

Effect of the Economy on Executive Compensation Programs

About the Survey

In early December 2008, Watson Wyatt surveyed management-level HR and compensation executives at large U.S.-based companies to understand what effect the economy is having on their executive pay programs. We received 264 responses.

Executive Summary

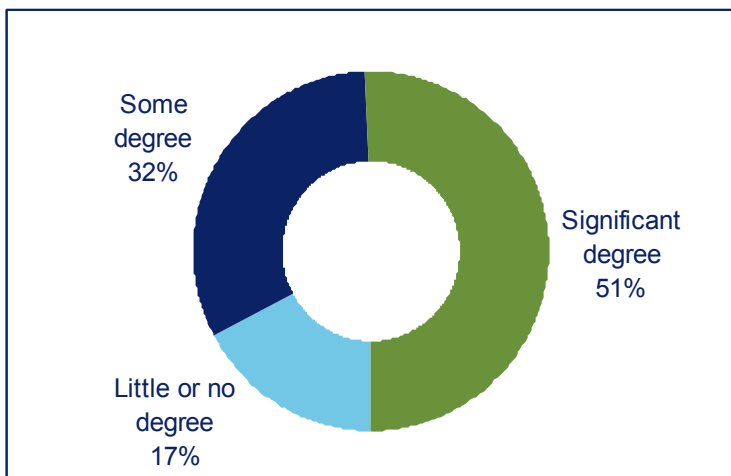
The current financial crisis is significantly affecting the executive compensation programs of most companies. Compensation committees and management are being challenged to balance their need to retain key executive talent while responding to economic and public pressures to adjust executive pay levels and program components. Overall, executives will see their compensation decrease in 2009: half of all companies surveyed will cut the size of their annual bonus pool compared to the prior year; nearly 40 percent have decreased planned merit increases or expect to do so; and almost one in four companies have frozen salaries, or expect to do so. In addition, one-quarter of companies expect to decrease the value of their longer-term incentive grants in 2009.

Key Findings

- Half of all companies (49 percent) expect their current year bonus pool to decrease from the prior year. Of those, 23 percent expect it to decrease by more than 50 percent, and 11 percent do not plan to pay any bonuses at all.
- 24 percent of companies have already frozen salaries or expect to do so, and 39 percent have already decreased or expect to decrease their planned merit raises.
- One in four companies (23 percent) expects to reduce their long-term incentive grant dollar values in 2009.
- 21 percent of companies have already reduced or eliminated perquisites or expect to do so, and another 10 percent are considering making this change.
- Despite the current economy, companies are still concerned about executive retention. 21 percent of companies are considering making special retention bonuses for their executives, and 9 percent have already made them. 13 percent of companies are considering repricings or exchanges for underwater options.

The current financial crisis has adversely affected most companies to some degree.

Figure 1 | To what degree has the current financial crisis adversely affected your organization?



The most common actions already taken are decreasing planned merit raises, salary freezes and reducing or eliminating perquisites.

Figure 2 | Given the recent events in the economy and financial markets, what changes do you expect to make to your executive pay programs?

	Have already made change	Expect to make change in next 12 months	Considering a change	No change expected
Decrease planned merit increases	30%	9%	35%	26%
Freeze salaries	21%	3%	20%	56%
Delay planned merit increases	13%	3%	17%	67%
Reduce salaries	2%	0%	6%	92%
Reduce LTI plan eligibility or participation	4%	2%	12%	83%
Reduce/eliminate deferred compensation	4%	0%	5%	91%
Reprice or exchange underwater stock options	1%	1%	13%	85%
Require equity grants to be held to retirement	0%	0%	2%	98%
Reduce/eliminate perquisites	17%	4%	10%	69%
Add clawback program/policy	13%	1%	11%	75%
Make special retention bonuses (cash or equity)	9%	3%	21%	67%
Reduce/eliminate SERPs	8%	1%	3%	88%
Eliminate/reduce change-in-control excise tax gross-ups	6%	1%	5%	88%
Eliminate change-in-control agreements	2%	0%	4%	94%
Adopt "say on pay" shareholder advisory vote	2%	1%	4%	93%

The median merit increase for executives in 2009 is 3 percent.

Figure 3 | What is the expected size of your organization's 2009 merit increase pool?

