



Executive Compensation News & Views

Fourth Quarter 2009

RiskMetrics Updates to Compensation

Updates to RiskMetrics' Group ("RMG") U.S. corporate governance policies were released on November 19, 2009, and apply to companies with shareholder meeting dates on or after February 1, 2010. RMG's updates to compensation focused on corporate governance issues, including Pay-for-Performance, Management Say-On-Pay ("MSOP"), and changes to burn rates policies for equity plan proposals. The following is a summary of RMG's compensation updates. RMG recommends that voting occur on a case-by-case basis on MSOP, election of directors or equity plans. Voting should take into consideration the alignment of CEO pay and performance with regard to shareholder returns over time.

Pay-for-Performance

RMG recommends focusing on companies that have underperformed the peer group over a sustained period, with performance measured by the company's stock performance over time. RMG states that even when financial or operational measures are utilized in incentive awards, the achievement related to those measures should be ultimately reflected by superior shareholder returns over the long-run.

RMG's guidelines for peer performances are as follows:

- Whether a company's one- and three-year total shareholder return ("TRS") are in the bottom half of its industry group (i.e., four-digit GICS – Global Industry Classification Group); and
- Whether the total compensation of a CEO who has served at least two consecutive fiscal years is aligned with the company's TSR over time, including both short- and long-term periods.

If a company falls into the bottom half of its four-digit GICS, an analysis of the company's pay elements and whether they create or reinforce shareholder alignment is necessary, as well as consideration of the alignment of the CEO's total direct compensation and total shareholder return over a period of at least five years.

RMG noted that if there is a misalignment between CEO pay and performance with regard to shareholder value, it will recommend a vote against MSOP and/or election of directors, which in the case of compensation, are generally compensation committee members. It is

continued on pg. 2

Bank Bonuses Rise Under Fire

Goldman Sachs, Morgan Stanley and JPMorgan Chase, three of the largest banks that have managed to successfully depart the government's TARP plan, are set to pay record bonuses this year. The banks are expected to pay an estimated \$29.7 billion in bonuses, compared to approximately \$26.8 billion in 2007.

How Big Banks Are Paying

It is anticipated that the banks will award more stock and defer a larger percentage of cash payments as a result of pressure from the government, however the likelihood is high that there will be a backlash from the general public over the size of bonuses, especially after all three companies took advantage of government relief programs.

Goldman Sachs, in particular, has examined the possibility of paying all annual senior executive bonuses in stock, including the pay for Lloyd Blankfein, the company's CEO. This is in response to the looming possibility of government pay regulation combined with shareholder pressure for say-on-pay. Currently, employees at Goldman Sachs receive up

continued on pg. 3

cont'd from page 1

RiskMetrics Updates to Compensation

important to note that if a significant portion of the CEO's misaligned pay is attributed to equity awards, and there is an equity plan up for vote in which the CEO participates, RMG will recommend a vote against the plan.

Management Say-On-Pay

In an attempt to manage excessive risk taking, RMG focused on changes that identify the practices that may motivate inappropriate or excessive risk-taking. RMG noted that certain practices are acceptable in certain industries or unique to specific companies, and all companies will be reviewed on a case-by-case basis. However, RMG specifically identified certain practices that are against general pay-for-performance philosophy. This list includes, but is not limited to, the following:

- Multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation;
- Including additional years of unworked service that result in significant additional benefits without sufficient justification, or including long-term equity awards in the pension calculation;
- Perquisites for former and/or retired executives, and extraordinary relocation benefits (including home buyouts) for current executives;
- Change-in-control payments exceeding three times base salary and target bonus; "single triggers"; new or materially

amended agreements that provide for "modified single triggers"; new or materially amended agreements that provide for an excise tax gross-up (including "modified gross-ups");

- Tax reimbursements related to perks or other payments (i.e., personal use of company aircraft, executive life insurance, bonus, etc.);
- Dividends or dividend equivalents paid on unvested performance shares or units

RMG specifically mentioned company policies and practices that could provide incentive to take excessive risks. The examples are as follows:

- Guaranteed bonuses
- A single performance metric used for short- and long-term plans
- Lucrative severance packages
- High pay opportunities relative to industry peers
- Disproportional supplemental pensions
- Mega annual equity grants that provide unlimited upside with no downside risk

RMG noted that if concerns raised in management say-on-pay proposals aren't sufficiently addressed in the subsequent year, it may recommend withhold or against votes on Compensation Committee members.

Volatility and Stock Price Assumptions in Equity Plan Proposals

One of the key changes is that RMG has reverted to using 200-day volatility in calculating Shareholder value Transfer ("SVT") and will use the 200-day average stock price for the SVT policy. The rationale behind this change (from a 400-day average) is that during 2008 and early 2009 the stock market experienced unprecedented levels of volatility. RMG believes that the market has stabilized enough that 200-day volatility is sufficient for calculations, and will generally reflect less abnormal volatility.

The burn rates have dropped significantly for Real Estate (GICS 4040), to 1.04% from 2.05%. RMG will recommend a vote against equity plans for companies whose average three-year burn rate exceed the greater of (1) the mean plus one standard deviation of the company's GICS group (in the case of Real Estate, 1.04%); or (2) two percent of weighted common shares outstanding.

