2008**, Mr. Smith received a grant of **2,555 restricted shares**, which **vest on January 30, 2009 and on April 30, 2009** with respect to **7 shares per day providing** Mr. Lucien **remains employed** by the Company and subject to the **achievement by the Company of positive net income**. The terms of Mr. Lucien's grant also provide that, on any date that a tranche of restricted shares is scheduled to vest, if the Company has achieved positive net income **and at least one of the following two performance objectives** for the fiscal period: (1) the Company's Total Shareholder Return ("**TSR**") **either exceeds 10% or falls within the top quartile** of the Mid-Cap Bank Performance Index, **or** (2) the Company's earnings per share ("**EPS**") **for any fiscal period increases by 8% or more** over the Company's EPS for the same period in the prior fiscal year, the number of shares that will vest will be **10.5 shares per day**. On January 30, 2009, Mr. Lucien became vested in 1,750 shares under this grant.



The Governance Issues

- ❖ Total cost of operation
- ❖ Part of the “LTI Portfolio”
- ❖ Allowing 83(b) elections
- ❖ Administration on spreadsheets



The Solutions

- ❖ Focus on integrated design
 - ❖ Performance plan shouldn't "stand alone"
 - ❖ How does performance award interact with
 - ❖ Other forms of equity
 - ❖ Cash compensation
 - ❖ Deferred compensation
 - ❖ Stock ownership guidelines



The Solutions

- ❖ Keep it simple
 - ❖ Stock options and RSUs may be criticized, but they are simple
 - ❖ Program that is easy to understand by participants, investors, proxy advisors, and media
 - ❖ Positive corporate governance tactic
 - ❖ Misunderstanding and miscommunication of companies' pay programs is widespread



The Solutions

- ❖ Focus on the real governance issues
 - ❖ In say-on-pay environment, companies need to choose their battles
 - ❖ Impossible to meet the preferences of all investors and their various proxy advisors
 - ❖ Companies must understand what will and won't satisfy their key investor base
 - ❖ Move forward with those features
 - ❖ Focus on strategy with good communication to investors about that focus



The Solutions

- ❖ Put strategy over market data
 - ❖ Not useful to base design decisions on survey data that tells “what other companies are doing”
 - ❖ Data may be outdated
 - ❖ Plans may have been unsuccessful
 - ❖ Great variation in performance plan design not captured by existing surveys
 - ❖ Data can lead to erroneous conclusions



The Solutions

- ❖ Use an integrated process
 - ❖ Avoid top-down design process
 - ❖ Involve more people in the design process (include stock plans and accounting)
 - ❖ Everyone's best interest to involve more people
 - ❖ Transcend obsession for independence to exclusion of business strategy, culture, organizational needs, and administrative constraints
 - ❖ Educate up to “get a seat at the table”



The Solutions

- ❖ Rethink Communication
 - ❖ Performance plans are designed to motivate behavior
 - ❖ If the plan is well designed but poorly communicated, impossible to motivate desired behavior
 - ❖ Ask other, non-stock plan personnel to review communications
 - ❖ Remind personnel about the goals and their progress (or lack thereof) toward the goals



The Solutions

- ❖ Rethink Communication (continued)
 - ❖ Approach depends on number of participants
 - ❖ Survey participants
 - ❖ Gauge understanding and value
 - ❖ Webinars (live and recorded)
 - ❖ In-person/brown bag meetings
 - ❖ Examples
 - ❖ FAQs
 - ❖ Use tables, graphs and graphics in communications



The Solutions

- ❖ Define and adhere to standard processes
 - ❖ Assessment and certification process should be formulaic, not ad-hoc
 - ❖ Do you have a grant date? If you have too much discretion in “certification”?
 - ❖ Once performance plan is in place – draft assessment and certification process
 - ❖ Much simpler with formulaic, relative plans
 - ❖ Flow charts, swim lanes or color coding, can help
 - ❖ Ask others, including other departments, to review and sign off



The Solutions

- ❖ Assess System Capabilities
 - ❖ Talk to your provider about what your stock plan system can (and can't) support
 - ❖ Get several opinions
 - ❖ Network
 - ❖ Post your questions to a user group
 - ❖ Talk to others with similar designs
 - ❖ Develop standardized workarounds for things your system can't support
 - ❖ From accounting to communication, automation will produce better, less risky results
 - ❖ Custom reports, Access queries, Mail Merge, Intranet information
 - ❖ Document processes



The Solutions

- ❖ **Assess System Capabilities** (continued)
 - ❖ When evaluating new systems, ask them to show you how it works with a grant similar to yours
 - ❖ End-to-end process from grant to financial reporting



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