SHEARMAN & STERLING LLP

2010

Corporate Governance of the Largest US Public Companies

Director & Executive Compensation

This Survey and our companion survey regarding general governance practices are available on the Shearman & Sterling LLP web site at www.shearman.com/corporategovernance.

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Corporate Governance of the Largest US Public Companies

Director & Executive Compensation

Our eighth Annual Survey of Selected Corporate Governance Practices of the Largest US Public Companies (the *"Survey"*) reflects a year of consolidation, rather than innovation, in compensation disclosure by the largest US public companies. The proxy statements of the Top 100 Companies* continue many of the trends noted in prior years: enhanced attention to the risk profile of compensation strategies; more companies adopting clawback policies; increased acceptance of shareholder say-on-pay votes; and increased use of independent compensation consultants.

Few proxy statements report new compensation strategies or novel approaches to compensation disclosure. One possible reason for the relative stability in compensation practice and disclosure was the absence of significant new legislation during the period covered by this Survey. Companies were not required to assimilate and react to anything nearly as dramatic as the legislation implementing the Troubled Asset Relief Program (*"TARP"*) of the prior year.

*See "Survey Methodology" on page 56 of this Survey for the list of the Top 100 Companies.

Introduction

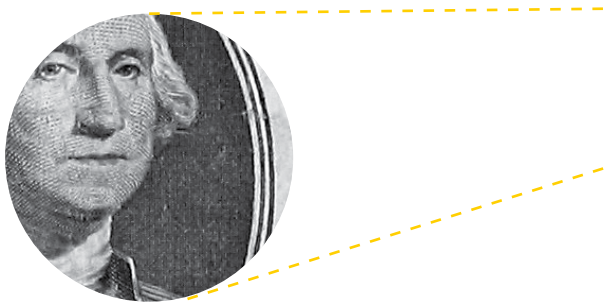
Regulatory developments did, however, have some impact on this year's Survey results. In particular, on December 16, 2009, the Securities and Exchange Commission (the *"SEC"*) amended its proxy disclosure rules relating to executive compensation to require disclosure regarding:

- The relationship of compensation policies to risk
- Compensation consultant independence
- The reporting of stock options and other equity awards

The amended SEC rules also mandate new or expanded disclosure on other topics related to corporate governance, including the board's role in risk management, the board's leadership structure, and director and nominee disclosure (including how the company considers diversity in the nomination process) — all of which are discussed in our companion survey.

The period covered by this Survey straddles the February 28, 2010 effective date of the revised SEC disclosure rules, but the majority of companies surveyed — 80 of the Top 100 Companies — filed their proxy statements after the new disclosure requirements became effective. As discussed throughout this Survey, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the *"Reform Act"*) was signed into law by President Obama on July 21, 2010. The Reform Act addresses a number of issues included in this Survey (including say-on-pay, clawbacks and compensation consultant independence) and will likely change practices at all public companies in the future.

Companies must disclose the relationship between their compensation practices applicable to all employees — and their risk management philosophy only if the risks arising from their compensation programs are "reasonably likely to have a material adverse effect."



Risk Assessment

The most striking change in this season's proxy statements is the increased prominence accorded to discussions of "risk." This year's Survey indicates that a decisive majority of the Top 100 Companies addressed the impact of the company's compensation programs on its overall risk profile (see page 18). Regulatory developments, including the applicability of the new SEC disclosure rules, help explain the enhanced emphasis on risk.

For the nine Top 100 Companies subject to the regulations issued under TARP, proxy statement discussion of compensation risk was mandatory.* Financial institutions that participate in TARP must ensure that their compensation programs *"exclude incentives for senior executives to take unnecessary and excessive risks that threaten the value of the company"* for so long as the institution has outstanding obligations to the government. Compensation committees of TARP entities must conduct semiannual reviews of all employee compensation plans for unnecessary risk and the manipulation of reported earnings. Finally, a TARP entity must certify in its proxy statement that its compensation committee met with senior risk officials and assessed whether their executive compensation programs encourage executives to take unnecessary and excessive risks.

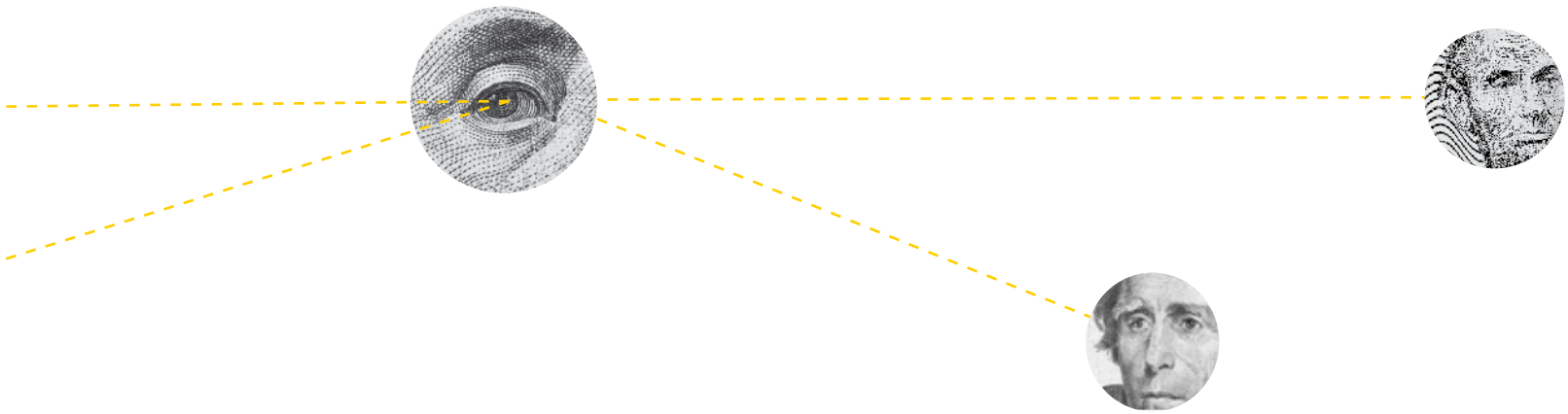
For companies not subject to TARP, compensation risk disclosure is required under the SEC's new disclosure rules only under limited circumstances. Companies must disclose the relationship between their compensation practices applicable to *all* employees — not only those applicable to the named executive officers (*"NEOs"*) — and their risk management philosophy only if the risks arising from their compensation programs are *"reasonably likely to have a material adverse effect"* on the company.

Of the Top 100 Companies that filed before the new rules went into effect, a narrow majority — 12 of 20 companies — voluntarily included some discussion of compensation risk. None of the Top 100 Companies concluded that risks were reasonably likely to have a material adverse effect on the company.

Practitioners initially expected companies to shy away from making conclusory statements on risk, absent an affirmative requirement. Experience in the 2010 proxy season has proved otherwise: 61 of the Top 100 Companies voluntarily affirmatively stated that their compensation policies and practices do not create material adverse risk. At least some public companies that omitted an affirmative statement received SEC comment letters asking for confirmation that they have addressed the disclosure requirement, and that the absence of disclosure resulted from a risk assessment process. This may foretell more detailed disclosure requirements in the future.

Indeed, process, as much as disclosure, seems to be the key to the evolving "best practice" on compensation risk. Companies are coming to terms with basic procedural issues, such as who should assess the risks arising from compensation policies and practices. The compensation committee is one obvious candidate, but compensation committees have historically focused on arrangements for executive officers, whereas risk assessment needs to encompass compensation programs for *all* employees, both to ensure that the SEC requirements are satisfied and

*For purposes of this Survey, the following companies are considered TARP companies: American Express Company; American International Group, Inc.; Bank of America Corporation; Citigroup Inc.; The Goldman Sachs Group, Inc.; The Hartford Financial Services Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; and Wells Fargo & Company.



as a matter of sound corporate governance. (One of the lingering concerns from the financial crisis is that compensation programs for employees well below the executive level can adversely impact a company's financial position if they lack appropriate risk mitigants). For a compensation committee to conduct a risk assessment effectively, it must work closely with management and the audit and risk committees of the board and must feel comfortable relying on the information provided by management and its consultants and advisers. Identifying the risk profiles of a company's various business activities — typically the responsibility of management and the audit committee — is the first step in assessing risk. Once these risks are identified, the compensation committee may examine whether the company's compensation programs operate to control or exacerbate these risks, or whether they create new risks.

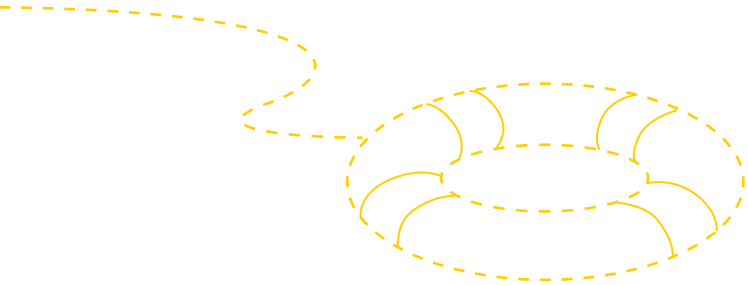
Early experience with compensation risk disclosure suggests that responsibility for the assessment is most typically delegated to the compensation committee. Ten of the Top 100 Companies have formalized this arrangement by including risk assessment as one of the committee responsibilities listed in the committee charter. The results of this year's Survey, however, do not allow us to generalize about how companies are integrating the roles of the compensation committee, other board committees, management and independent consultants in conducting compensation risk assessments.

What companies say about compensation risk varies widely. A small minority of the Top 100 Companies included no more than a conclusory statement that they had conducted a review and that their compensation policies and practices are not reasonably likely to have a material adverse effect on the company. (As was the case with companies that made no affirmative disclosure at all, some companies that did no more than state the result of their risk assessment attracted an SEC comment asking for a description of the process that the company undertook to reach the conclusion). Most of the Top 100 Companies, on the other hand, explained their positions by pointing out various features of their policies and practices that are designed to discourage excessive risk taking.

The proxy statements of the surveyed companies were remarkably consistent in the factors listed to support a company's conclusion that compensation policies do not pose a risk to the enterprise. The listed items include:

- providing a mix of cash and equity and of annual and longer-term incentives;
- using multiple metrics to determine payout in order not to put too much emphasis on any single measure;
- caps on incentive award payouts (for example, 200% of target);
- share ownership guidelines that require employees to retain award shares for a specified period, or through retirement, so that they retain the risks of share ownership;
- multi-year vesting periods; and
- implementing and enforcing clawback policies.

Each of these considerations can appropriately factor into a company's evaluation of its compensation risk profile. We anticipate that a key issue over the next several years will be how companies translate their evolving risk assessment practices into disclosure that will provide shareholders with useful insight into the company's processes of risk assessment applied to compensation policies.



Global Focus

Risk

There are numerous initiatives outside the US aimed at aligning executive compensation with proper risk management. In April 2009, the G20 nations agreed to implement principles aimed at promoting compensation practices that *"create appropriate incentives for effective risk management"* and *"avoid excessive risk-taking"* in the financial services sector. Codified as The Financial Stability Board's Principles for Sound Compensation Practices *(the "FSB Principles")*, these principles relate to:

- the effective governance of compensation;
- the effective alignment of compensation with prudent risk-taking; and
- the effective supervisory oversight and engagement by shareholders.

The FSB Principles are framed in general terms, permitting implementation to be adjusted according to national circumstances, but recommend that: (1) compensation timing be sensitive to the time horizon of risks (with deferred compensation used where risks can only be realized over time) and (2) financial institutions provide clear, comprehensive and timely disclosure regarding compensation practices.

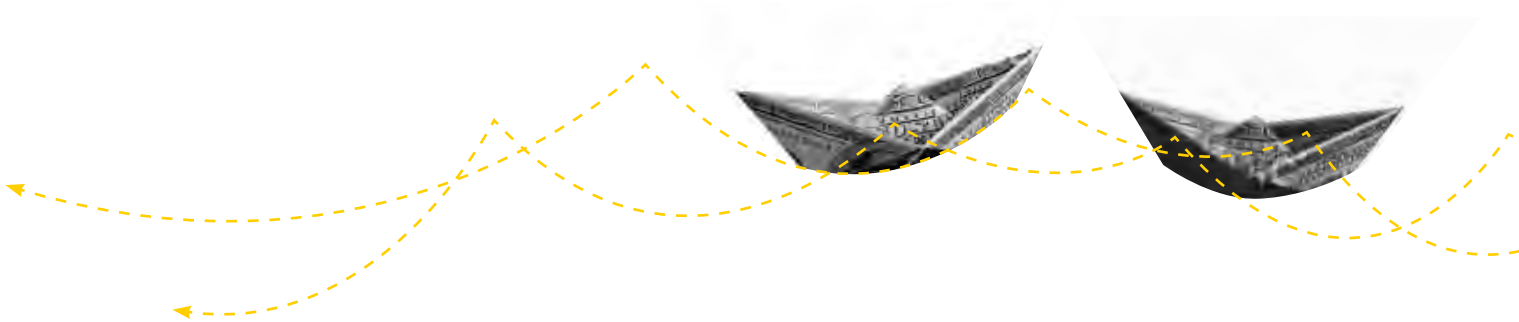
The FSB Principles have already been implemented in many of the world's major financial centers (e.g., the UK, Germany, France, Japan, Hong Kong and the US).

In some countries, these measures are only at the preparatory stage (e.g., Brazil, Singapore, Mexico and South Africa) or under initial consideration (e.g., India, Indonesia and Russia).

In the EU, while many member states currently require that executive compensation at all listed companies be linked to individual and corporate performance, there is increasing emphasis on ensuring that compensation is structured to avoid (or at least not incent) inappropriate risk taking. In April 2009, the European Commission issued two nonbinding recommendations, both of which attempt to introduce controls on risk-taking.

- First, in the financial sector only, the European Commission recommends that: *"Member States should ensure that financial institutions establish, implement and maintain compensation policies which are consistent with and promote sound and effective risk management and which do not induce excessive risk-taking."* This would include, for example: (1) structuring compensation to include an appropriate balance of fixed and variable compensation; (2) subjecting compensation to maximum payout limits; and (3) deferring a significant portion of bonuses.
- Second, the compensation of executives of *all listed companies* should be principally based on performance and be in the

Globally, there is increasing emphasis on ensuring that compensation is structured to avoid (or at least not incent) inappropriate risk taking.



long-term interests of the company. It recommends, among other measures: (1) limits on the amount of variable compensation; (2) the deferral of a significant portion of variable compensation; (3) imposing performance conditions on variable compensation; and (4) clawbacks of variable compensation awarded on the basis of data that proves to be manifestly misstated.

In April 2010, the European Parliament requested that the European Commission adopt strong binding principles on compensation in the financial sector, including a *"naming and shaming"* procedure for listed companies that do not comply with the principles. In June 2010, the Commission noted various deficiencies in the implementation of the recommendations that have been *"neither uniform nor satisfactory."* Future EU developments are anticipated.

On July 7, 2010, the European Parliament approved legislation on bonuses paid in the banking industry. In particular: (1) 30% of a total bonus may be paid in cash (with a 20% cap for "large bonuses"); (2) 40% of a bonus must be deferred and paid back pro-rata if investment performance is weaker than expected (60% for "large bonuses"); (3) 50% of a total bonus must be paid in the form of contingent capital (e.g., funds called upon first if a bank is in difficulty); (4) each bank must set a maximum limit on the size of staff bonuses proportionate to salary; and (5) exceptional pension payments must be held in contingent capital.

The provisions are expected to become effective in January 2011. They leave considerable discretion to the national regulators and it is unclear to which institutions they will apply and the extent to which they will affect existing national rules.

Outside the EU, the Hong Kong Guidelines on Sound Remuneration aim to ensure that *"remuneration systems are consistent with and promote effective risk management"* and avoid *"excessive risk-taking"* through the use of deferred variable compensation and assessment of financial and non-financial criteria. Similarly, the Chinese Supervisory Guidelines on Sound Compensation in Commercial Banks require performance-based compensation to take account of corporate risk.

Clawback Policies

Another noteworthy development over the last several years has been the dramatic increase in the number of companies that report the maintenance of "clawback" policies. The number of Top 100 Companies that disclose that they maintain a clawback has increased from 35 companies in 2007 (the first year that this Survey tracked the topic) to 56 companies in 2009 to 71 in 2010. In addition, eight more of the Top 100 Companies have stated that they will expand existing policies or implement a new clawback policy in 2010. As the Reform Act will require clawback policies to be adopted by all listed companies, these policies will no longer be optional.

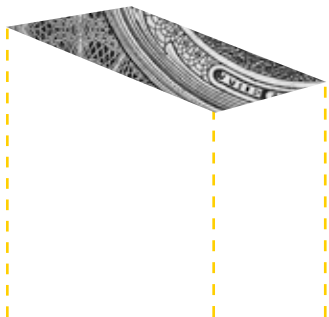
Several factors likely have contributed to the widespread adoption of clawback policies by the Top 100 Companies. Section 304 of the Sarbanes-Oxley Act, adopted in 2002, mandates compensation recovery from a public company's CEO and CFO in limited circumstances where the issuer is required to prepare an accounting restatement as a result of misconduct. On June 9, 2010, the US District Court for the District of Arizona denied a motion to dismiss a claim by the CEO of CSK Auto Corporation in an action by the SEC to recover compensation under Section 304, notwithstanding the fact that the executive committed no personal wrongdoing.

