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At a Glance

Companies are starting to shift to broader changes to executive pay as a result of the current economic crisis.

Long-term incentive grant dollars are down in 2009, and companies are changing performance metrics for the plans.

While companies are concerned about issues concerning “excessive risk,” most companies have yet to take action.

Effect of the Economy on Executive Compensation Programs

Update: March 2009

About the Survey

In early March 2009, Watson Wyatt surveyed 145 HR and compensation executives at large U.S.-based organizations to understand what effect the economy is having on their executive pay programs.

Executive Summary

Companies are making more dramatic adjustments to their executive pay programs in recognition of the recession and financial markets’ decline. Since our December 2008 survey, companies have extended cost-management actions to multiple programs. In step with measures organizations are taking with their broad-based employee programs, more than half of respondents (55 percent) have frozen executive salaries, ten percent have reduced executive salaries, and annual incentive plans are declining. Companies are also adding clawback programs and examining their performance metrics for annual and long-term incentive plans.

Companies are concerned about issues related to “excessive risk.” However, most companies have yet to take action.

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Key Findings

- Fifty-five percent of respondents have frozen salaries – 34 percentage points higher than reported in the December 2008 survey (21 percent).
- Twenty percent of respondents have reduced or are considering reducing salaries versus only 8 percent in the December 2008 survey.
- Thirty-eight percent are making changes to their annual incentive plan performance measures and 30 percent are making changes to their long-term incentive plan measures.
- About one-third of respondents are shifting toward time-based restricted stock and performance-based shares.
- One-third of respondents are reducing their long-term incentive grant values.
- Only 1 percent of respondents have taken action on underwater stock options, although 17 percent are considering doing so.
- About one in three organizations have changed or are considering changes in their executive pay programs to address "excessive risk."

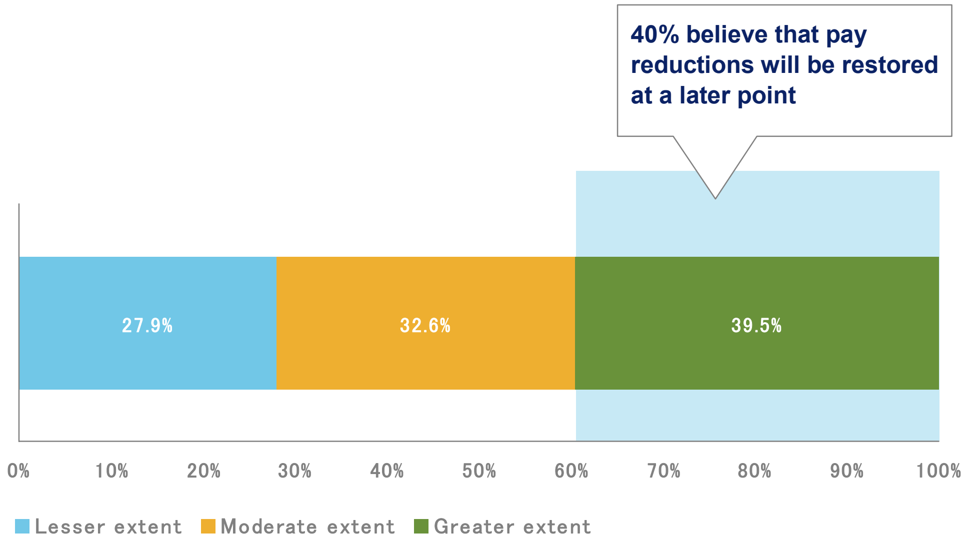
The most common actions taken include freezing salaries, decreasing merit budgets, delaying merit increases and adopting clawback policies.

Figure 1 | Given the recent events in the economy and financial markets, what changes has your organization made/expect to make to your 2009 executive pay programs?

