

Two Nations Divided by a Common Language - Corporate Governance Influences in the US and UK

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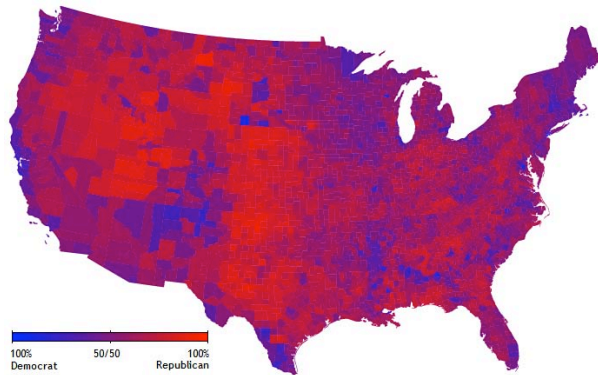


Discussion Topics

- Is compensation governance culture affected by national culture?
- Who are the influencers?
- What are their philosophies and positions?
- How is this affecting equity plan design now and in the future?
- Overview of policy details
- Looking forward to next year

National Culture

The US Political Dichotomy – a Standoff



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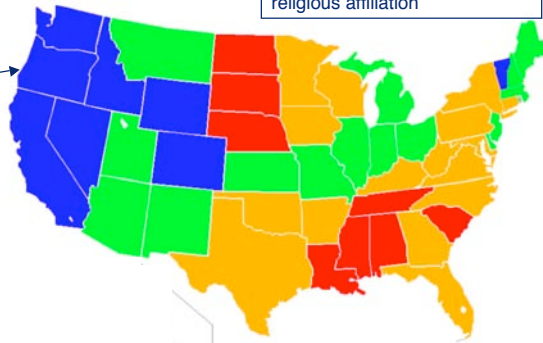
National Culture

The US Religious Dispersion – Affecting Political Alignment

Nationally: 20% claim no religious affiliation

Pacific Northwest: 60% claim no religious affiliation

Blue: > 20% claim no religious affiliation
Green: >15% claim no religious affiliation
Orange: > 10% claim no religious affiliation
Red: <10% claim no religious affiliation



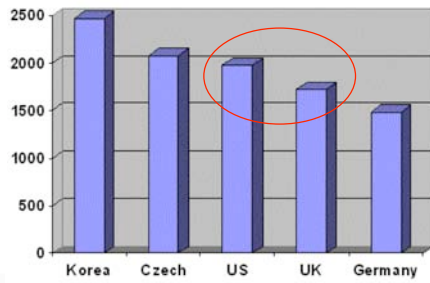
Three out of five UK adults have a religious affiliation.

The remaining two fifths (39%), 19 million adults, say they have no religion.

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National Culture

Work Culture

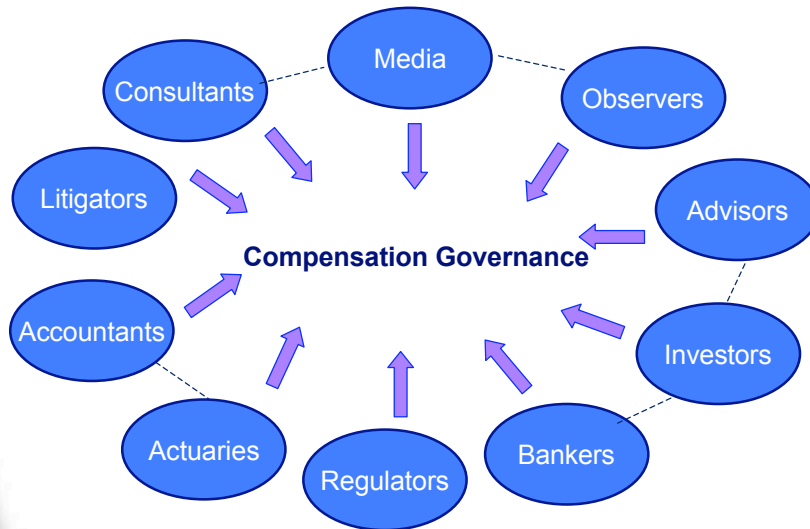


"Workers in the United States are putting in more hours than anyone else in the industrialized world."

Lawrence Jeff Johnson -- the chief labor market economist who has led the ILO team in producing its new "Key Indicators of the Labor Market 2001-2002" study -- also says American workers are, per person, more productive than their counterparts in other countries.

The United Nations' International Labor Organization (ILO)

Who are the Influencers?