The TARP regulations also mandate clawbacks. Financial institutions subject to TARP generally are required to recover compensation paid to 25 of their top employees (essentially their NEOs and the 20 other most highly compensated employees) if retention awards, bonuses or other incentives are paid based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

The prevalence of clawbacks does not suggest that they have become standardized in operation and as to the types of compensation arrangements they cover. As we detail on page 28 of this Survey, the expression "clawback policy" covers a wide array of practices. When designing compensation recovery policies, companies will need to address the following key variables:

- **Who is covered by the policy?** Possibilities include NEOs only; all executives; all executives and a specified universe of other highly compensated employees; and all employees. The dominant trend among the Top 100 Companies is to cover all executive officers (40 of the 71 Top 100 Companies with clawback policies), but the practice is by no means universal. Clawback policies as mandated by the Reform Act will need to apply to all current and former executives.

Companies that disclose that they maintain a clawback increased from **35** companies in 2007



71

companies in 2010

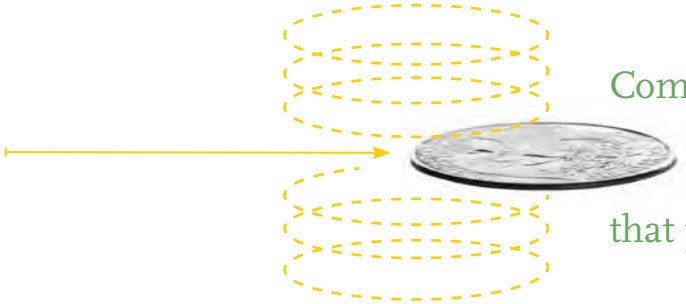
56

companies in 2009

- **What are the events that trigger recovery?** The narrowest policies provide for recovery only when the individual has engaged in fraud or other misconduct that has resulted in a financial restatement. Other policies allow recovery whenever there has been a financial restatement, even if no misconduct was involved. Still others allow recovery even if the company has not been forced to restate financial statements, but there was error in determining performance against the targets or metrics that were used to calculate the amount of compensation. Yet another approach focuses on activity deemed harmful to the company (e.g., leaving to work for a competitor, or disclosing confidential information) and uses specified forms of misconduct as the trigger for recovery. There are nearly as many variations and combinations of these strategies as there are companies with clawback policies. The Reform Act clawback requirement is triggered upon an accounting restatement due to material noncompliance with any financial reporting requirement.
- **How far back should the clawback provision reach?** The Sarbanes-Oxley Act provides for recoupment of compensation received within the 12-month period following the public release of the financial information that subsequently has to be restated, while the Reform Act requirement will apply to compensation received during the three years preceding the date on which the issuer is required to prepare an accounting restatement. Proxy statement disclosure does not provide sufficient detail for us to generalize about how the Top 100 Companies have addressed this issue in their clawback policies.
- **How is the clawback enforced?** Another decision point is whether recovery will be mandatory or discretionary, and, if the latter, who decides when, and against whom, to enforce the clawback. To date, discretionary policies prevail at the Top 100 Companies (80% of the companies with clawback policies).

More clarity on clawback design features may be forthcoming in related SEC regulations to be issued under the Reform Act. However, the Reform Act does not impose a deadline for the implementation of the SEC rules.

As companies make decisions on clawback design and shift their focus to enforcement of these policies, the legal issues raised by compensation recovery can be expected to come to the fore. Companies implementing clawback policies need to consider applicable state wage-deduction laws that limit the circumstances under which an employer may recoup "wages" from employees. Rules also vary from country to country, which may make implementing a uniform global clawback policy challenging.



Companies should be able to reclaim variable components of compensation that were awarded for performance on the basis of data that proved to be manifestly misstated.

Global Focus

Clawback Policies

Outside of the US, clawbacks are also gaining traction. The revised UK Corporate Governance Code provides that consideration should be given to enabling the clawback of performance-related executive compensation in *"exceptional circumstances of misstatement or misconduct."* Under the UK's Financial Services Act 2010, the FSA is empowered to seek recovery of compensation paid in breach of its compensation rules. Moreover, the European Commission Recommendations state that companies should be able to reclaim variable components of compensation that were awarded for performance on the basis of data that proved to be manifestly misstated.

The extent to which clawbacks are actually being implemented at a local level, however, is inconsistent. In some EU member states, existing restrictions in statutory employment laws make the implementation of clawbacks problematic. For example, in France, the Netherlands and Austria, it is not possible under current employment laws to require an employee to repay any compensation (including incentive compensation and equity awards) that has already been paid. In the UK, although clawbacks are theoretically enforceable (and are advocated by various institutional shareholder bodies), careful structuring is needed to avoid a clawback being deemed an unenforceable penalty clause or void under restraint of trade principles. Moreover, in jurisdictions such as Germany, alterations to compensation payments are often required to be reflected in an employment contract, necessitating employee consent.

In other EU countries, clawbacks appear to be uncommon. Instead, companies implement long-term deferred variable compensation programs that are subject to performance criteria and can be forfeited if the criteria are not satisfied. This is aligned with the FSB Principles and Implementation Standards.

Clawbacks can also present an issue outside of Europe. The Hong Kong Guidelines on Sound Remuneration, expected to be binding on banks by the end of 2010, provide for the clawback of incentive compensation in the event of a misstatement of performance data, fraud or other misfeasance on the part of the employee, or an employee's violations of internal control policies. Likewise, in China, commercial banks are required to formulate provisions on the clawback of deferred performance-based compensation and, where there has been an atypical exposure to risk, require the refund of performance-based compensation from senior executives.

Some shareholder advocates have focused on the legislative process rather than pursuing ballot initiatives that might be rendered moot or superseded by Congressional action.

What Shareholders Are Voting on

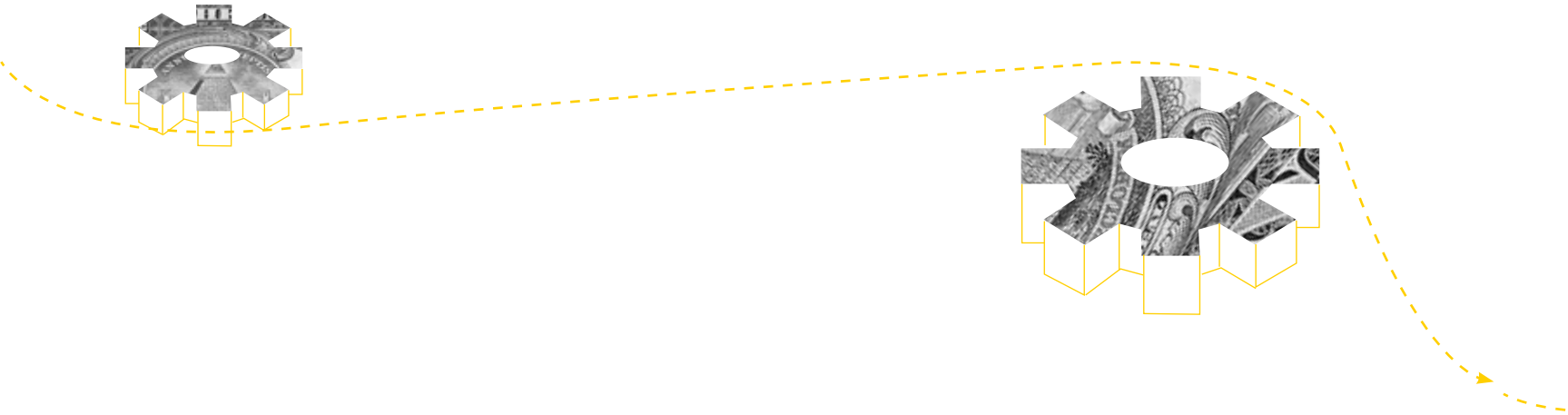
In the 2010 proxy season, for a second consecutive year, the number of compensation-related shareholder proposals was lower than the prior year. The Top 100 Companies presented a total of 89 compensation-related shareholder proposals for vote during the 2008 proxy season; the number declined to 77 proposals during the 2009 proxy season and diminished further to 69 in 2010. Page 20 details the compensation-related proposals at the Top 100 Companies.

One factor that at least partially explains the decline is that shareholders have been anticipating the legislative reforms on compensation that are included in the Reform Act. Many of the matters addressed in the Reform Act overlap with the subject matter of many of the compensation-related proposals advanced by shareholders in recent years. It appears, moreover, that some shareholder advocates have focused on the legislative process rather than pursuing ballot initiatives that might be rendered moot or superseded by Congressional action.

The most frequent compensation-related shareholder initiative at the Top 100 Companies this year continued to be a request that companies institute advisory say-on-pay votes. Although the details of say-on-pay proposals vary, the fundamental point of the proposals is to request the company to institute an annual (or other periodic) nonbinding shareholder vote on executive compensation practices. Shareholder initiated say-on-pay proposals sometimes also request the company to establish other mechanisms for the company to consult with shareholders and for shareholders to provide feedback to the company on executive pay.

During the 2010 proxy season, 19 of the Top 100 Companies submitted their executive compensation programs for approval by shareholders, either as required by TARP (eight of the Top 100 Companies) or pursuant to say-on-pay policies that the company adopted even though not legally required to do so (an additional 11 companies).

With the adoption of the Reform Act, say-on-pay will be mandatory for all public companies in the 2011 proxy season. The Reform Act requires a vote to occur at least once every three years (unlike prior proposals which required annual votes). In the first instance, shareholders must be given the opportunity to vote on both (1) the say-on-pay resolution and (2) a separate resolution to determine whether the company's say-on

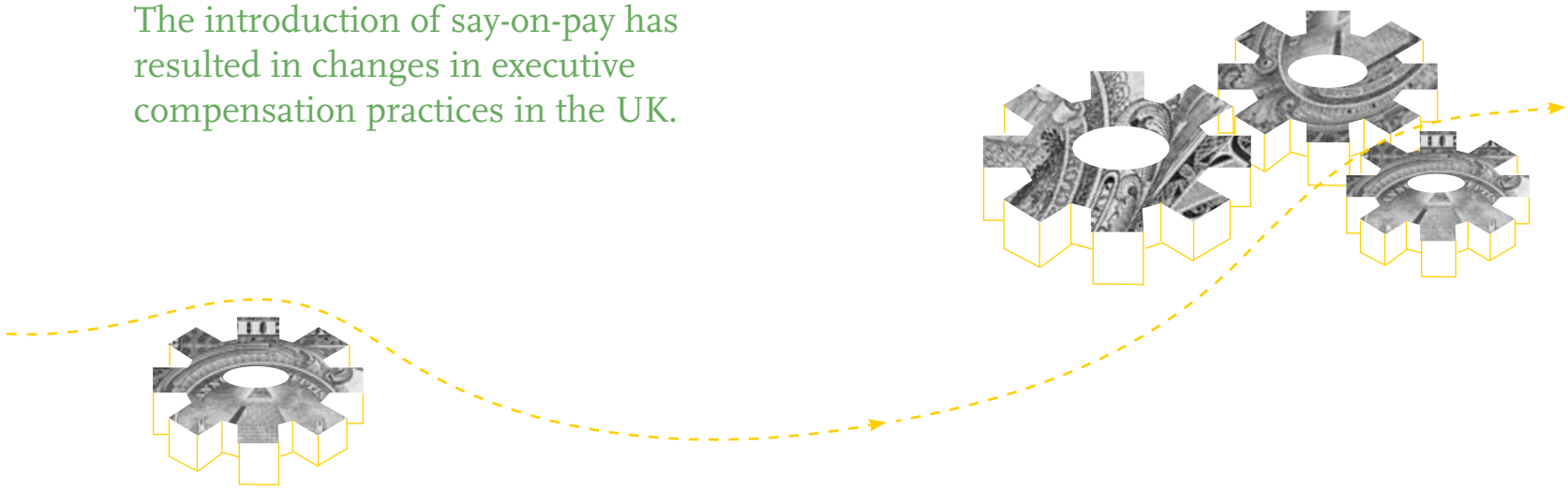


pay-vote will be held every one, two or three years. Thereafter at least once every six years, shareholders must be given the opportunity to redetermine whether the say-on-pay vote will be held every one, two or three years. The vote is nonbinding and will not be construed as overruling the board's compensation decisions or imposing additional fiduciary duties on the board. However, if an issuer does not respond to a negative vote, in the future, shareholders may take further action such as withholding votes for members of the compensation committee.

One lesson from this proxy season is that companies cannot assume say-on-pay resolutions will pass. One Top 100 Company — Motorola, Inc., which voluntarily implemented say-on-pay — and at least two other public companies, Occidental Petroleum Corporation and KeyCorp, failed to win majority support for their compensation policies. The defeat of the proposal by Occidental Petroleum's shareholders is striking since the company had pursued other avenues for shareholder consultation and feedback on executive pay issues, including meetings with shareholders, in addition to voluntarily adopting say-on-pay. On a similar note, shareholders at Abercrombie & Fitch Co. rejected a proposed new long-term incentive plan by a wide majority (Abercrombie has been widely criticized for certain executive compensation practices, including its recent decision to pay its chief executive officer $4 million to forgo his right to use the company's aircraft for personal travel. The defeat of these proposals illustrates how shareholders are beginning to send a clear message to companies that they will not accept what they have identified as poor pay practices. This trend could gain traction next year as companies implement the say-on-pay vote under the Reform Act.

Only a handful of public companies have voluntarily implemented say-on-pay policies to date. For the 2010 proxy season, brokers were entitled to cast discretionary votes on management say-on-pay proposals, and brokers are believed generally to vote with management's recommendations. Winning approval for say-on-pay (and other compensation-related shareholder proposals) may prove even more challenging in years to come as the Reform Act will disallow discretionary votes by brokers on these proposals.

The introduction of say-on-pay has resulted in changes in executive compensation practices in the UK.



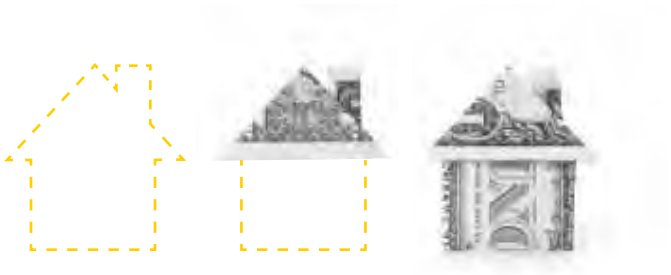
Global Focus

Say-on-Pay

The UK provides a good case study of what impact an advisory say-on-pay vote can have on the behavior of companies and shareholders. Since 2002, UK-listed companies have been required to provide shareholders with an advisory say-on-pay vote on compensation policies detailed in a report submitted with the company's annual financial report. The vote is advisory in nature and director entitlements (both executive and non-executive) to compensation are not conditioned on shareholder approval. Nonetheless, a significant vote against the report can force the board to consider revisions to compensation arrangements.

Historically, most say-on-pay resolutions in the UK have been approved by shareholders with a low level of negative votes (generally at the 1 to 2% level). Recently, however, a number of companies have received a more substantial percentage of negative votes and there have been a number of well-publicized instances where the compensation policies have not received shareholder approval. For example, in 2009, say-on-pay proposals were rejected by shareholders at The Royal Bank of Scotland plc (over 90% voting against), Royal Dutch Shell plc (over 60% voting against), Bellway plc (59% voting against) and Provident Financial plc (51% voting against). In 2010, there has been significant shareholder resistance (although approval has been obtained) at other companies including Xstrata plc (33% negative vote after the Chief Executive received a 41% increase in pay) and Cobham plc (33% negative vote following changes to executive bonus arrangements and pension increases for two senior executives).

The introduction of say-on-pay has resulted in changes in executive compensation practices in the UK. For instance, the majority "no" vote at Royal Dutch Shell plc in May 2009 has been followed by an overall freeze on the salaries of its top executives, prohibitions on the payment of bonuses to management who miss performance targets and the introduction of new "individual performance" elements to incentive payments.

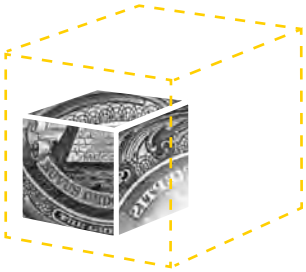


The adoption of say-on-pay in other EU jurisdictions varies.

The adoption of say-on-pay in other EU jurisdictions varies. Since 2009, German-listed companies are required to provide shareholders with a nonbinding advisory vote on the compensation arrangements for members of the management board of directors. In Italy, shareholders must approve the company's general compensation policies and the compensation for non-executive directors, but there is no similar requirement for executive directors. Similarly, in France, shareholders must approve the aggregate amount of non-executive directors' fees, while the individual allocation among the members of the board of directors or of the supervisory board is then decided by the board. Sweden and the Netherlands both provide shareholders with a binding vote on executive compensation policies. In Switzerland, while there is no legislative requirement, shareholder groups have been successful in persuading some noteworthy companies, including UBS AG, Credit Suisse Group AG, ABB Ltd and Nestlé S.A., to voluntarily provide shareholders with an advisory vote on their compensation reports and systems.

Outside of the EU, the Australian government has recently indicated support for a proposal to modify its existing nonbinding advisory voting system by introducing a "two-strikes" vote where, if over 25% of shareholders vote against a compensation policy, the directors must respond with a revised compensation report in the next year. If, on the second vote, 25% of shareholders oppose the revised report, all of the directors who signed the report will face reelection at a special meeting to be called within 90 days. The reelection resolution would require a 50% majority to be passed.