	HAVE ALREADY MADE CHANGE		CONSIDERING A CHANGE		EXPECT TO MAKE CHANGE IN NEXT 12 MONTHS		NO CHANGE EXPECTED	
	March 2009	December 2008	March 2009	December 2008	March 2009	December 2008	March 2009	December 2008
Base Salary/Merit Increases								
Freeze salaries	55%	21%	8%	3%	3%	20%	35%	56%
Decrease planned merit increases	48%	30%	11%	9%	5%	35%	36%	26%
Delay planned merit increases	23%	13%	7%	3%	3%	17%	67%	67%
Reduce salaries	10%	2%	10%	0%	3%	6%	76%	92%
Annual Incentives								
Implement a discretionary plan	10%	n/a	10%	n/a	0%	n/a	80%	n/a
Reduce target bonus opportunities	9%	4%	9%	8%	1%	4%	81%	84%
Reduce bonus plan eligibility or participation	7%	3%	5%	5%	1%	3%	87%	89%
Decreasing the maximum award opportunity	7%	n/a	6%	n/a	1%	n/a	86%	n/a
Long-Term Incentives								
Reduce LTI plan eligibility or participation	12%	4%	8%	2%	4%	12%	76%	83%
Decrease the maximum award opportunity for performance-based awards	11%	n/a	8%	n/a	3%	n/a	78%	n/a
Reprice, exchange or surrender underwater stock options	0%	1%	16%	1%	0%	13%	84%	85%
Require equity grants to be held to retirement	0%	0%	3%	0%	0%	2%	97%	98%
Other Pay Programs								
Add clawback or recoupment program/policy	23%	13%	13%	1%	1%	11%	63%	75%
Cap change in control benefits to 3X the safe harbor limit	17%	n/a	3%	n/a	0%	n/a	80%	n/a
Analyze actual "realized" pay in relation to target compensation granted	16%	n/a	13%	n/a	4%	n/a	68%	n/a
Make special retention bonuses (cash or equity)	13%	9%	16%	3%	1%	21%	71%	67%

While most respondents believe that pay reductions will be temporary, almost 30 percent are not as confident.

Figure 2 | To what extent do you believe that reductions in salary, bonus and/or long-term incentives will be later restored?



Companies are expecting to make similar changes to their performance goals for annual incentive plans and long-term incentive plans compared to the December 2008 survey.

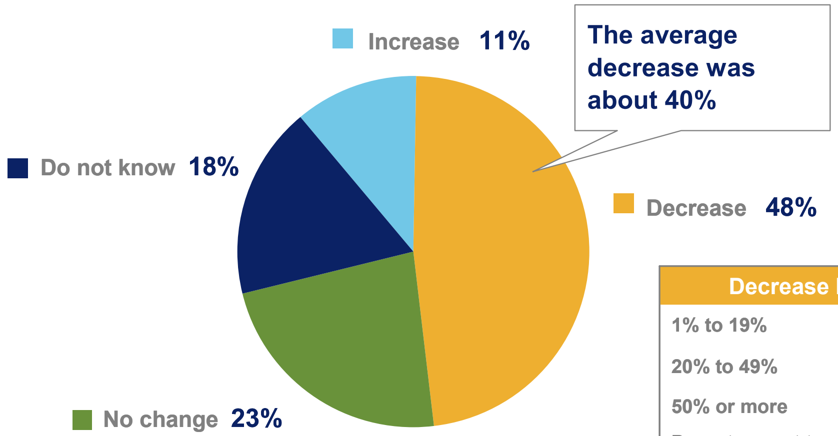
Figure 3 | What changes does your organization expect to make to performance goals for the current fiscal year's annual incentive plan and long-term performance plan?

	ANNUAL INCENTIVE PLAN	LONG-TERM PERFORMANCE PLAN
Change performance metrics	38.3%	30.2%
Raise performance goals relative to last year's actual performance	30.1%	17.9%
Lower performance goals relative to last year's actual performance	28.6%	18.9%
Decrease bonus payout for same level of performance as last year	20.3%	8.5%
Widen the incentive payout zone	18.0%	7.5%
Increase bonus payout for same level of performance as last year	8.3%	6.6%
Shorten the performance measurement period	2.3%	6.6%
No changes	19.5%	28.3%
Do not know at this time	9.8%	17.0%

In December, only 29% of companies were changing performance metrics in their annual incentive plan, and 21% in their long-term incentive plan.

Similar to our December 2008 survey, about half of the companies have decreased their bonus pool funding for the current fiscal year.

Figure 4 | Do you expect this fiscal year's bonus pool to increase or decrease over the last year's?



Decrease by:	
1% to 19%	29.7%
20% to 49%	35.9%
50% or more	17.2%
Do not expect to pay bonuses this year	17.2%

Companies changing the type of long-term incentive vehicles are placing greater emphasis on time-based restricted stock and performance-based shares.

Figure 5 | Has your organization changed, or does it plan to change, the types of long-term incentive plan vehicles used by the organization's executive pay program?