Survey submission forms for our 2010 CoMP Survey will be sent out in March 2010. [Click here](#) to request information to participate.

cont'd from page 1

Bank Bonuses Rise Under Fire

to 75% of their bonuses in restricted stock or options. The company also published a 14 page guide justifying its compensation policy.

For 136 executives at seven of the largest companies still operating under TARP, Kenneth Feinberg, the Treasury Department's pay master, slashed total compensation by an average of 50%, and base salaries were reduced by approximately 90%. Revised 2010 pay guidelines for the top 25 executives at the firms will be completed by the end of the first quarter of next year.

At Bank of America ("BofA"), the 2009 salaries of the CEO and the president of the mortgage unit were cut by \$300,000. The salary reduction was approved by Mr. Feinberg. Note that the two executives will receive meaningful stock awards, which may be unrestricted as soon as BofA repays the over \$45 billion it received under TARP. The Treasury's new guidelines effectively tie pay to increased risk management, and the CEOs of Goldman Sachs, JPMorgan Chase and Morgan Stanley have apparently been asked to follow the new rules.

Threats from Executives Operating Under TARP

According to Reuters, five senior executives at American International Group (AIG) have informed the company that they may quit if compensation was cut significantly by Mr. Feinberg. In addition, AIG CEO Robert Benmosche reportedly threatened to quit in November, partly due to his not having discretion regarding pay decisions for executives.

It is clear that the balance of compensation with preservation of talent at companies operating under TARP is a major challenge facing Mr. Feinberg. We note that Mr. Feinberg must make his compensation decisions by year end, the same deadline that, should the AIG executives quit, they will still be entitled to benefits.

The Impact on Joe Executive

The SEC compensation disclosure rules have been revised, asking companies to state how compensation policies relate to the realization of risks resulting from the actions of employees (see Executive Compensation News & Views 3Q09). While the rules do not explicitly require pay to be tied to risk management, we believe that investors expect more internal controls regarding risk management. In addition, we expect to see a higher percentage of compensation to be paid in the form of stock that may be subject to clawbacks depending upon a company's future performance.

Preparation for 2010

Adjusting compensation for 2009 may present issues for some companies, excepting those operating under TARP. Compensation committees should consider a thorough review of 2009 compensation and in-depth planning of 2010 compensation in the first quarter of the year. In the current environment, a complete investigation of different compensation scenarios for executives is warranted.

**Please join us for our webinar, 2010 Proxy Disclosure:
New SEC Rules and Best Practices, on January 27, 2010 at 12:30pm ET.**

Registration is available at www.smglp.com/webinars.html

Compensation Notes from the G-20 Meeting

At the end of September, the Group of 20 (“G-20”) leaders agreed to adopt compensation guidelines, a step that was not a surprise in the current environment. The G-20 guidelines are specifically aimed at investment banks in an effort to curb the risky behavior that many believe fed the financial crisis. The principles, to which the G-20 agreed, would discourage bonus guarantees extending more than one year, encourage companies to defer bonuses to senior executives and other key employees and permit pay clawbacks if losses occur after compensation is granted.

The guidelines also state that a meaningful portion of bonuses should be paid in shares or share-linked instruments that would be subject to restrictions. In addition, cash bonuses could also be deferred and even clawed back should the company fail to perform during the vesting period. Banks have already started to comply. Credit Suisse announced in late October that it intends to change the ratio of salaries and bonuses for its highly-paid employees, as well as tie bonuses

to a specific financial measure and impose clawbacks if the bank fails to perform. It is important to note that these changes will not necessarily reduce compensation levels, but will change how and when compensation is paid.

The Credit Suisse plan covers approximately 2,000 US employees, with executives expected to receive a larger portion of total compensation in the form of base salaries, and bonuses to be split evenly between cash and stock. Equity bonuses will vest in four years and the cash portion will vest in three, but both elements

are subject to bank performance over the vesting period, as well as the performance of the particular executive’s business unit over the same period. The exact performance levels were not specified.

The impact of the G-20 guidelines beyond foreign investment banks may not be immediately apparent, however, the federal government is working closely with both the Financial Services Authority (“FSA”) and the G-20 to impose rules and guidelines that will impact public companies operating outside TARP and the banking community.

The Top Performers

Top 10 REITs Based on Year-to-Date TRS Gain:			
	Company	Ticker Symbol	Year-to-Date TRS (1/1/09-12/29/09)
1	Arlington Asset Investment Corp.	AI	353.82%
2	Ashford Hospitality Trust, Inc.	AHT	291.30%
3	KKR Financial Corp	KFN	236.68%
4	CapLease, Inc.	LSE	172.70%
5	Newcastle Investment Corporation	NCT	152.38%
6	HRPT Properties Trust, Inc.	HRP	124.78%
7	The Macerich Company	MAC	116.85%
8	Starwood Hotels & Resorts Worldwide, Inc.	HOT	109.55%
9	SL Green Realty Corp.	SLG	107.29%
10	LaSalle Hotel Properties	LHO	102.26%

The Schonbraun McCann Group Executive Compensation Team

Larry Portal, Senior Managing Director ❖ Anthony Saitta, Managing Director

About The Schonbraun McCann Group

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