Finally, Japanese companies have historically been required to put the compensation paid to their executives up for a vote of shareholders each year. In the past, the amount of compensation was disclosed on an aggregate basis. On February 12, 2010, the Japanese Financial Services Agency amended the Cabinet Office Ordinance on Disclosure of Corporate Affairs to require Japanese publicly-listed companies to individually disclose the names and statutory pay levels of all directors and statutory auditors receiving 100 million Yen or more in salary, bonus, stock options and retirement payments. Companies will also be required to disclose and explain their pay policies and how they are determined. While the shareholder approval requirements were not amended, the additional information to be provided to shareholders may affect their votes.



Many companies will need to reexamine their compensation policies and procedures over the next year to take into account the requirements of the Reform Act.

What to Expect Next Year

First, all reporting companies will be subject to the new SEC disclosure rules for the 2011 proxy season. Most of the Top 100 Companies will have a year of experience with the new rules under their belts and will have the benefit of SEC interpretations through comment letters (formal) and public speeches (informal). Treatment of disclosure topics that have been addressed this year in varied ways is likely to be more uniform next year as practice trends emerge. In particular, we think that more of the Top 100 Companies will include a more detailed discussion of their risk assessment processes and of the basis for their conclusion that their compensation programs do not present a risk of a material adverse effect on the company. It is not clear, however, how meaningful this disclosure will prove to be to investors.

Second, the presentation of compensation information, particularly their Compensation Discussion and Analysis (*"CD&A"*), will likely continue to improve. An increasing number of companies begin the CD&A with an executive summary that provides a road map for the ensuing disclosure. Many companies use informative and easy to read graphics, tables or other visual aids to help explain performance metrics or the relationship among different elements of compensation. Although still infrequent, some Top 100 Companies have converted their CD&A to a Q&A format. Many Top 100 Companies continue to take seriously the SEC's admonition to present their compensation disclosure in a manner that makes it accessible and understandable to the average reader who is not an expert in the field.

Finally, some of last year's disclosure and governance trends have become this year's law. Many companies will need to reexamine their compensation policies and procedures over the next year to take into account the requirements of the Reform Act.

In addition to the say-on-pay and clawback provisions detailed previously, the Reform Act includes the following key points:

Disclosure and Vote on Golden Parachutes

The Reform Act requires proxy statements and consent solicitations filed by issuers in connection with mergers, acquisitions and major asset sales to describe, in clear and simple form, the arrangements with any NEOs of the issuer or the acquiring company concerning all compensation (whether present, deferred or contingent) that is related to the transaction. Companies would also be required to disclose the aggregate amount of compensation that will be paid or may become payable to the NEOs (together with the conditions to payment) as a result of the transaction. The SEC is directed to promulgate regulations governing the specifics of this disclosure.

Rather than setting explicit independence standards for compensation committee members, the Reform Act tasks listing authorities with defining independence.

The proxy statement must also provide shareholders the opportunity to cast a separate nonbinding vote to approve these payments unless the arrangements have been previously subject to a say-on-pay vote.

This provision applies to all meetings occurring on or after January 21, 2011.

Compensation Committee Independence

The Reform Act requires the SEC to direct the national securities exchanges and associations to prohibit the listing of securities of any issuer whose compensation committee is not comprised exclusively of independent directors. Compensation committee independence rulemaking must be implemented within one year from the enactment of the Reform Act. Rather than setting explicit independence standards, the Reform Act tasks listing authorities with defining independence. In formulating the definition, factors to be considered include:

- the source of compensation of the director, including any consulting, advisory or other fees paid by the issuer;
- whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer; and
- the compensation committee independence requirements do not apply to certain issuers, including "controlled companies" (e.g., companies where more than 50% of the voting power is held by an individual, a group or another issuer) and foreign private issuers.

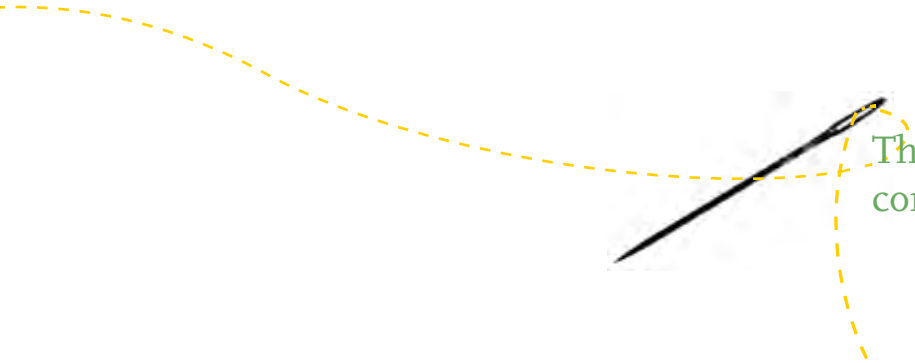
Compensation Consultant Independence

The Reform Act provides that a compensation committee (1) may, in its sole discretion, obtain advice of consultants, legal counsel and other advisers and (2) must be directly responsible for the appointment oversight and compensation of these advisers. Any committee that elects to retain a consultant, however, will not be compelled to follow the adviser's advice and must exercise its own judgment in fulfilling its duties and making compensation decisions. Issuers are required to provide funding for the adviser compensation determined by the committee.

In selecting its advisers, compensation committees must take into account factors affecting independence. The Reform Act directs the SEC to identify independence factors that are competitively neutral among categories of consultants, legal counsel and other advisers and provides the following partial list of considerations:

- provision of other services by the adviser's employer;
- the amount of fees paid to the adviser's employer, considered as a percentage of the employer's total revenues;
- the policies and procedures of the adviser's employer that are designed to prevent conflicts of interest;
- any business or personal relationship between the adviser and a member of the compensation committee; and
- the adviser's ownership of stock of the issuer.

Unlike previously proposed legislation, the Reform Act does not require that consultants be independent. In any proxy statement filed on or after January 21, 2011, issuers must disclose (in accordance with rules to be established by the SEC): (1) whether the compensation committee retained a consultant,



The Reform Act does not require that consultants be independent.

(2) if the consultant's work raised a conflict of interest and (3) how that conflict is being addressed.

Within one year following enactment of the Reform Act, the SEC must adopt rules that require the listing authorities to prohibit the listing of securities of any issuer that does not comply with the consultant and adviser independence rules. The listing authorities must also set forth procedures providing companies with a reasonable opportunity to cure any defect before a delisting.

The compensation consultant independence provisions do not apply to "controlled companies."

Additional Disclosure

The Reform Act directs the SEC to require additional compensation-related proxy disclosure regarding:

- The relationship between compensation actually paid and the financial performance of the issuer, taking into account any change in the stock value and dividends paid. Issuers may use a graph to illustrate the relationship.
- The median total annual compensation of all employees (other than the CEO), the annual total compensation of the CEO, and the ratio of these two amounts. Total compensation would be calculated in the same manner as the summary compensation table.
- Whether any employees (not only executive officers) or directors (or their designees) can hedge against decreases in the value of equity granted as compensation or otherwise directly or indirectly held by the employee or director. Many public companies already prohibit hedging and, in accordance with existing SEC guidance, discuss in their CD&A any policies regarding hedging the economic risk of share ownership.
- Policies on incentive-based compensation that is based on the issuer's financial reports.

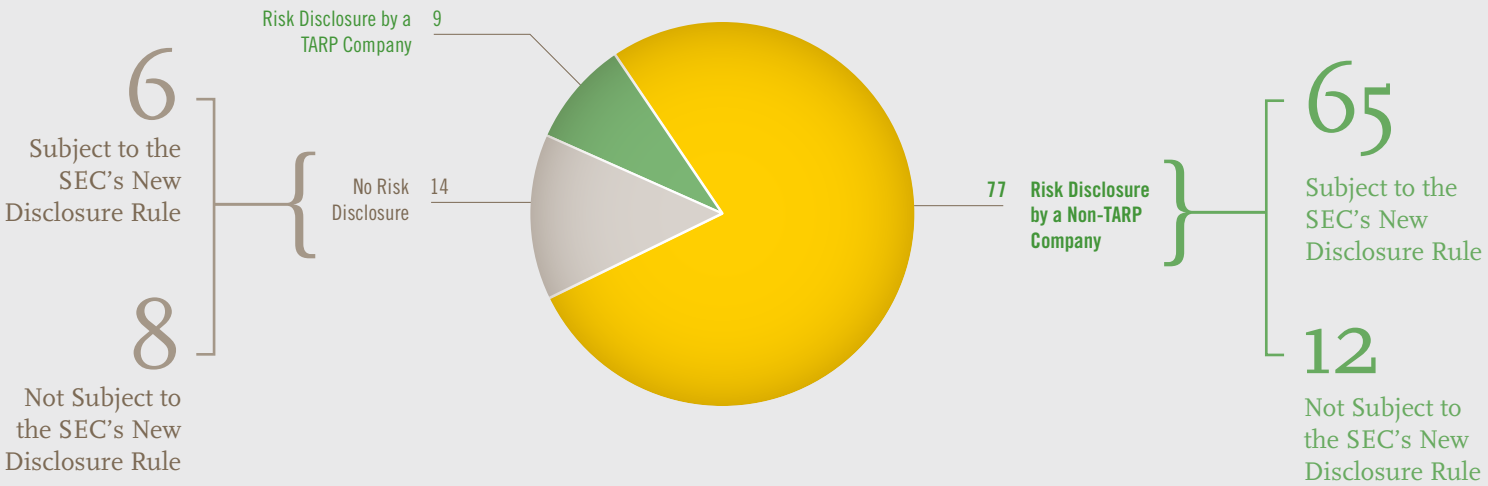
The Reform Act does not specify a deadline for the SEC's rulemaking relating to additional disclosures.

July 29, 2010

Relationship of Compensation to Risk

Under the SEC's amended proxy rules, companies must disclose the relationship between their compensation practices for all employees—not only NEOs—and their risk management philosophy if the risks arising from their compensation programs are "reasonably likely to have a material adverse effect" on the company. Eighty-six of the Top 100 Companies provided some level of "risk" disclosure in their proxy statement (including 12 of the 20 companies not subject to the new disclosure rules). None of these companies concluded that compensation-related risks are reasonably likely to have a material adverse effect on the company. As set forth on the following page, the content of the risk disclosure varied significantly.

Executive Compensation Risk Disclosure of the Top 100 Companies



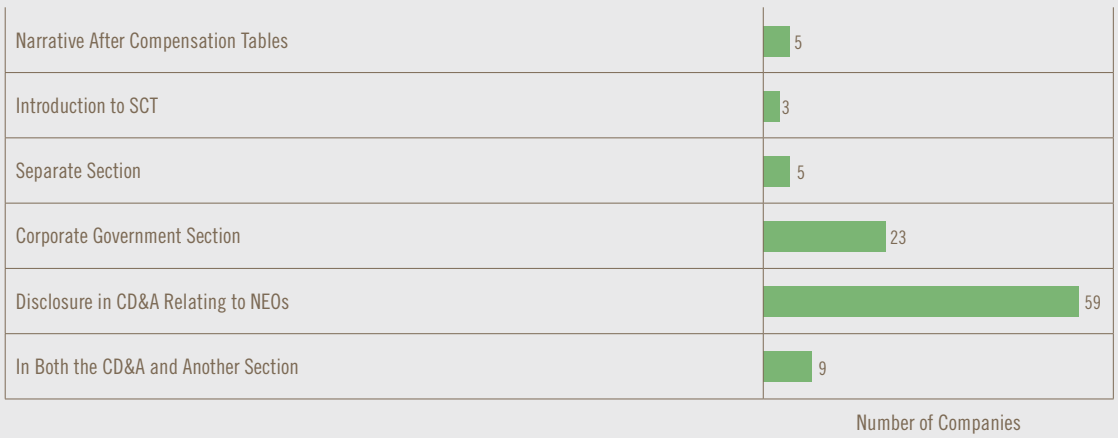
In 2010,

61

Top 100 Companies affirmatively stated that their compensation practices do not lead to material adverse risks.

Location of Risk Disclosure

The placement of risk disclosure within the proxy statement varied widely. The SEC's final proxy rules did not adopt an earlier SEC proposal that would have required the risk disclosure to be incorporated into the CD&A. Companies as a result have discretion over placement. The SEC, by means of a Compensation and Disclosure Interpretation, has encouraged issuers to present risk disclosure together with the remaining Item 402 compensation disclosure. Some issuers have addressed risk in more than one section of the proxy statement.



In response to the SEC's disclosure rules, many companies, including 11 of the Top 100 Companies, have begun to mandate an annual risk assessment in their governance documents, such as the compensation committee charter or the corporate governance guidelines.

Compensation Committee Charter

3

Corporate Governance Guidelines

2

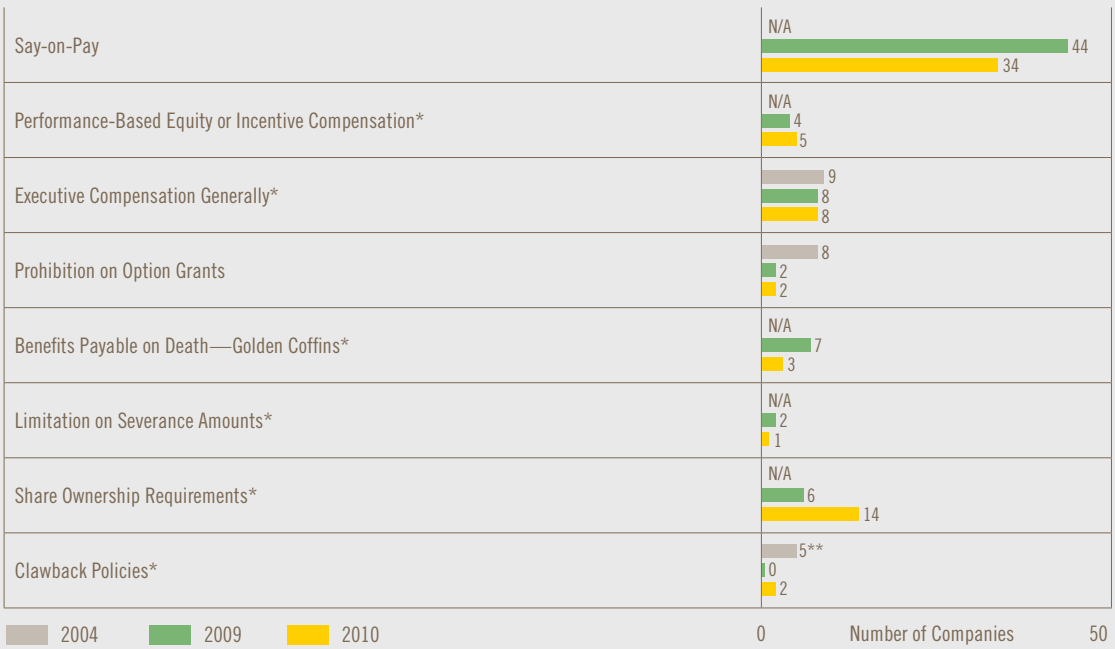
Both Corporate Governance Guidelines and Compensation Committee Charter

Compensation-Related Shareholder Proposals

An aggregate of 69 compensation-related shareholder proposals were submitted at the Top 100 Companies during the 2010 proxy season, down from 73 in 2009 and 89 in 2008. Once again, say-on-pay proposals were the most frequent, with 34 proposals in 2010 (down from 44 in 2009 and 41 in 2008). The numbers of shareholder proposals on say-on-pay and the implementation of clawbacks are likely down as shareholders have anticipated legislation mandating these practices.

Interestingly, the number of proposals requesting share ownership requirements jumped dramatically to 14 in 2010, up from six in 2009 and two in 2008. Thirteen of these proposals sought the adoption of "Hold Through Retirement" policies that would require executives to retain a significant portion of their shares (generally, 75%) acquired through equity compensation programs until at least two years following retirement or other termination from employment.

Shareholders at six Top 100 Companies approved proposals requesting the implementation of say-on-pay. No other shareholder proposals were approved.



*Due to the increased number of compensation-related shareholder proposals, we have collected data in several new categories since 2004, some of which were previously included in the "executive compensation generally" category. In addition, proposals regarding "clawback policies" were previously aggregated in the "performance-based equity or incentive compensation" category.

**Data from 2008.

Say-on-Pay

Allow shareholders to annually pass a nonbinding advisory resolution ratifying the NEO compensation disclosed in the proxy.

Performance-Based Equity or Incentive Compensation

Require: (1) future equity grants and incentive awards to be performance-based; (2) the company to adopt a "pay for superior performance" policy linked to peer group performance; or (3) a significant portion (generally 75%) of future equity grants to employees to be performance-based.

Executive Compensation Generally

Include: (1) requesting the reduction of executive compensation; (2) requesting disclosure of independence of compensation consultants; (3) requiring shareholder approval of supplemental retirement benefits or limiting such plans; (4) eliminating all "golden parachute" excise tax gross-ups; (5) pay disparity; (6) adopting clawback policies; and (7) broad "kitchen sink" proposals seeking a variety of compensation reforms, including pay caps, mandatory share ownership requirements, severance limitations, limitations on SERPs and performance-based equity vesting.