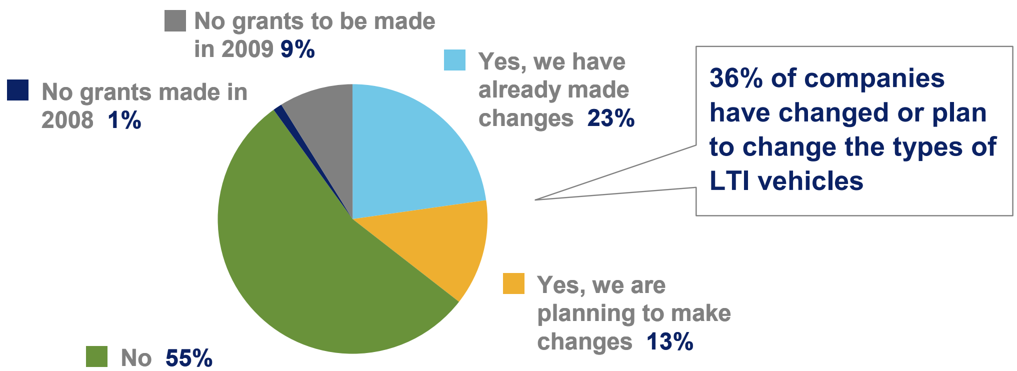


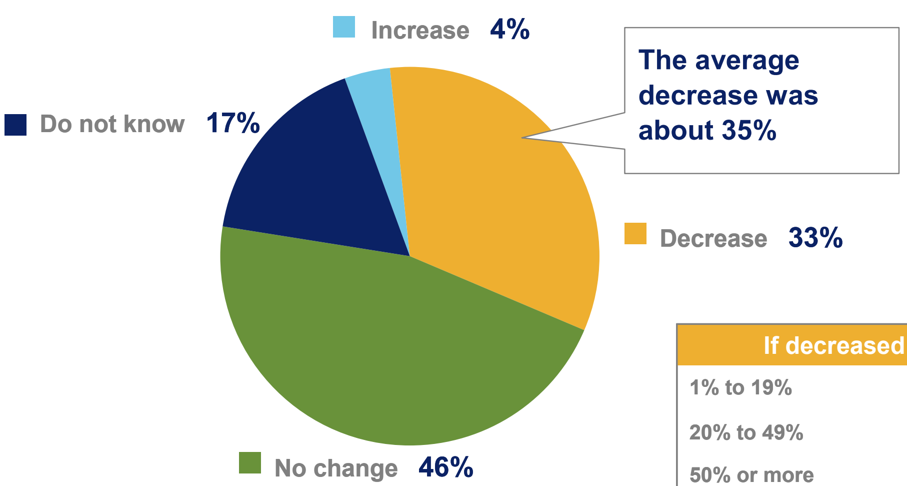
Figure 6 | If you have changed plan vehicles, how have they changed? Will the changes be a temporary or permanent program change?

Plan vehicle changes	
More emphasis on time-vested restricted stock	42.6%
More emphasis on performance-based shares	31.9%
More emphasis on performance cash plans	21.3%
More emphasis on stock options	19.1%
Do not know	14.9%

Temporary	6.1%
Permanent	40.8%
Unsure	53.1%

One-third of respondents expect to reduce their long-term incentive dollar grant values compared to the prior year – up from 23 percent in the December survey.

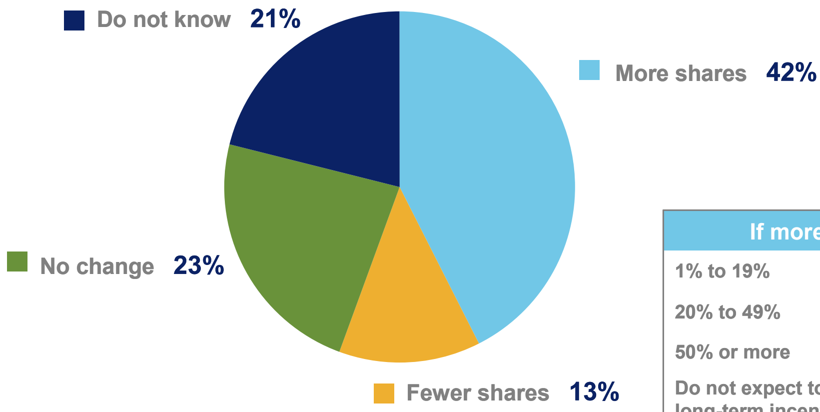
Figure 7 | Do you expect your organization's 2009 long-term incentive grant dollar values to increase or decrease over the prior year?



If decreased:	
1% to 19%	29%
20% to 49%	47%
50% or more	22%
Do not expect to pay bonuses this year	2%

Forty-two percent of respondents plan to grant more shares compared to the prior year.

Figure 8 | Does your organization plan to grant more shares or fewer shares over the prior year?