Key players: Regulators

<i>Regulators</i>	UK	USA
Government	Department of Trade and Industry	SEC
		Dept of Justice
		Congress
		Dept of Treasury-IRS
Quasi-Government	Financial Standards Authority	FASB
	ASB and IASB	PCAOB

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Key players: Investors

<i>Investors</i>	UK	USA
Pension	HERMES	CalPERS
	NAPF	Wisconsin Board
	PIRC	TIAA-CREF
		CalSTRS
Investment Firms	ABI	Fidelity
	Standard Life	Putnam
	Morley	Vanguard
	Fidelity	Dimensional
	Legal & General	Legg Mason

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Key players: Advisers

<i>Advisors/Advocates</i>	UK	USA
	ISS/RREV	ISS/IRRC
	Manifest	Proxy Advisors
		Glass Lewis
		Moody's

Recent Developments:

- ISS acquired by RiskMetrics Group (January 2007) – IPO planned?
- Glass Lewis acquired by Xinhua Finance of China

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Key players: Critics

<i>Influencers</i>	UK	USA
	Media	Labor Unions
		Media
		Commentators

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Points of Contention

Content

- Dilution (overhang, run rate, re-use of shares)
- Severance and golden parachutes (conditions and amounts)
- Excessive perquisites (cost, purpose)
- Supplemental retirement and deferred compensation (amount)
- Performance measures (EPS, level of difficulty)
- Tactics (vesting acceleration, backdating, option valuation)



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Points of Contention

Process

- Shareholder approval
- Board elections
- Consultant relationships
- Insider relationships
- Disclosure
- Peer group references



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Let's compare: Background assumptions and themes

• US perspective

- There is a competitive market for executive talent
- If you do not pay appropriately you will not hire the best
- Although the numbers for a given CEO may be large they are totally immaterial in the context of wealth created by the CEO
- There is no embarrassment at earning huge sums of money – tens to hundreds of millions of dollars

• UK perspective

- The market is not perfect – there is a shortage of talent and paying more does not necessarily increase the supply of talent
- Some of the wealth created is by factors entirely external to the company and management performance e.g. the oil price
- UK corporate governance requires very detailed disclosure of packages – some of the large numbers are embarrassing in the British context – it is easier to go to a private equity house and avoid detailed disclosure of earnings

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Let's Compare: Options are pay for performance

US Perspective (pre-Enron)

- Options are pay for performance (good) restricted stock is pay for attendance (bad)
- Accounting issues prior to FAS123R have mitigated against options with performance targets (would have been good)

US Perspective (2002-2006)

- Options encourage high-risk behaviors (bad)
- Options create no downside risk (bad) or real ownership (bad)
- Restricted stock avoids those problems (good)

US Perspective (2006-2007)

- Restricted stock is pay for attendance (bad) and should have performance conditions attached
If combined with performance shares, options are an appropriate element of the LTI portfolio

UK perspective

- Options are not pay for performance – they are a free ride and usually bound to pay out over a ten year life especially with annual grants
- Since 1987 shareholders have insisted on options having performance hurdles applied to them
- Typical targets are EPS growth requirements of 9% - 15% above inflation over a three year performance period
- Performance shares typically have comparative TSR targets with outperformance required for vesting
- Restricted Stock use is very rare
- Accounting has never been an issue

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Let's Compare: Restricted stock is pay at risk

US Perspective

- Restricted stock avoids over-reliance on the price at grant date
- Restricted stock creates ownership

Or...

- Restricted stock is "pay for attendance", stock-denominated salary
- Restricted stock was an amateurish way to create immediate compliance with new "ownership guidelines"

UK perspective

- Restricted stock is just pay in another form
- Delivery in the form of shares gives alignment but not risk as such



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Let's Compare: Shareholder approval for stock plans

US perspective (old)

- Always applied to qualified plans
- Since June 2003 has been a NYSE/NASDAQ requirement

US perspective (new)

- Shareholder approval is an after-the-fact confirmation of previous discussions
- Companies can still use "inducement award" loophole for non-approved awards
- Companies must do a pre-IPO-type "roadshow" to "sell" the program
- ISS is a point of view that doesn't apply to all companies
- The investors driving the vote are the investors

UK perspective

- Dilutive stock plans have always needed shareholder approval
- UK shareholders publish their guidelines for acceptable dilution levels
- 10% dilution in a ten year period is maximum acceptable for all plans and 5% dilution in ten years is guideline for executive plans
- Shareholders vote – they also name and shame in newspaper articles



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Let's Compare: Shareholders vote on board elections

US perspective

- Shareholders votes do not count – as long as 1 share has voted in favour of a director a majority against is ignored
- Very few top executives sit on the board often on CEO and Chairman
- CEO/Chairman role is combined in over 60% of public companies

UK perspective

- Every vote counts – a majority against mean that the individual is not elected to the board
- Many top executives sit on the board – most of the C-suite
- CEO and Chairman roles are filled by different individuals
- Progression from CEO to Chairman is frowned upon