Prohibition on Option Grants

Prohibit all future option grants.

Benefits Payable on Death—"Golden Coffins"

Eliminate arrangements providing for enhanced payments to the estates or beneficiaries of its senior executives upon death and/or requests that the company require shareholder approval in order to provide death benefits to senior executives in the future.

Limitation on Severance Amounts

Board must either: (1) seek shareholder approval of future severance agreements with senior executives that provide for benefits exceeding 2.99 times the sum of the executive's base salary plus bonus or (2) otherwise limit severance payments.

Share Ownership Requirements

Require directors and executive officers to attain minimum share ownership levels or to retain equity award shares for a specified period, often post-retirement.

Global Focus

Although legislation in many non-US jurisdictions permits shareholders to challenge corporate policies (e.g., through the ability to convene shareholder meetings or remove directors), in practice, shareholders rarely raise compensation proposals. The European Commission has stated that the short-term investment horizon of many shareholders has led to a lack of shareholder interest in the long-term objectives of companies. As a result, in June 2010, the Commission announced its intention to launch a broad review of corporate governance in EU-listed companies aimed at encouraging shareholder engagement through, for example, disclosure of voting practices, identification of potential conflicts of interest, and providing shareholders with better information on risk.

There have been a number of proposals at a national level to ensure that shareholders more actively scrutinize compensation policies. A proposed Stewardship Code in the UK outlines good practices for institutional shareholders. This Code aims to encourage shareholder communication with boards, collaboration with other investors where appropriate and fostering a sense of ownership among institutional investors that will result in greater activism. The Code will apply on a "comply or explain" basis.

Say-on-Pay

Nineteen of the Top 100 Companies held nonbinding say-on-pay advisory votes in 2010, including each of the TARP recipients other than The Hartford Financial Services Group, Inc. The Non-TARP recipients were Sysco Corporation, Apple Inc., Microsoft Corporation, Honeywell International Inc., Pfizer Inc., Valero Energy Corporation, Verizon Communications Inc., Prudential Financial, Inc., Motorola, Inc., Intel Corporation and Tech Data Corporation. Shareholders at at least three public companies (including Motorola) did not approve the programs.

CVS Caremark Corporation has announced that it will implement a say-on-pay advisory vote in its 2011 proxy.

Two companies voluntarily put the implementation of a policy up for a vote to their shareholders in 2010:

- Hewlett-Packard Company requested that shareholders approve an annual advisory say-on-pay vote commencing in the 2011 proxy season. This proposal was approved by shareholders on March 17, 2010.
- SUPERVALU INC. requested that shareholders adopt a policy which would provide them with an advisory vote at every third annual meeting. This proposal was approved on June 24, 2010. It is unclear when the first advisory vote will occur.

The Reform Act mandates say-on-pay advisory votes for all annual meetings occurring on or after January 21, 2011.

Of the Top 100 Companies that Held a Say-on-Pay Advisory Vote in 2010,

8

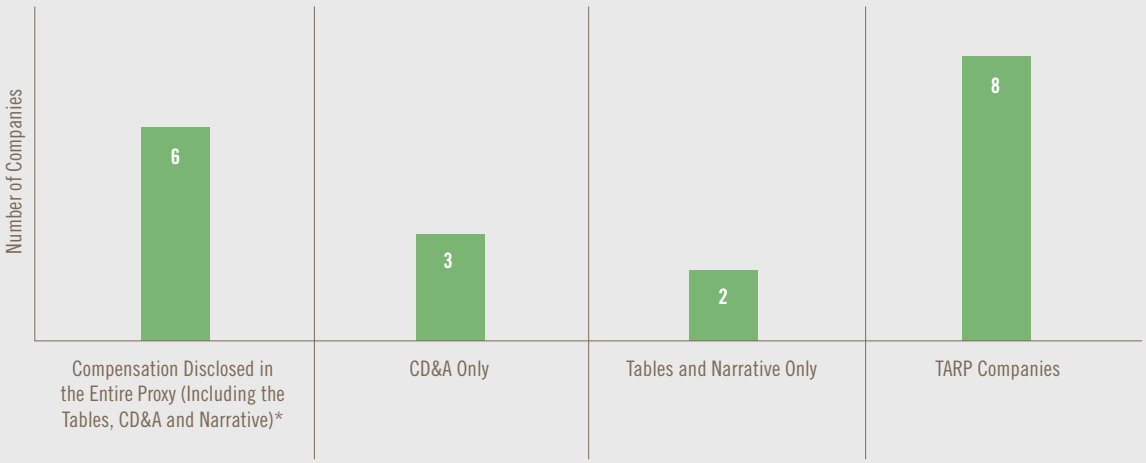
were TARP Recipients

11

were Non-TARP Recipients

Of the 19 Top 100 Companies that held say-on-pay votes in 2010, 18 were approved.

Compensation Being Approved



*Includes one company requesting shareholder approval for the CD&A, the tables and the compensation committee report.

A fundamental say-on-pay implementation question is how to structure the shareholder resolution.

TARP companies must seek shareholder approval of compensation as disclosed in the compensation tables, accompanying narrative and the CD&A. For non-TARP companies, the most common approaches are to request approval of the compensation disclosed in either: (a) the entire proxy (including the CD&A), (b) the tabular and narrative disclosure (but not the CD&A) or (c) only the CD&A.

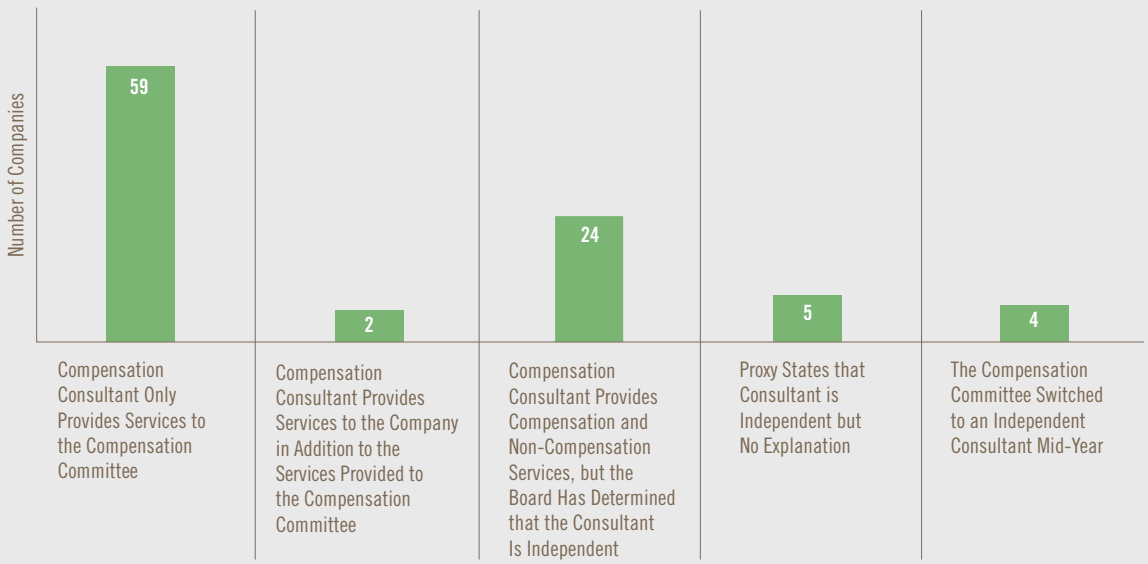
Some public companies (but none of the Top 100 Companies) have adopted more tailored policies that either allow separate votes on the amount of compensation and the compensation committee's decisions or requested separate votes on the compensation of the CEO and the other NEOs. None of the Top 100 Companies, however, provided shareholders with a means to specify which compensation elements or philosophies they approved or disapproved. Marathon Oil Corporation, a Top 100 Company, has not implemented a say-on-pay advisory vote but has publicly encouraged shareholders to contact the company to comment on executive compensation.

Under the Reform Act, shareholders will be asked to approve all compensation disclosure in the proxy statement (including say-on-pay requirements of the CD&A, tables and narratives).

Compensation Consultant Independence

There is growing concern from regulators and shareholder advocates that the use of compensation consultants that provide a broad array of services to the company (such as actuarial, tax, risk management, insurance and information technology services) could create a conflict of interest that calls into question the objectivity of the consultant's recommendations to the board on director and executive compensation matters. Ninety of the Top 100 Companies disclosed that they retained a compensation consultant during calendar year 2009. In addition, management at more than 21 Top 100 Companies retained separate compensation consultants.

Two companies also disclosed that the compensation committee retained independent legal advisers.



The Reform Act does not require that compensation consultants, legal counsel or advisers to the compensation committee of any issuer be independent. The SEC is directed to identify independence factors that compensation committees should take into account in selecting their advisers.

90 } of the compensation committees at Top 100 Companies used the services of compensation consultants

42 } of the Top 100 Companies disclosed that they have voluntarily adopted compensation consultant independence policies

Global Focus

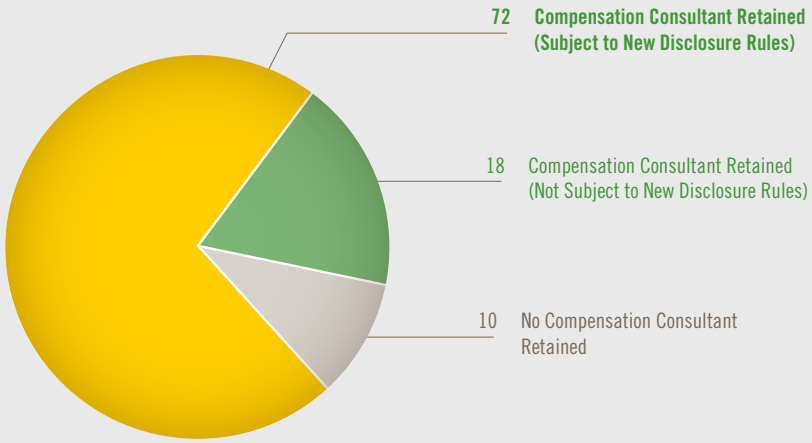
The use of compensation consultants by listed companies is relatively widespread in the EU and questions regarding their independence are receiving increasing attention. The European Commission has stated that compensation committees should ensure that their compensation consultants do not simultaneously advise management (although this recommendation is not binding). In the UK, industry groups representing compensation consultants recently established general rules on independence and conflicts, and recommend that consultants should not accept fees contingent on the introduction of new compensation arrangements for executives. The German corporate governance code also emphasizes the need for the independence of compensation consultants. Similarly, the Italian Stock Exchange's Code of Corporate Governance requires verification of the independence of any compensation consultant proposed to be appointed by a compensation committee.

Where compensation consultants are used, the UK's Corporate Governance Code requires disclosure of whether they have any other connection with the company. Although other EU countries, such as France, Germany and Italy, do not formally require this disclosure, it is often provided voluntarily. In Germany, companies are required to explain the use of non-independent compensation consultants.

There is less concern regarding the use of, and disclosure regarding, independent compensation consultants outside of the EU and the US, including Asia-Pacific jurisdictions.

Compensation Consultant Disclosure

Public companies must: (1) identify any compensation consultants retained and describe who retains them (e.g., the compensation committee or management) and (2) describe the nature and scope of the consultants' assignment and the material elements of the instructions given to the consultants with respect to the performance of their duties.



Of the 10 Top 100 Companies that did not retain a compensation consultant,

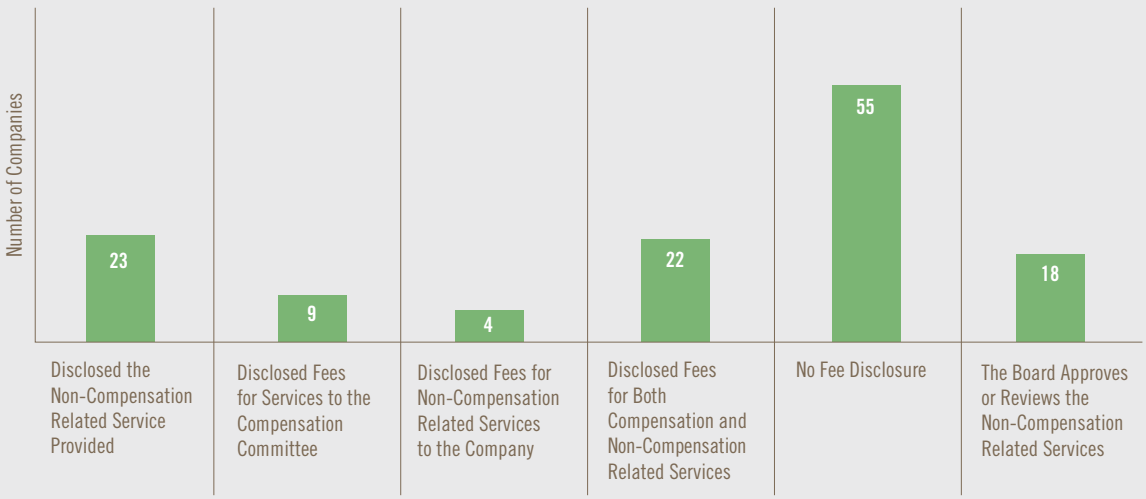
6

Affirmatively Stated That They Did Not Retain a Compensation Consultant

4

Provided No Disclosure

Beginning with proxy statements filed on and after February 28, 2010, (1) if a board retains its own compensation consultant and (2) the consultant also provides non-executive services to the company and receives fees for such non-executive services in excess of $120,000 during the applicable year, then the company must disclose the fees for both (A) executive and director compensation services and (B) non-executive and director compensation services. If the board has not engaged its own consultant, fee disclosure is also required if a consultant provides both executive and non-executive services to the registrant and the fees for the non-executive services exceed $120,000. In many instances, companies provided fee disclosure even if not required. The company must also disclose whether the board approved the non-executive services.



Any proxy statement filed one year after the enactment of the Reform Act must also disclose (in accordance with rules to be established by the SEC): (1) whether the compensation committee retained a compensation consultant, (2) if the consultant's work raised a conflict of interest and (3) how that conflict is being addressed.

Clawback Policies

In 2010, a record number of Top 100 Companies (71 companies) publicly disclosed that they maintain a "clawback policy" triggered upon the occurrence of certain events affecting the company's financial statements. An additional eight of the Top 100 Companies have disclosed that they adopted a clawback policy or expanded their existing clawback policy effective in 2010 or later. In addition, shareholders at two Top 100 Companies have submitted proposals requesting that the company adopt a performance-compensation clawback policy. The Reform Act requires all public companies to implement a clawback policy. Most companies will likely need to revisit their existing policies to comply with the Reform Act's requirements.

The number of Top 100 Companies that publicly disclosed that they maintain a "clawback policy" reached record heights this year,

in 2007 — 35

in 2009 — 56

in 2010 — 71

Location of Clawback Policies

Ten Top 100 Companies maintain the policy in the corporate governance guidelines, 19 companies disclose that the policy is included as a provision in a plan or award agreement, one includes the policy as a provision in the compensation committee charter and one includes the policy in both the corporate governance guidelines and the compensation committee charter. The remaining 40 Top 100 Companies do not publicly disclose where the policy is formalized.

Clawback Policy Trigger Events

One of the most challenging aspects of understanding and drafting clawback policies pertains to the applicable trigger events. Over 56% of the Top 100 Companies that maintain clawback policies require fraud or misconduct resulting in a financial restatement as a trigger event. In contrast, approximately 25% enhance the scope of the policy by triggering the recovery solely upon the occurrence of a financial restatement, regardless of the cause. Another 15% require fraud or misconduct relating to the company's financials but do not require a financial restatement. Finally, more than 39% of the Top 100 Companies require that the employee be involved in the fraud or misconduct in order to trigger recoupment—more than double the number from 2009. The Reform Act triggers recoupment upon an accounting restatement due to material non-compliance with any financial reporting requirement; there is no fraud or misconduct requirement.

Surprisingly, only approximately 20% of the clawback policies maintained at the Top 100 Companies are mandatory and the remainder of the clawback policies leave the discretion to the company's board as to whether recoupment will be required.

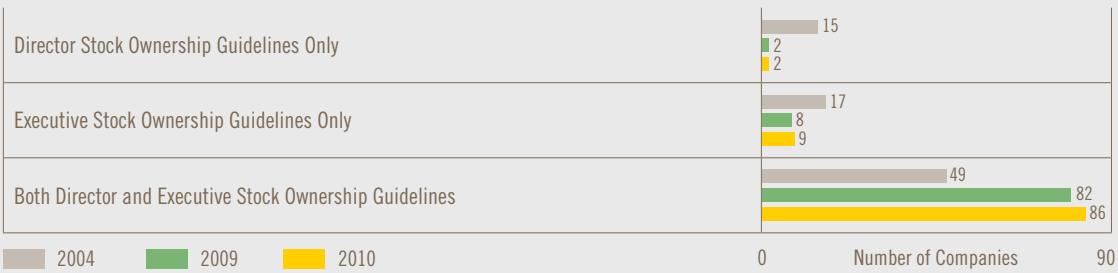
this is an almost **103%** increase since 2007

Employees Subject to Clawback Policies

A threshold issue is determining which employees will be subject to the clawback policy. Just over half of the Top 100 Companies who disclosed clawback policies provide that the policy covers all executive officers (40 of the 71 Top 100 Companies). However, less than 6% of the policies apply exclusively to NEOs, approximately 28% cover a select group of employees (such as senior managers) and approximately 10% apply the clawback to all employees. Only one of the Top 100 Companies did not publicly disclose the employees who are subject to the clawback policies. Clawbacks as mandated under the Reform Act will apply to all current and former executive officers.