If more shares:	
1% to 19%	42%
20% to 49%	38%
50% or more	21%
Do not expect to make long-term incentive grants this year.	0%

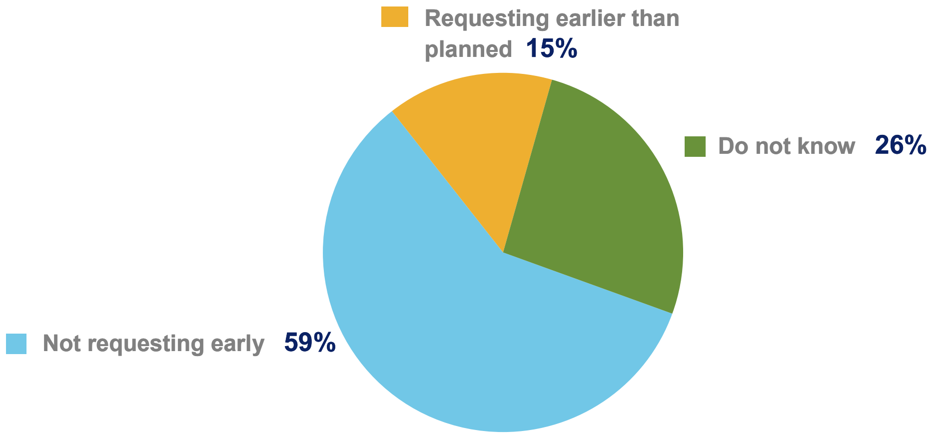
Companies that have reduced their long-term incentive dollar grant values over the prior year did so largely because it was the right thing to do in response to a decline in shareholder value, in anticipation of lower competitive values or to manage their run rates.

Figure 9 | If your organization reduced or plans to reduce long-term incentive value grants over the prior year is it primarily due to:

REASON	PERCENTAGE OF COMPANIES
Right thing to do in response to decline in shareholder value	37.1%
Expectation that competitive values will be lower given the economic conditions	33.9%
Manage run rate/dilution	32.3%
Lack of shares available in the plan	29.0%
Poor company performance	22.6%
Expect significant rebound in stock prices in the near term	1.6%
Government requirements	1.6%
Reduce motivating “excessive risk”	1.6%
Shareholder pressure	1.6%

Companies are managing with the shares they already have. Fifty-nine percent of respondents do not plan to request additional shares earlier than expected.

Figure 10 | Do you expect to request additional shares from shareholders to fund your long-term incentive equity plans earlier than planned?



Very few companies have taken action on their underwater stock options, but 17 percent are considering action in the next 12 months.

Figure 11 | Has your organization taken action on underwater stock options (such as repricing, cash buy-out, exchange for other equity or voluntary surrender) for senior executives and/or for all stock option participants?

Companies have not taken action on underwater stock options

	Yes, for all participants	Yes, but only below senior executive levels	No, but considering in the next 12 months	No	Company does not grant stock options
PERCENTAGE OF COMPANIES	1%	0%	17%	67%	15%

There is concern surrounding the effect of potential legislation/guidance in the areas of Say on Pay, expanding CD&A disclosure requirements, lowering of 162(m) limits, deferred compensation limits, and "excessive risk" in executive pay programs.

Figure 12 | To what degree is your organization concerned about effects on your executive compensation programs from the following areas of potential legislation/guidance?

	Very little concern 1	2	3	4	Significant concern 5
Say on Pay	18%	26%	33%	19%	5%
Expanded CD&A disclosures	18%	33%	37%	11%	2%
Lowering 162(m) deduction limits below $1 million	24%	28%	29%	15%	4%
Deferred compensation limits	31%	24%	28%	17%	1%
Executive programs cannot include "excessive" risk	23%	34%	32%	10%	1%
Adopting international accounting standards	34%	25%	34%	7%	0%
Capping executive salaries under TARP-type programs	44%	21%	14%	14%	8%
Golden parachute limits	38%	28%	27%	6%	1%
Expanded clawback coverage	32%	34%	23%	10%	1%

Less than 10 percent of respondents have made changes to their program to address “excessive risk.”

Figure 13 | Has your organization made or does it expect to make any of the following changes to its executive compensation program to address the issue of “excessive risk”?

Few companies have already made changes in response to “excessive risk”

	Have already made change	Expect to make change in next 12 months	Considering a change	No change expected
Adding a formal risk assessment process	9%	3%	19%	70%
Curtailing stock option grants	8%	2%	7%	83%
Certifying in the proxy that a risk assessment has been performed	7%	5%	19%	69%
Reducing maximum payouts on incentive plans	5%	0%	8%	87%
Adjusting pay mix to mitigate pay risk	2%	0%	13%	86%
Requiring mandatory deferral of cash incentive payouts	2%	0%	4%	94%
Instituting a bonus bank (deferral of cash where value rises and falls)	1%	0%	2%	97%

Conclusion

The current spotlight on executive pay has caused many companies to take a step back and think about the long-term implications of their executive pay policies. Companies appear to be taking actions that not only help their organizations control costs, but address public criticism and shareholder concern. Decisions easily made a few years ago (such as repricing underwater stock options) are more difficult to accomplish in today’s environment. In addition, companies are concerned about potential legislation and are likely to start addressing those issues – particularly around risk and clawback policies.

Watson Wyatt Worldwide

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