Expected 2009 increase	
Mean	3.06%
Median	3.00%

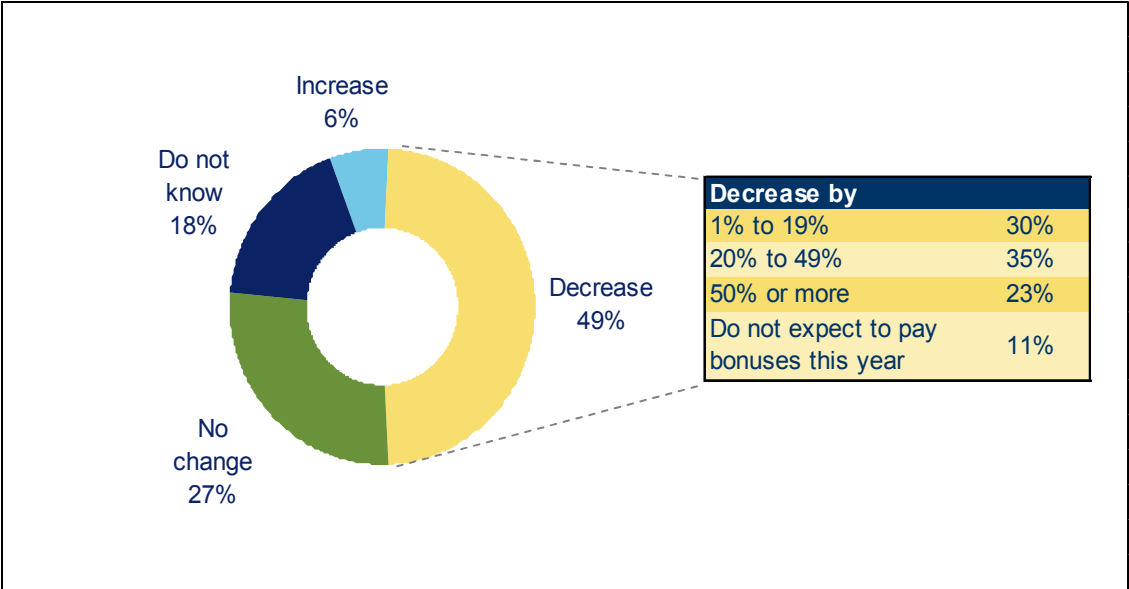
Twenty-nine percent of companies expect to change the performance metrics of their annual bonus plan and 21 percent expect to change them in their long-term performance plan.

Figure 4 | What changes do you expect to make to performance goal-setting for next fiscal year’s annual bonus plan and long-term performance plan?

	Annual bonus plan	Long-term performance plan
Raise performance goals relative to last year’s goals	21%	9%
Lower performance goals relative to last year’s goals	19%	8%
Change performance metrics	29%	21%
Widen the incentive payout zone	15%	8%
No changes	16%	27%
Do not know at this time	34%	38%
We do not set goals	2%	6%

Half of companies expect to decrease their current year bonus pool funding compared to the prior year.

Figure 5 | Do you expect your current year bonus pool to increase or decrease over the prior year?



Companies plan subtle changes to long-term incentive vehicles.

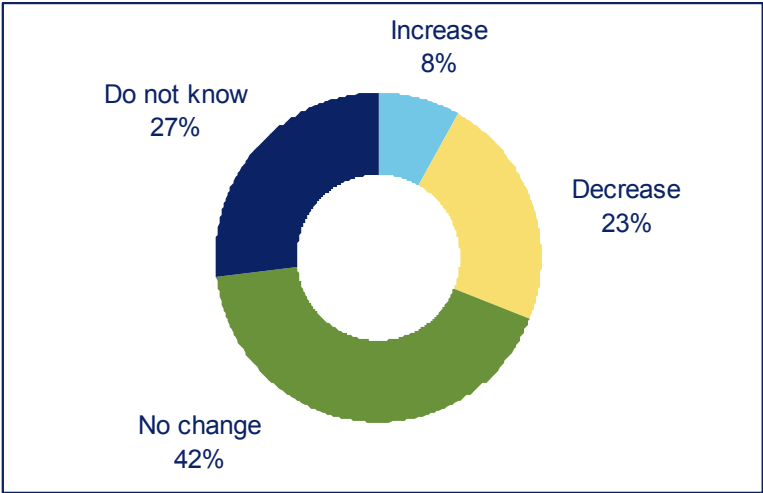
Figure 6 | Which of the following long-term incentive vehicles does your organization use in executive pay packages, and what changes do you expect for 2009?