Stock Ownership Guidelines

Ninety-five of the Top 100 Companies maintain stock ownership guidelines for their executives (an increase from 90 companies in 2009) and 88 companies maintain director stock ownership guidelines (an increase from 84 in 2009). An additional seven companies strongly encourage director stock ownership without mandating specific ownership requirements.



Further Consideration

A growing design trend is the addition of "hold until" or "hold through" retirement features that require executives to retain a percentage of the after-tax shares acquired from equity awards (generally 75%) until termination of employment or for a specified period thereafter. Hold until or through retirement policies address investor concerns that stock ownership guidelines have not kept pace with the increased level of equity grants and emphasize long-term performance as executives will not be permitted to benefit from short-term fluctuations in share prices.

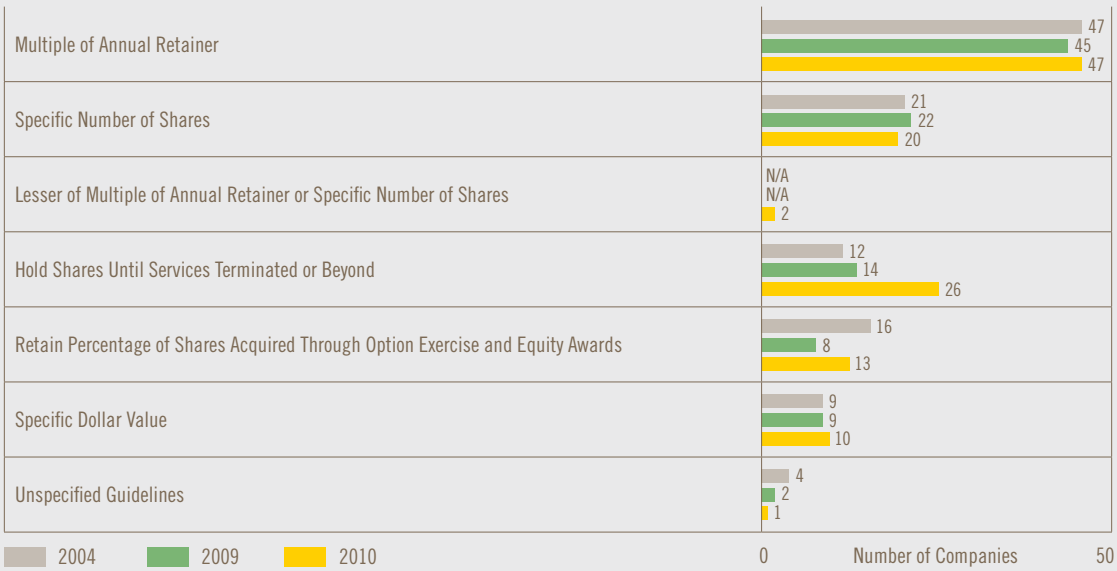
Retention-based programs have garnered significant momentum with shareholder advocates and institutional shareholders. Shareholders at 13 Top 100 Companies proposed the adoption of these policies in 2010. None of the proposals were approved by shareholders. More than 26 of the Top 100 Companies publicly disclosed that they maintain hold until — or hold through — retirement policies for directors and/or executives.

Design decisions for such guidelines include (1) how deeply within the executive ranks to apply the requirements, (2) the percentage of after-tax shares executives must retain, (3) how long the holding requirement should be and (4) the consequences of a failure to comply.

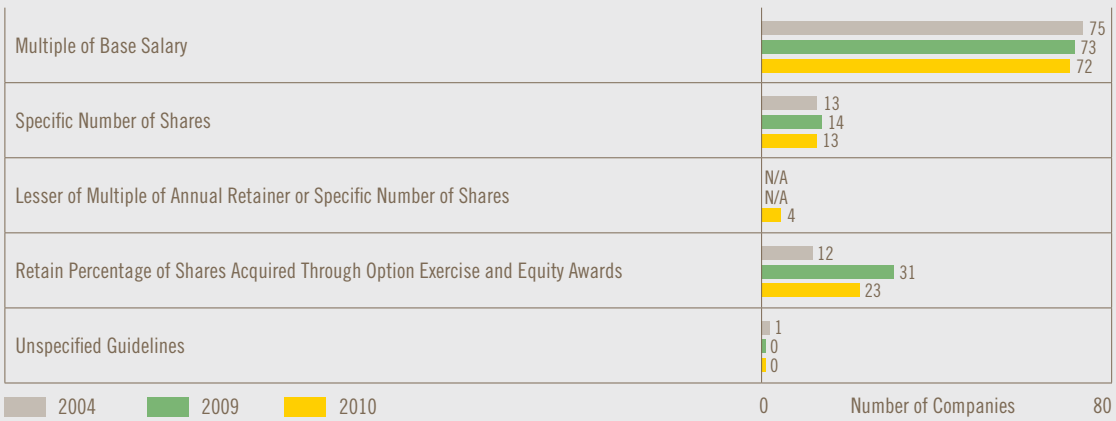
While hold-until retirement requirements could give valued executives with significant equity holdings an incentive to retire early in order to be able to realize value from their stockholdings and avoid the risk of price fluctuations, requiring executives to hold equity for one to two years following separation from service could mitigate this incentive.

- The terms of stock ownership policies vary among the Top 100 Companies. In most instances, directors and executives are given a period of time (generally 3-5 years) to satisfy the guidelines.
- Four of the Top 100 Companies provide that directors and executives will be ineligible to receive future equity grants until the ownership requirements are attained.
- Twenty-seven of the Top 100 Companies provide that directors and executives must hold all or a portion of their equity grants until the company's stock ownership guidelines have been satisfied.

Director Guidelines



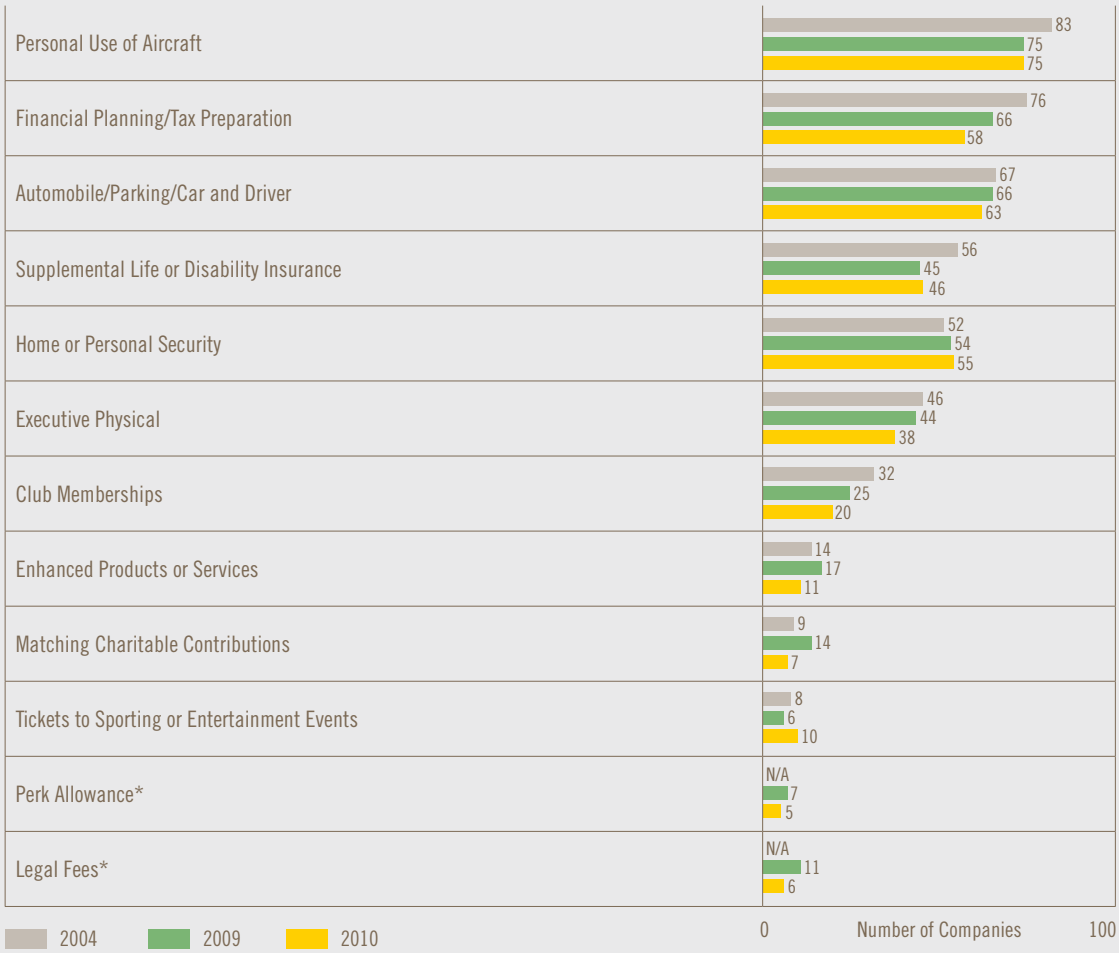
Executive Guidelines



Sixty-eight of the 97 Top 100 Companies that maintain stock ownership guidelines disclosed the progress by each director or executive toward satisfying the guidelines; a majority noted that all directors and executives were in compliance or on their way to compliance within the required time period.

Executive Perks

Executive perks have generated much debate in today's unstable economy. While the overall use of executive perks remained fairly steady in 2010, there was a slight, but noticeable, decline from 2009 in certain perks. More than eight of the Top 100 Companies also disclosed that they would reduce or eliminate the use of perks beginning in 2010 or 2011.



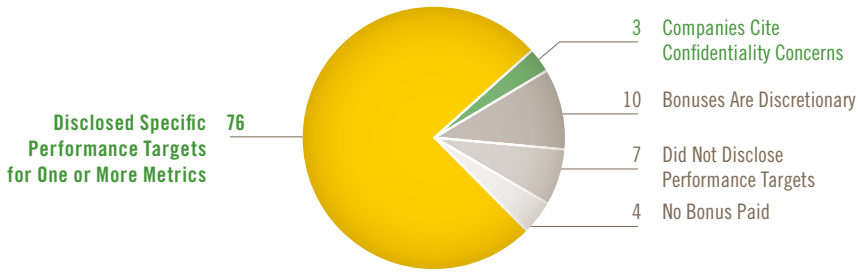
*Data not collected in 2004.

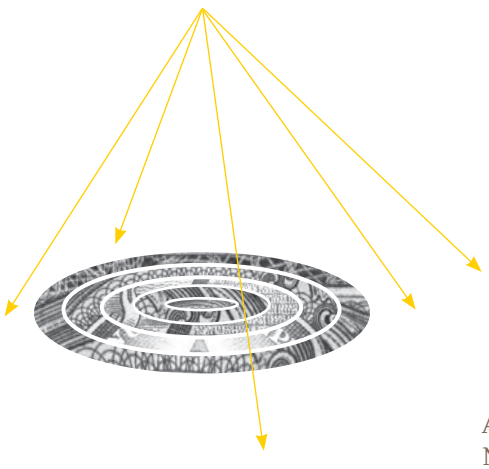
Global Focus

It is common in many jurisdictions outside of the US to provide limited perks such as cars, insurance or gym membership to a wide range of employees. Criticism of these practices does not, however, appear to be at the same level as in the US, perhaps because perks are more limited in nature, and their provision is not confined to senior executives. Extensive perks, such as use of private jets, are very uncommon outside the US, and their use would be subject to significant shareholder disapproval.

Annual NEO Bonuses

Issuers regularly grapple with the requirement that they disclose details regarding their performance-based annual bonus programs, including the specific performance targets for each performance measure. The SEC's comment letters often request additional disclosure regarding performance targets, and the SEC will permit the exclusion of performance targets from a proxy statement only if the information satisfies the SEC's standards governing confidential filing treatment. Many issuers will disclose performance targets for some metrics (such as company-wide metrics) but not others (including certain business unit metrics). The number of Top 100 Companies that disclose specific performance targets for one or more metrics has steadily increased by 31% from 45 in 2007 to 76 in 2010.





Top 100 Companies that did not pay bonuses or paid reduced bonuses due to the failure to meet performance targets,

in 2010

25

in 2009

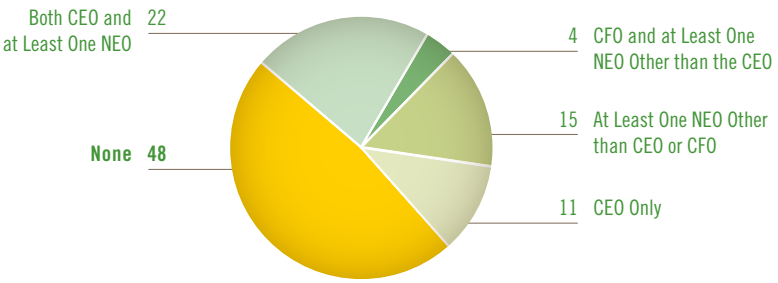
15

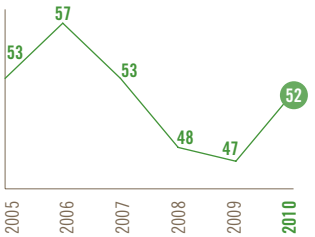
At least three Top 100 Companies paid bonuses to one or more of their NEOs notwithstanding that the performance criteria were not satisfied.

NEO Agreements

NEO Employment Agreements

Of the Top 100 Companies, 52 have entered into employment agreements with one or more of their NEOs, including 33 with the CEO, 22 with the CFO and 38 with other NEOs.



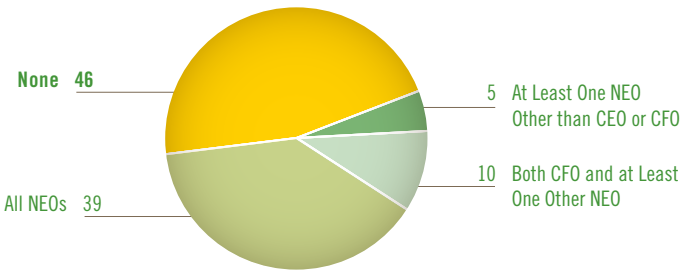


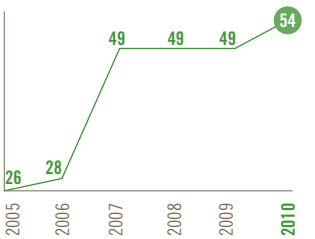
Number of companies maintaining employment agreements with one or more NEOs

Two of the Top 100 Companies announced that they have terminated employment agreements with one or more of their NEOs beginning in 2009, and one company has adopted a standard severance arrangement for all NEOs commencing in 2009.

NEO Stand-Alone Severance Plans/Arrangements

Of the Top 100 Companies, 54 maintain stand-alone severance plans or agreements for their NEOs.



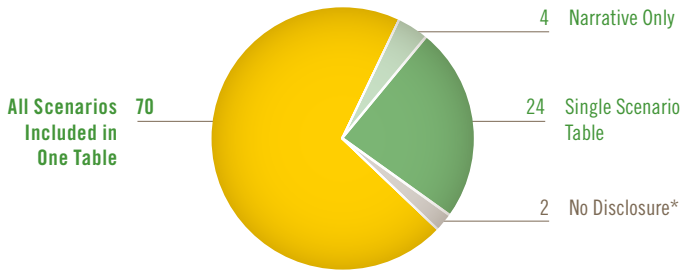


Number of companies providing severance protection to one or more NEOs

Termination/Change in Control Disclosure

Presentation of Disclosure

Public companies must quantify the potential awards payable to each NEO assuming a termination of employment or change in control occurred on the last day of the year. The SEC has indicated that it prefers tabular disclosure over narrative disclosure. Of the 98 Top 100 Companies that offer post-employment benefits, 94 provided tabular disclosure (up from 90 in 2009) and four provided their required disclosure in a narrative format (down from eight in 2009).



Nature of Amounts Disclosed

Although the disclosure rules require disclosure only of unvested amounts that are payable upon a triggering event, the SEC and many shareholder activist groups continue to express their preference for disclosing the aggregate amount payable upon each triggering event, often referred to as the "walk away" number. This would include amounts that have previously been earned and vested such as supplemental pensions, deferred compensation and equity awards. The number of Top 100 Companies disclosing both vested and unvested amounts decreased from 13 in 2009 to nine in 2010.

Unvested Amounts Only

9

Both Vested and Unvested Amounts

7

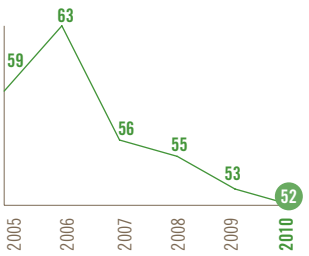
Not Specified*

*Includes two companies that do not provide post-employment or change in control benefits.