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Let's Compare: Change of Control philosophies

US perspective

- COC payments originally justified to ensure alignment of management with current shareholders in takeover situations
- Objective is to remove from the CEO's mind concern about his future position so that he can concentrate on what is best for Company and shareholders
- COC provisions have evolved to become an element of pay
- COC at 2 to 3 x base + target bonus is accepted as reasonable
- Acceleration of vesting – single or double trigger – is present in most plans

UK perspective

- COC happens because the top management team has failed to deliver, the share price has fallen, shareholders have lost money
- Shareholders hate to see the management team rewarded for failure
- 1 x base salary is maximum COC payment acceptable, anything greater will be voted against see Glaxo SmithKline's J P Garnier

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Let's Compare: Disclosure of pay

US perspective

- Top 5 disclosed since 1980s
- Increased disclosure in 1990s
- Addition of 8-K disclosures in 2004- more information than in the proxy
- New proxy disclosure rules for 2007
- Philosophy = transparency in lieu of regulation
 - Let the market decide
- Reaction = numbers need to be recalculated

UK perspective

- Pay has gone up
- Positioning of base is now mainly around the median
- Performance drives additional annual and long-term incentive vesting
- Disclosure is much more detailed since disclosure regulations of 2002
- Shareholders get an advisory vote on Remuneration Report – see GlaxoSmithKline



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Questions?

Thank you for your participation



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Appendix

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Voting on the Committee Report

- Non-binding votes matter
- A negative vote is a very strong message from the owners to management that action needs to be taken
- First example – GlaxosmithKline in connection with potential CoC/termination payments for Chief Executive
 - Company made necessary adjustments the following year
- There have been some notable cases where companies have lost these votes including:
 - Aegis, First Choice, GSK, Prudential, Slough Estates
- Possibly prior consultation was inadequate or failed to identify where shareholders had significant concerns.

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The Directors' Remuneration Report Regulations 2002

- A relatively short set of Regulations compared with the US version – some 17 pages long
- Divided into 4 main sections
 - The policy section – not subject to audit, paragraphs 2, 3 & 5
 - The performance graph, paragraph 4
 - The audited section – actual pay from years just ended, paragraphs 6 to 15
 - Interpretation, paragraphs 16 to 21
- The directors' remuneration report shall -
 - (a) name each director who was a member of the compensation committee
 - (b) name any person who provided to the committee advice, or services, that materially assisted the committee in their consideration of any such matter;
 - (c) in the case of any person named under paragraph (b), who is not a director of the company, state -
 - (i) the nature of any other services that that person has provided to the company during the relevant financial year; and
 - (ii) whether that person was appointed by the committee

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Paragraph 3 - Statement of company's policy on directors' remuneration

- **3. - (1)** The directors' remuneration report shall contain a statement of the company's policy on directors' remuneration for the following financial year and for financial years subsequent to that.
 - (2) The policy statement shall include -
 - (a) for each director, a detailed summary of any performance conditions to which any entitlement of the director -
 - (i) to share options, or
 - (ii) under a long-term incentive scheme,
 - is subject;
 - (b) an explanation as to why any such performance conditions were chosen;
 - (c) a summary of the methods to be used in assessing whether any such performance conditions are met and an explanation as to why those methods were chosen;

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Paragraph 3 continued

- **Statement of company's policy on directors' remuneration**

if any entitlement of a director to share options, or under a long-term incentive scheme, is not subject to performance conditions, an explanation as to why that is the case.

- (3) The policy statement shall, in respect of each director's terms and conditions relating to remuneration, explain the relative importance of those elements which are, and those which are not, related to performance.
- (4) The policy statement shall summarise, and explain, the company's policy on -
 - (a) the duration of contracts with directors, and
 - (b) notice periods, and termination payments, under such contracts



ABI Guidelines – 5 Core Principles

- Boards are responsible for adopting remuneration policies and practices that promote the success of companies in creating value for shareholders over the longer term. The policies and practices should be demonstrably aligned with the corporate objectives and business strategy and reviewed regularly.
- Remuneration Committees should be established in accordance with the provisions of the Combined Code. They should comprise independent directors who bring independent thought and scrutiny to all aspects of remuneration. It is important to maintain a constructive and timely dialogue between boards and shareholders regarding remuneration policies and practices.
- Executive remuneration should be set at levels that retain and motivate, based on selection and interpretation of appropriate benchmarks. Such benchmarks should be used with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.
- Executive remuneration should be linked to individual and corporate performance through graduated targets, that align the interests of executives with those of shareholders. The resulting arrangements should be clear and readily understandable.
- Shareholders will not support arrangements which entitle executives to reward when this is not justified by performance. Remuneration Committees should ensure that service contracts contain provisions that are consistent with this principle.