	Use in 2008	Plan to use in 2009
Stock options	60%	54%
Restricted stock/units – time-based vesting	57%	52%
Restricted stock/units – performance vesting	28%	31%
Performance shares	24%	21%
Performance cash	21%	21%
Stock settled SARs	8%	6%
Phantom stock	6%	6%
Cash settled SARs	4%	4%
Management Stock Purchase Plan (MSPP)	3%	3%
Other	4%	3%

	If plan to use in 2009		
	More emphasis vs. 2008	Less emphasis vs. 2008	No change in mix vs. 2008
Stock options	13%	24%	63%
Restricted stock/units – time-based vesting	29%	15%	56%
Restricted stock/units – performance vesting	24%	16%	60%
Performance shares	7%	11%	83%
Performance cash	19%	2%	79%
Stock settled SARs	12%	6%	82%
Phantom stock	14%	0%	86%
Cash settled SARs	8%	0%	92%
Management Stock Purchase Plan (MSPP)	15%	0%	85%
Other	23%	8%	69%

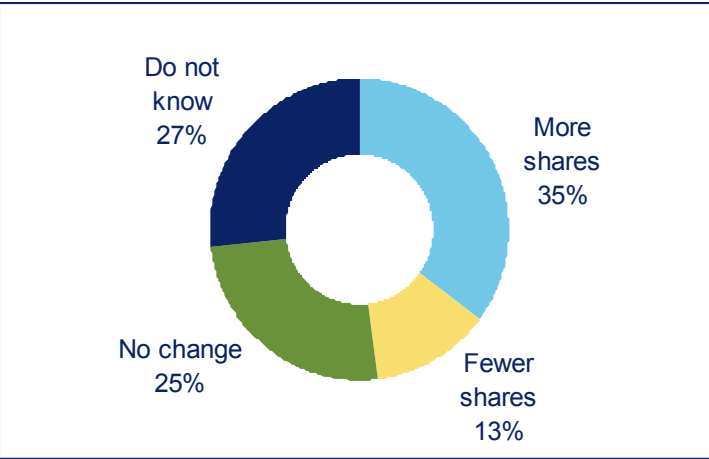
Twenty-three percent of companies expect to decrease their 2009 long-term incentive grant dollar values compared to the prior year.

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



One in three companies 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?

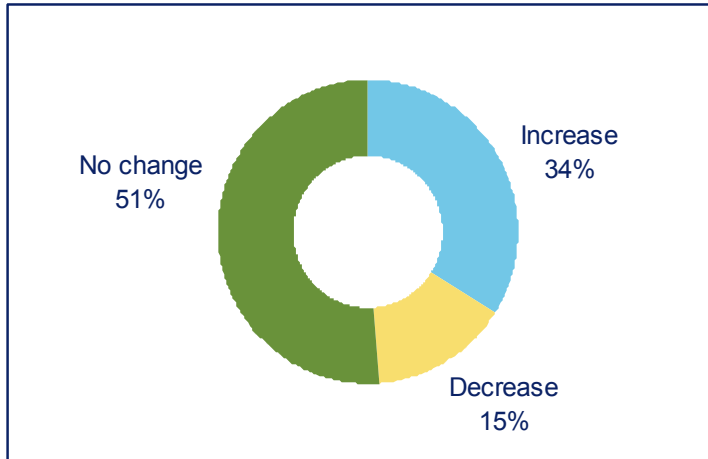


If you are granting more shares, is the increase in the pool size proportionate to the decline in your stock price or did you adjust the pool downward to manage the run rate?

Adjusted	Unadjusted
33%	67%

Half of companies do not expect their 2009 run rate to change.

Figure 9 | Do you expect your 2009 run rate to increase or decrease?



Demographics

Of the 264 employers who completed the survey:

- 74 percent are for-profit, publicly traded companies. Another 17 percent are for-profit, private companies, while the last 9 percent are non-profits.
- The median revenue/asset size is \$4 billion.
- 4 percent are already participating in one of the Emergency Economic Stabilization Acts with another 4 expecting to participate over the next 12 months.

The industry sectors with the largest participation include health care, high technology, financial services, manufacturing and retail.

Conclusion

Employers believe 2009 will be a tough year financially. As companies balance what is best for shareholders and the business, all employees—from top executives down through the ranks—should expect to see adjustments made to their compensation programs.

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- Developing attraction, retention and reward strategies that help create competitive advantage
- Advising pension plan sponsors and other institutions on optimal investment strategies
- Providing strategic and financial advice to insurance and financial services companies
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