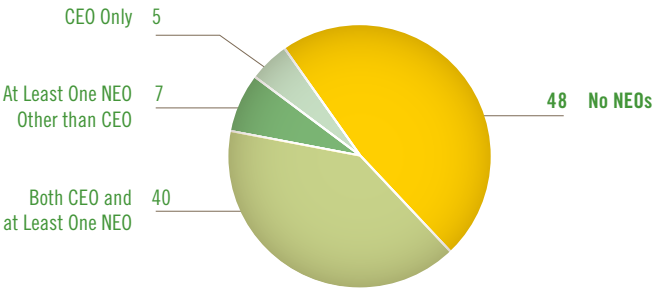
Change in Control Benefits

NEO Change in Control Arrangements

Of the Top 100 Companies, 52 disclosed that they provide change in control benefits to one or more of their NEOs, including 45 to the CEO, 46 to the CFO and 47 to other NEOs.



Number of companies providing change in control protection to one or more NEOs



Single or Double Trigger for Non-Equity Change in Control Benefits

Of the 52 companies that provide for enhanced benefits (other than accelerated equity) on a change in control, none of the Top 100 Companies provide for automatic payment upon a change in control (*"single trigger"*), down from four in 2009. Forty-nine companies provide for payment only if the executive's employment is terminated within a specified period following the change in control (*"double trigger"*), which is consistent with 2009. Three companies provide for both single and double trigger vesting, depending on the benefit.

Double Trigger

Both Single and Double Trigger (depending on the benefit)

Single Trigger

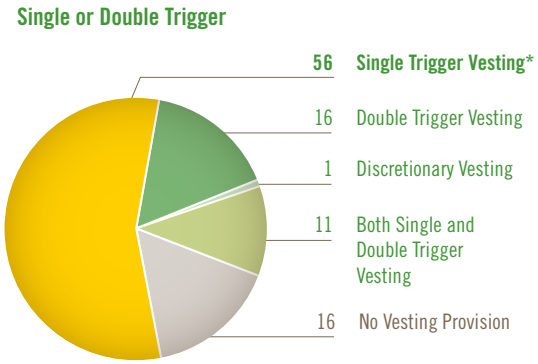
Equity Change in Control Vesting Provisions

84

Have disclosed in their proxy statements that they provide equity change in control vesting provisions

16

Have not disclosed equity change in control vesting provisions



*Includes plans that provide for automatic single trigger vesting unless awards are assumed by the surviving entity.

More than eight Top 100 Companies have announced that beginning in 2010 they will switch to double trigger vesting for equity awards.

Global Focus

The use of change of control provisions in non-US jurisdictions varies considerably. In the UK, Italy, Hong Kong and China, change in control provisions in employment contracts are uncommon. On the other hand, in Germany it is common to provide executives with change of control severance payments (capped at three years' salary by law). In France, the Code of Corporate Governance recommends that payments to executive officers of listed companies upon termination should be only provided where there is an *"imposed departure linked to change in control or change in strategy."* These provisions must be disclosed in the annual report and submitted for approval at the general shareholders meeting.

Tax Gross-Ups

Change in Control Gross-Up Provisions

There was a 12% decrease in the number of Top 100 Companies disclosing that they will provide gross-up payments for the effects of the "golden parachute" excise tax imposed under the US Internal Revenue Code since 2009. The provision of gross-ups is high on the list of poor pay practices for many institutional shareholders. Fourteen of the Top 100 Companies have announced that they have modified or eliminated gross-ups particularly for future arrangements. Two Top 100 Companies disclosed that they will reduce the amount of certain change in control payments to an amount below the Internal Revenue Code limits.

	2008	2009	2010
Provide Gross-Up Payments	51	51	43*
Will Not Provide Gross-Up Payments	49	49	57

*Includes four Top 100 Companies that provide a modified tax gross-up which only applies if the change in control payments subject to the gross-up exceed a specified amount.

Tax Gross-up for Perks

Tax gross-ups on perquisites are a hot-button issue with many shareholder activists. One Top 100 Company disclosed that it provides for a tax gross-up under Section 409A of the Internal Revenue Code.

Top 100 Companies that disclosed that they provided tax gross-ups on some or all of the perks provided to executives,

in 2009,

52

in 2010

38

and

12

Companies disclosed that they would eliminate tax gross-ups for some or all perks in 2010.

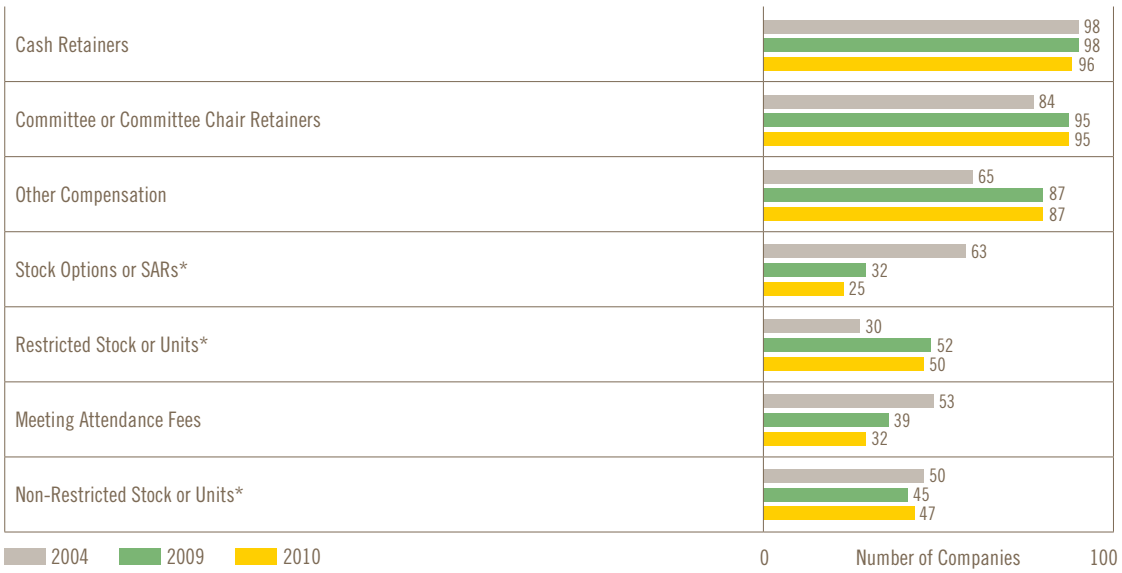
Director Compensation

Since 2004, we have monitored the components of director compensation and trends in director pay. The pages that follow illustrate the forms and amounts of current director compensation compared to the compensation paid in 2004.

Director Compensation

Overall Composition of Director Compensation

Director compensation continues to be comprised of a mix of cash and equity. Since 2004: (1) equity compensation has trended away from stock options and stock appreciation rights (*"SARs"*) to full-value share awards and (2) there has been a reduced reliance on meeting attendance fees.

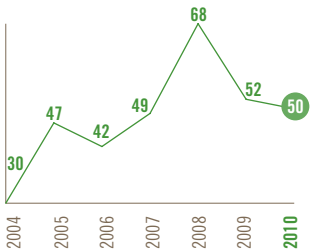


*Some of the Top 100 companies provide for initial equity grants even if no such grants were necessary in 2010.

Director Compensation— Equity Awards

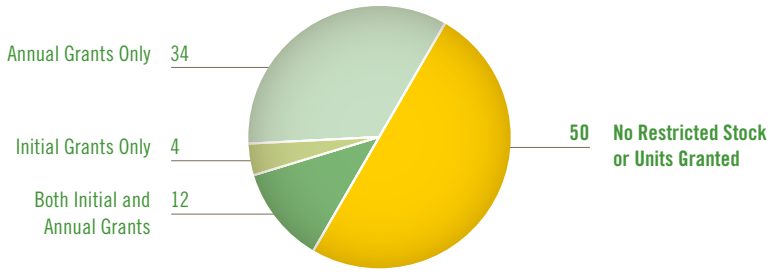
Director Restricted Stock or Unit Grants

Of the Top 100 Companies, 50 grant restricted stock or restricted stock units as a component of director compensation.*



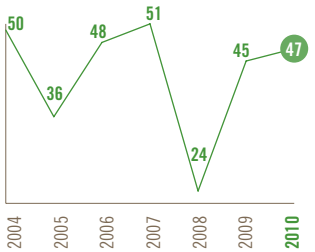
Number of companies granting restricted stock or units to directors

Frequency of Restricted Stock or Unit Grants



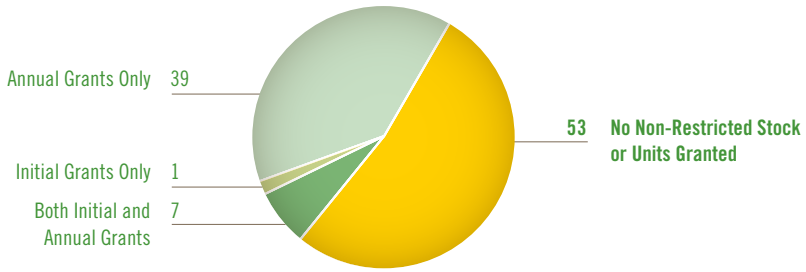
Director Non-Restricted Stock or Unit Grants

Of the Top 100 Companies, 47 grant non-restricted stock or units as a component of director compensation.*



Number of companies granting non-restricted stock or units to directors

Frequency of Non-Restricted Stock or Unit Grants



*Some of the Top 100 companies provide for initial equity grants even if no such grants were necessary in 2010.

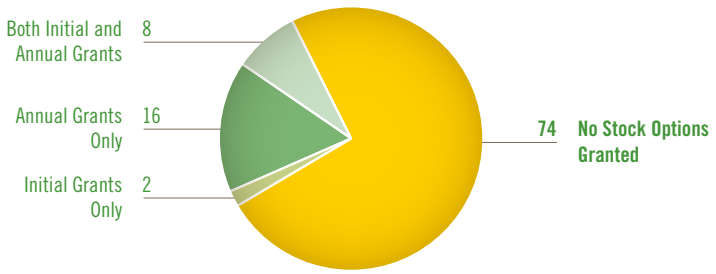
Director Compensation— Equity Awards

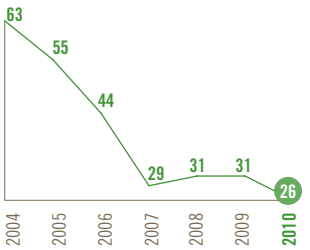
Director Stock Option Grants*

Twenty-six of the Top 100 Companies grant stock options, and one of the Top 100 Companies grants SARs, as a component of director compensation.

*Some of the Top 100 companies provide for initial equity grants even if no such grants were necessary in 2010.

Frequency of Stock Option Grants

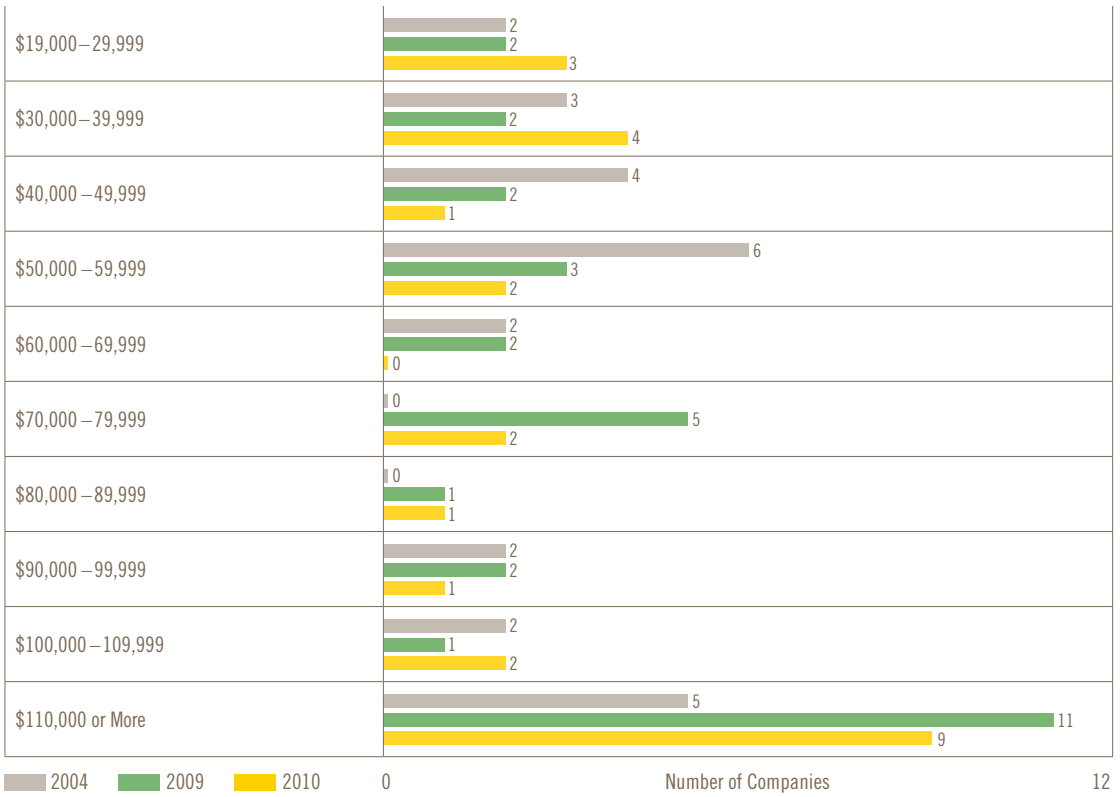




Number of companies granting stock options to directors

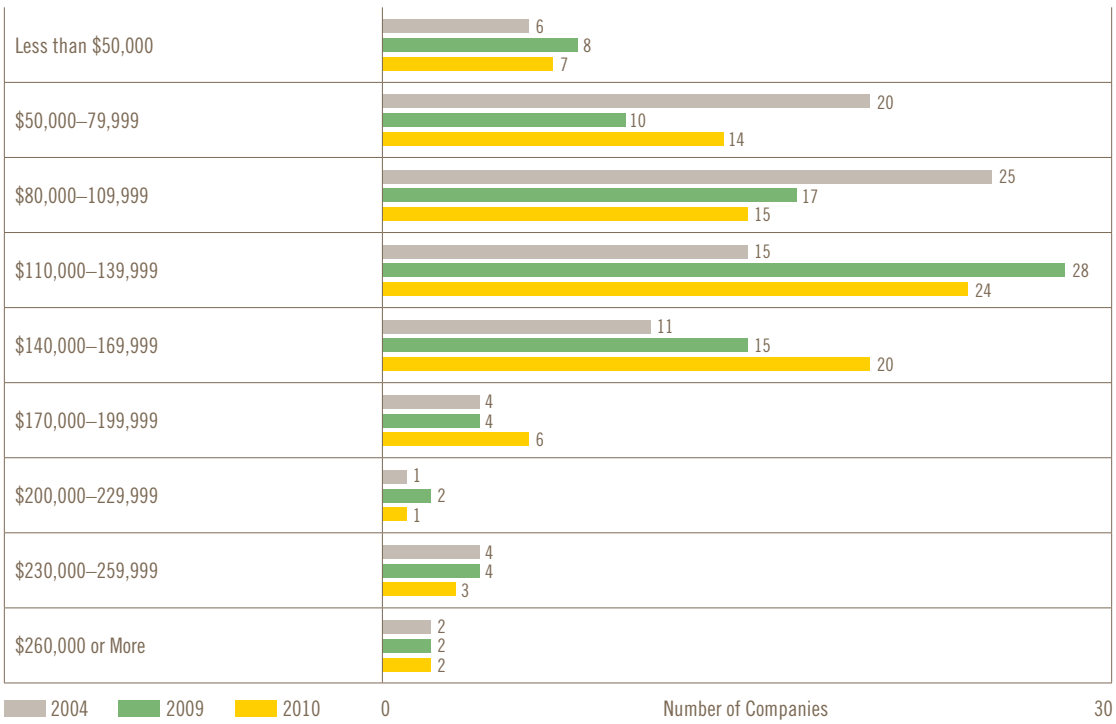
Grant Date Fair Market Value of Stock Options

The fair market value of stock options and SARs granted to directors (as determined under FAS 123R) ranged from $19,200 to $777,070, compared to a range of $7,195 to $1,296,700 in 2009.



Grant Date Fair Market Value of Stock Awards

The fair market value of stock awards granted to directors (as determined under FAS 123R) ranged from $30,000 to $497,156, compared to a range of $19,200 to $492,200 in 2009.

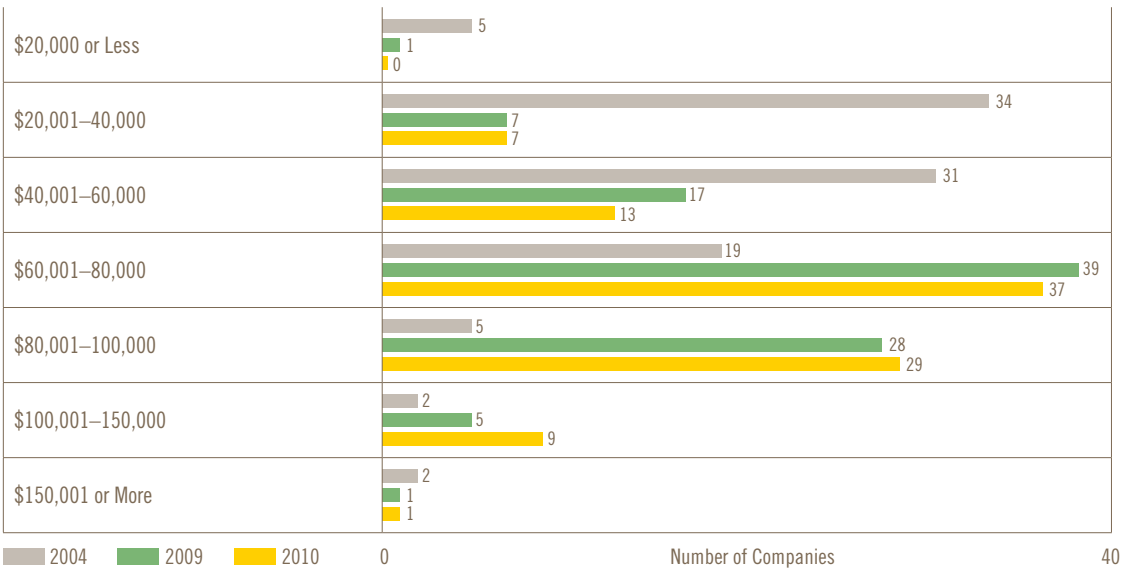


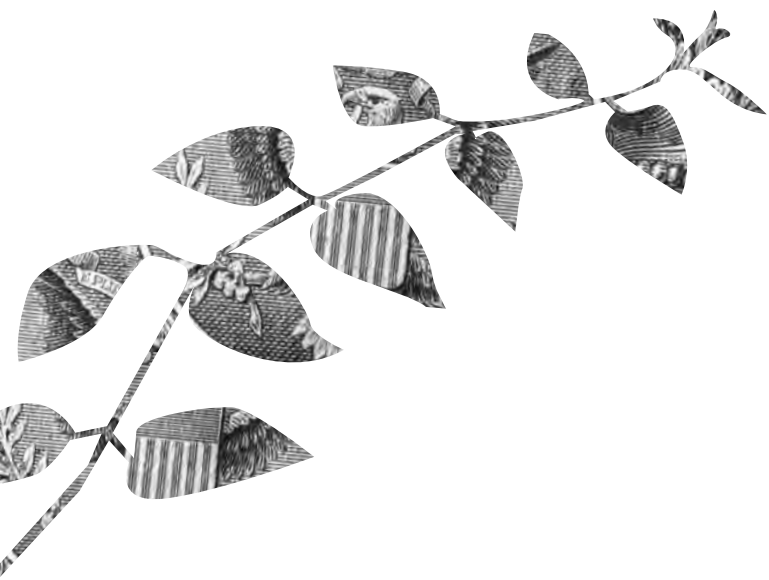
Ninety-six of the Top 100 Companies grant equity-based compensation to their nonemployee directors. Six of the Top 100 companies permit directors to select the composition of their equity awards (e.g., restricted stock, stock options or a combination thereof).

Director Compensation — Annual Cash Retainer

Amount of Annual Cash Retainer

Ninety-six of the Top 100 Companies paid annual cash retainers to directors. Annual cash retainer amounts ranged from $30,000 to $208,000 in 2010, remaining substantially similar to the ranges in 2009 ($20,000 to $192,500). The number of Top 100 Companies that pay annual retainers in the range of $60,001 – $100,000 has substantially increased since 2004 (from 24 companies in 2004 to 66 in 2010) — while the number of companies paying $60,000 or less has proportionately decreased (from 70 companies in 2004 to 20 in 2010). Directors at one Top 100 Company voluntarily forewent their annual cash retainer.





Equity Elections in Lieu of Cash

Of the Top 100 Companies, 83 permit directors to elect to receive stock options, stock, restricted stock or units, or a combination thereof, in lieu of cash retainers and fees. One company provides directors with a bonus equity grant if the director elects to receive equity in lieu of cash fees.

Form of Equity Elections

67

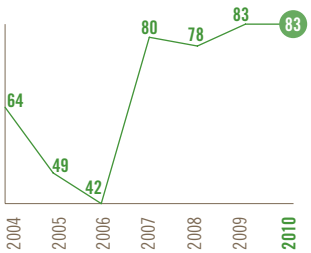
Companies permit directors to elect to receive non-restricted stock or units.

7

Companies permit directors to elect to receive stock options in lieu of cash fees.

9

Companies permit directors to elect to receive restricted stock or units subject to vesting.



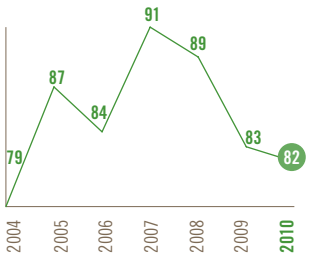
Number of companies permitting directors to elect to receive equity in lieu of cash

Companies continue to encourage equity ownership by directors by providing them with the opportunity to elect to receive equity in lieu of cash retainers. While there was no increase in this practice between 2009 and 2010, the number of companies that provide directors with the right to elect to receive equity in lieu of cash has almost doubled since 2006.

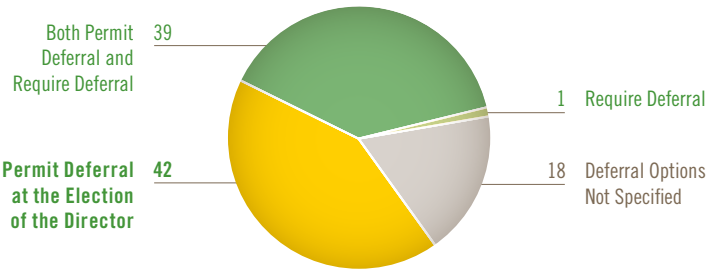
Director Compensation—Deferrals

Deferral of Board Compensation

Of the Top 100 Companies, 82 require or permit directors to defer all or a portion of their cash compensation or equity grants.



Number of companies that require or permit directors to defer cash compensation

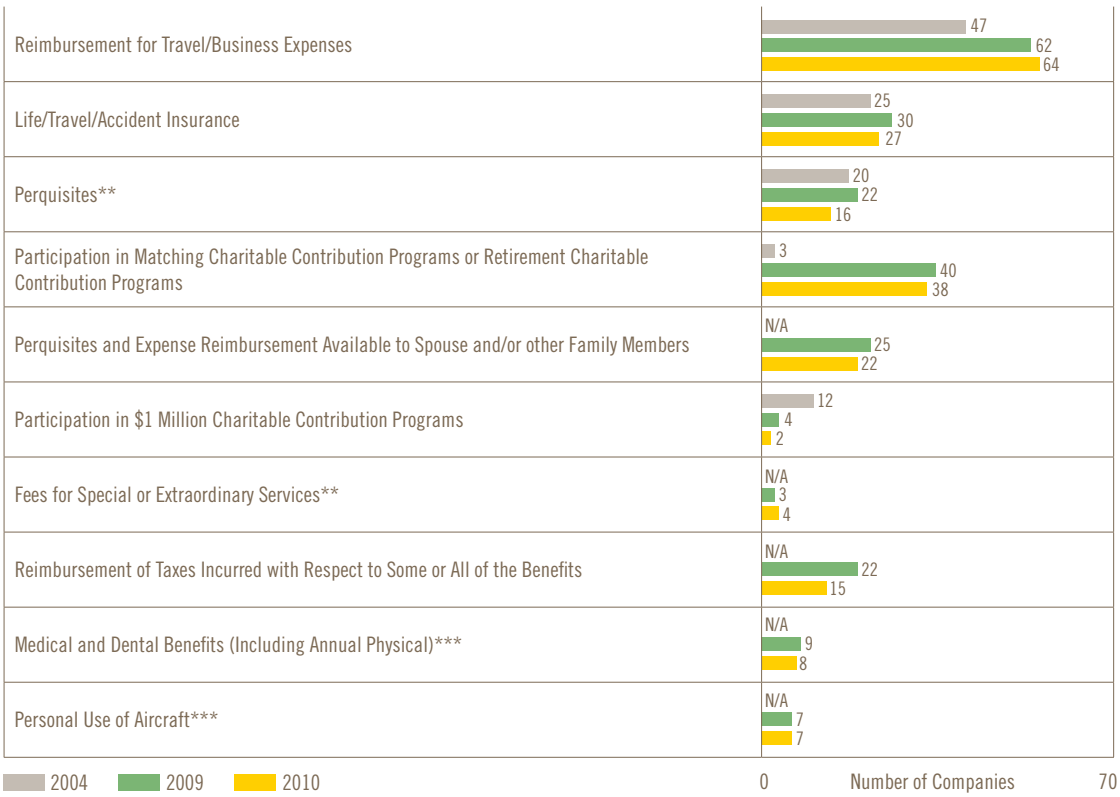


Many companies require or permit directors to defer all or a portion of their cash compensation or equity grants in order to more closely align the interests of the directors with those of the shareholders. While the number of companies requiring or permitting deferrals slightly decreased in 2010, shareholder activists continue to encourage companies to require that directors defer equity grants through or until their retirement from the board of directors.

Director Compensation — Other Compensation

Due to the more stringent proxy disclosure requirements, companies have provided greater details regarding perquisites and other benefits provided to directors since 2007. Not surprisingly, the number of companies providing perquisites to their directors decreased in both 2009 and 2010. The number of companies providing tax gross-ups with respect to perquisites also decreased in 2010, likely due to negative public perception. These tax gross-ups were often made with respect to the costs associated with the directors' spouses attending official events at the company's expense.

Other Forms of Director Compensation*



*Data only reflects active programs that are available to all directors. Frozen or grandfathered programs are excluded.

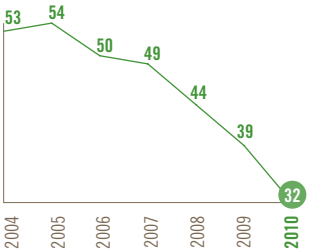
**The most common perks provided to directors are company products and services and tickets to sporting and similar events.

***Prior to 2007, these items were shown under the general perquisite category. However, due to enhanced perquisite disclosure requirements instituted in 2007, greater detail regarding director compensation is now publicly available, and we treat these as separate data points.

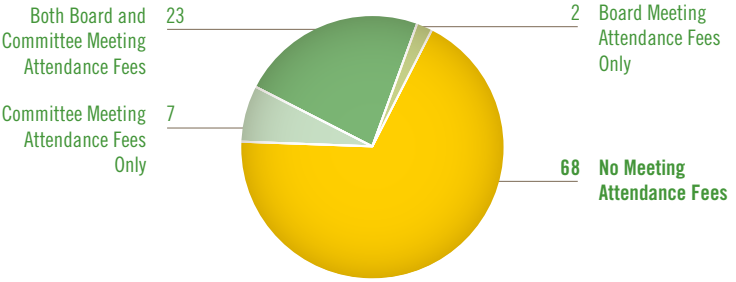
Director Compensation — Meeting Attendance Fees

Meeting Attendance Fees

Thirty-two of the Top 100 Companies paid board and/or committee meeting attendance fees in 2010.



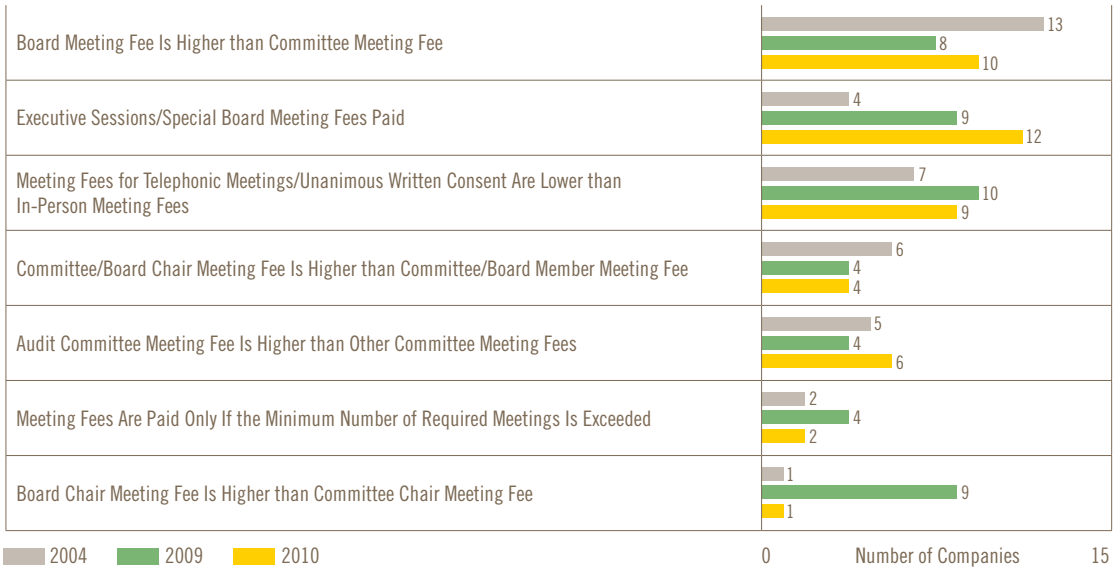
Number of companies paying meeting attendance fees to board and/or committee members



2010 showed a continued decrease in the use of board and committee meeting attendance fees. This reduction — when combined with the increased annual retainers, committee and committee chair retainers — evidences the consensus that director attendance at meetings is a requirement and is not optional.

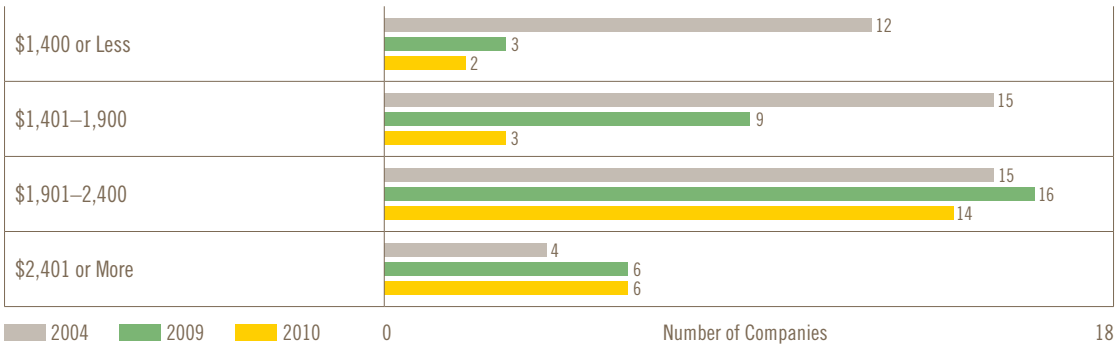
Amount of Meeting Attendance Fees

The amount of the meeting attendance fees differs based on the type of meeting (e.g., board or committee) and whether the meeting is in person or telephonic.



Board Meeting Attendance Fees

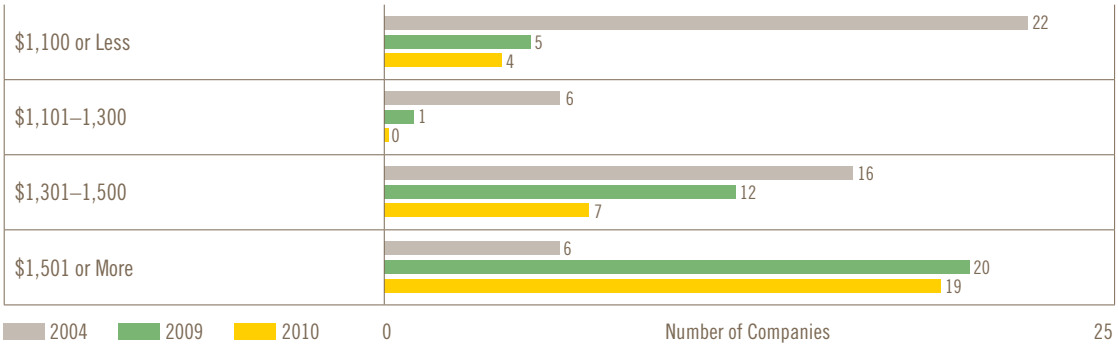
Twenty-five of the Top 100 Companies pay meeting attendance fees to members of the board, compared to 46 in 2005 and 34 in 2009.



Two Top 100 Companies reduce the annual retainer paid to a director if the director does not attend a specified percentage of board and committee meetings, usually 75% to 85%.

Committee Meeting Attendance Fees

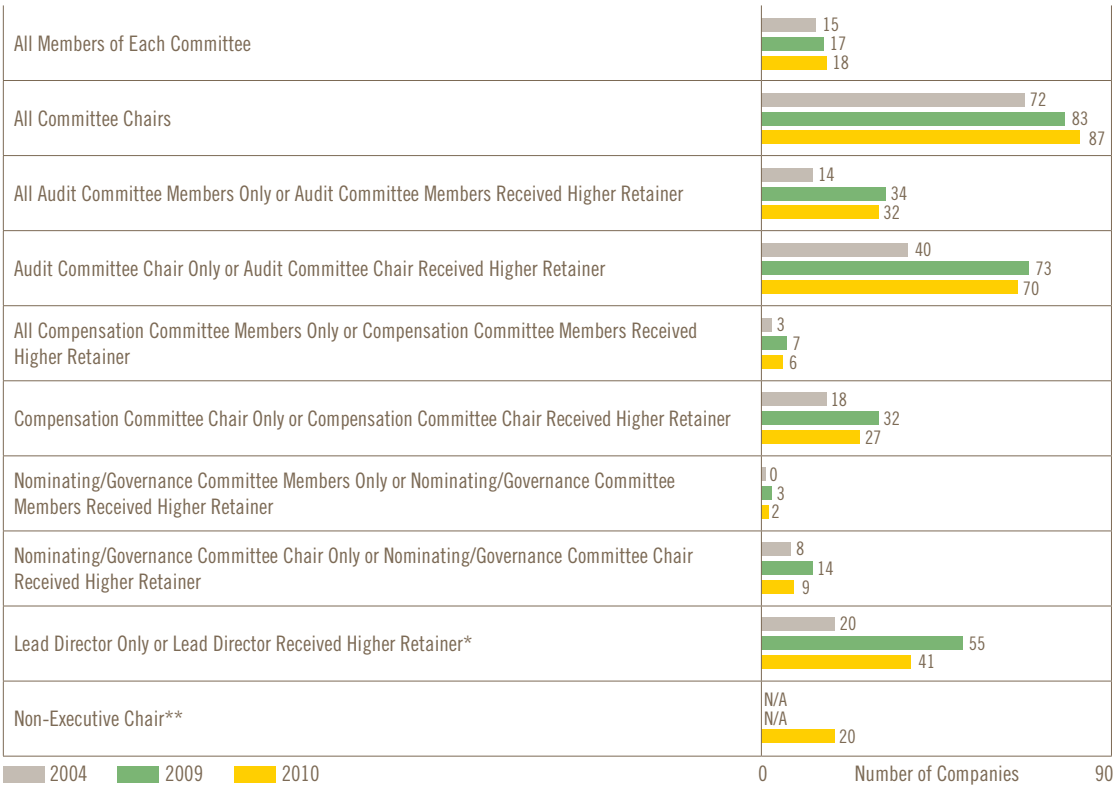
Thirty of the Top 100 Companies pay meeting attendance fees to members of committees, compared with 50 in 2004 and 38 in 2009.



Director Compensation — Committee Fees

Committee and Committee Chair Retainers

Ninety-five of the Top 100 Companies pay committee retainers to members and/or chairs of some or all of the board committees, the same as in 2009.

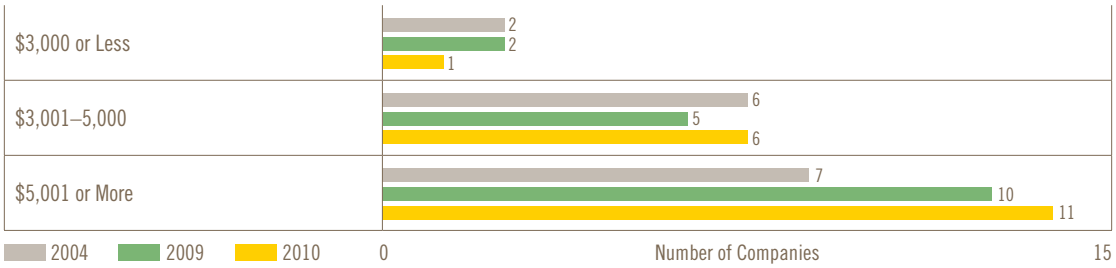


*Data for this category was not collected in 2004. Earliest data point reflects 2007 data. Data for 2007 and 2009 includes fees paid to the non-executive chair, which is included as a separate data point this year.

**Data for this category was not collected prior to 2010.

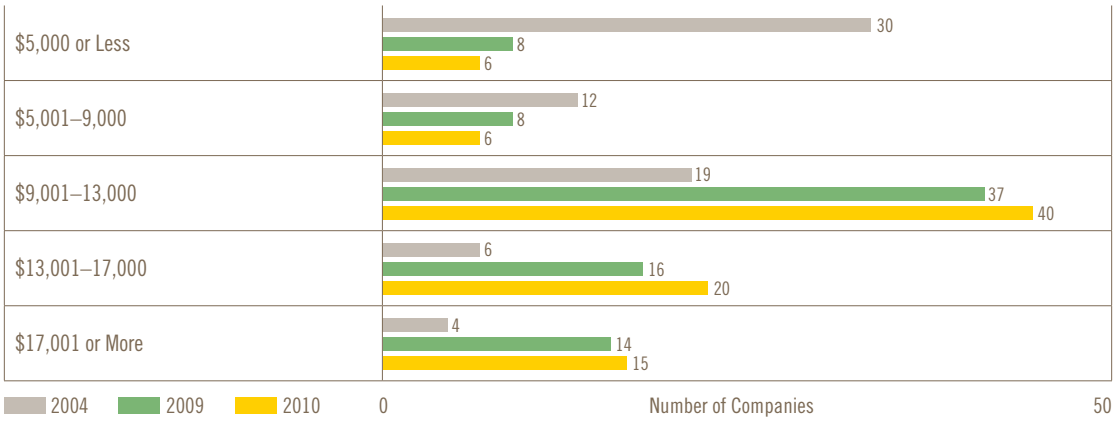
Committee Retainers

The number of companies that pay committee retainers has remained fairly constant since 2004. Of the Top 100 Companies, 18 pay a retainer to all committee members, one more than the number of the Top 100 Companies surveyed in 2009 and an increase from the 15 companies in 2004. The fees paid range from $2,500 to $20,000.



Committee Chair Retainers

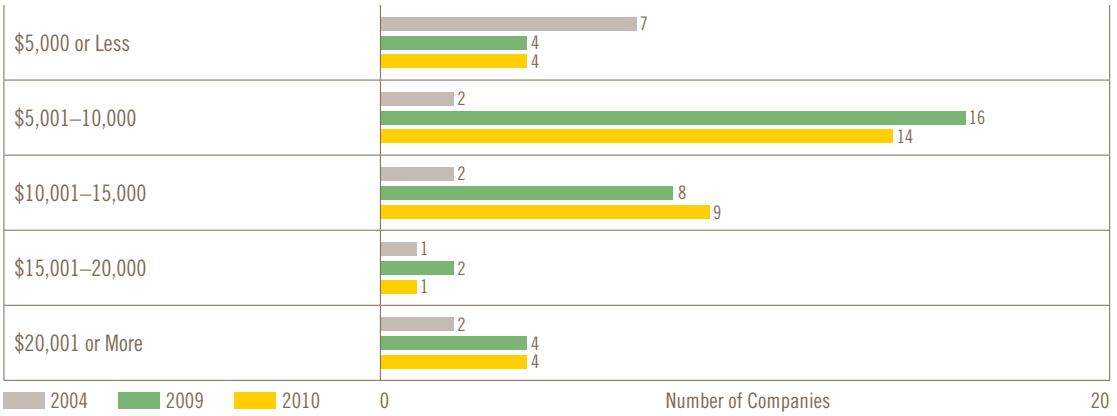
Of the Top 100 Companies, 87 pay a retainer to each committee chair, compared with 83 of the Top 100 Companies surveyed in 2009 and 71 in 2004. The fees paid range from $2,500 to $30,000. In 2009, the highest committee chair retainer was $68,672.



Director Compensation—Committee Fees

Audit Committee Retainers

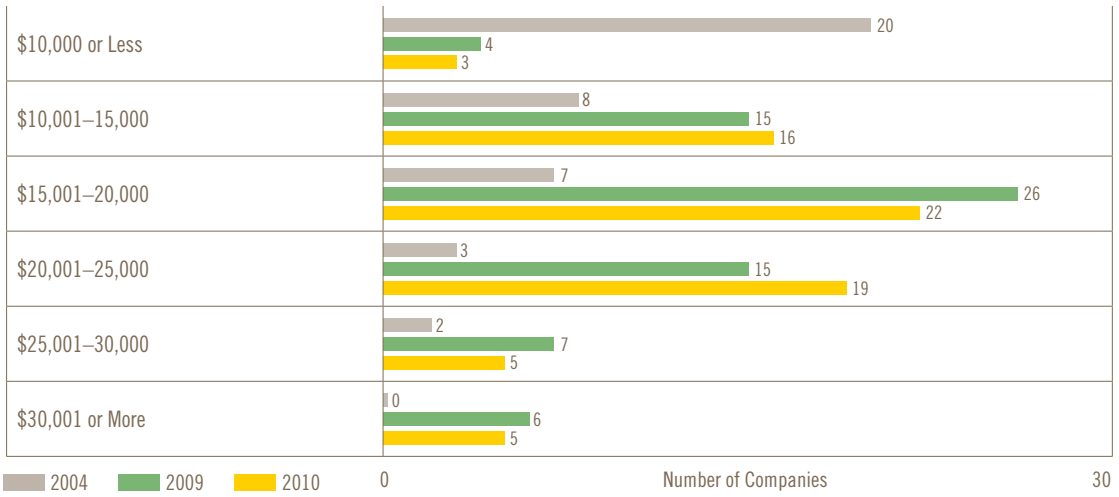
While 18 of the Top 100 Companies pay a retainer to all committee members, 32 either (1) pay a retainer to members of the audit committee (but not all other committees) or (2) pay a higher retainer to members of the audit committee (compared to other committees). The fees paid range from $2,000 to $30,000.



The significant increase in the number of Top 100 Companies paying retainers to the members of the audit and compensation committees since 2004 and the increase in the amount of the committee fees paid likely reflects that these directors are in regular contact with management, are significantly involved in the planning stages and preparation for committee meetings and have added responsibilities in risk management.

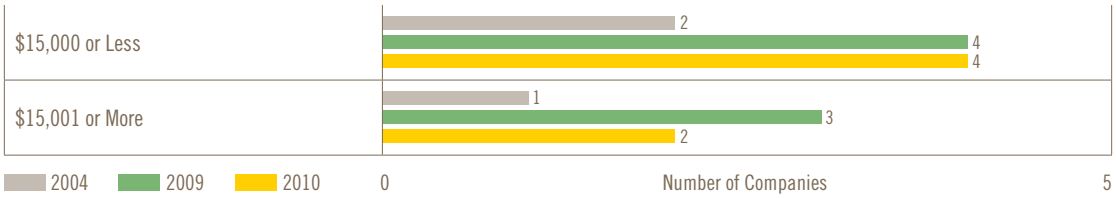
Audit Committee Chair Retainers

While 87 of the Top 100 Companies pay a retainer to all committee chairs, 70 either (1) pay a retainer to the chair of the audit committee (but not all other committee chairs) or (2) pay a higher retainer to the chair of the audit committee (compared to other committee chairs). The fees paid range from $10,000 to $50,000.



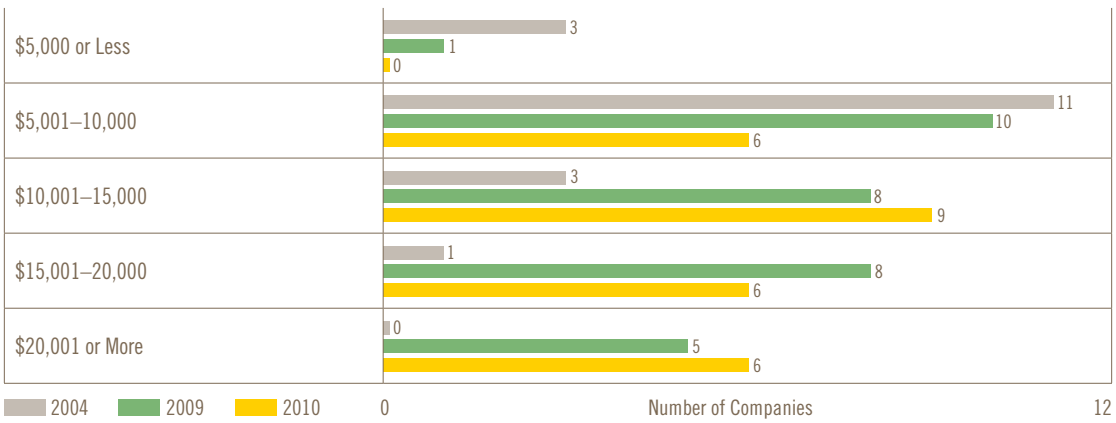
Compensation Committee Retainers

While 18 of the Top 100 Companies pay a retainer to all committee members, six either (1) pay a retainer to members of the compensation committee (but not all other committees), or (2) pay a higher retainer to members of the compensation committee (compared to other committees). The fees paid range from $5,000 to $25,000.



Compensation Committee Chair Retainers

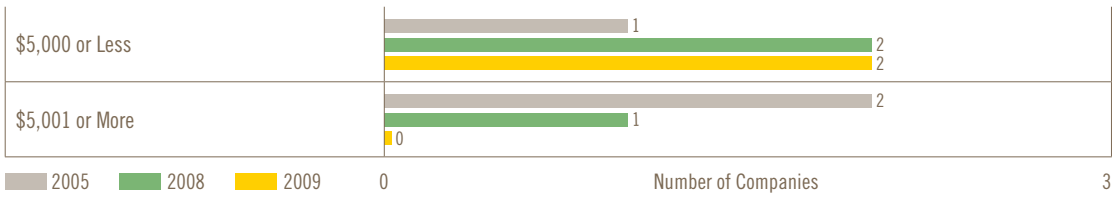
While 87 of the Top 100 Companies pay a retainer to all committee chairs, 27 either (1) pay a retainer to the chair of the compensation committee (but not all other committee chairs) or (2) pay a higher retainer to the chair of the compensation committee (compared to other committees). The fees paid range from $10,000 to $40,000.



Director Compensation — Committee Fees

Nominating/Governance Committee Retainers

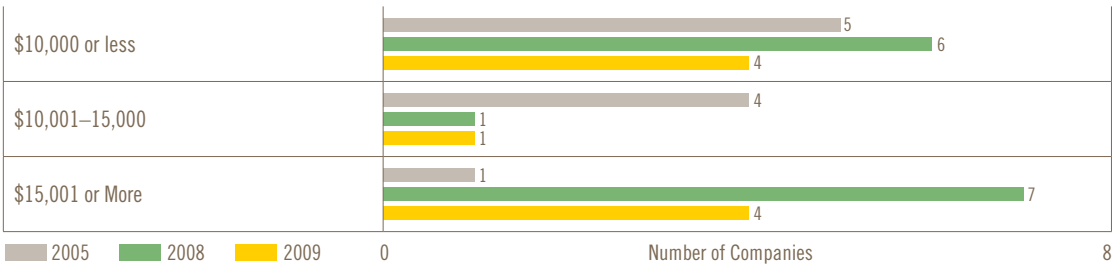
While 18 of the Top 100 Companies pay a retainer to all committee members, two either (1) pay a retainer to members of the nominating/governance committee (but not all other committees) or (2) pay a higher retainer to members of the nominating/governance committee (compared to other committees). The fee in each case was $5,000.*



*Data was not collected in 2004.

Nominating/Governance Committee Chair Retainers

While 87 of the Top 100 Companies pay a retainer to all committee chairs, nine either (1) pay a retainer to the chair of the nominating/governance committee (but not all other committees) or (2) pay a higher retainer to the chair of the nominating/governance committee (compared to other committees). The fees paid range from $10,000 to $32,000.*



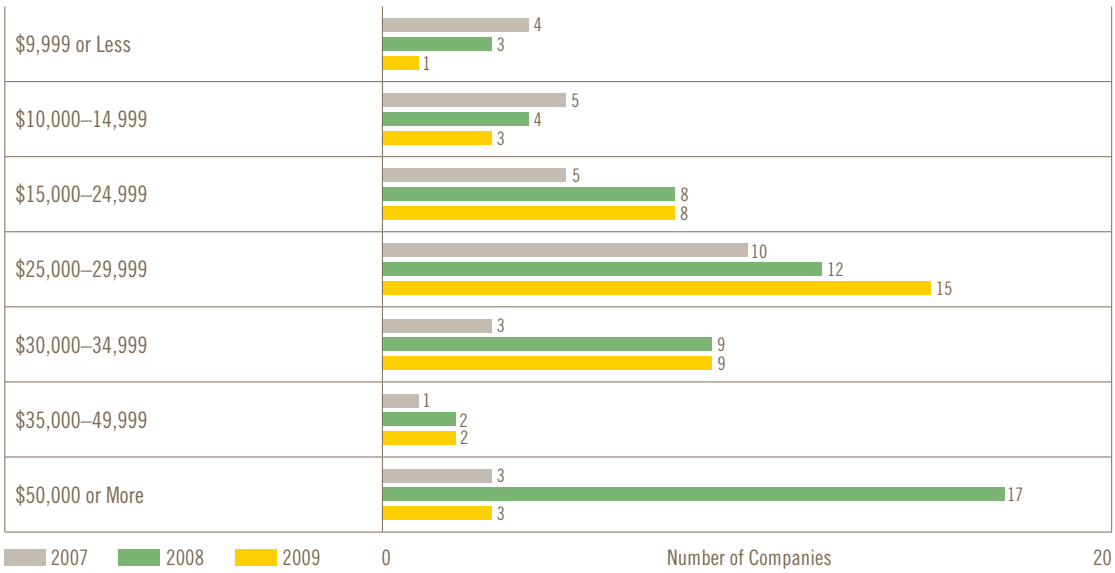
*Data was not collected in 2004.

Lead Director and Non-Executive Chair Retainers

Seventy of the Top 100 Companies have lead directors and 30 have non-executive chairs of the board (down from 81 and 31, respectively, in 2009). Given the increased time commitment and responsibilities for these directors, many of the Top 100 Companies have elected to pay enhanced fees to these directors and, in many circumstances, where additional fees are already paid to those in these roles, are increasing those fees.

Lead Director Retainers

Forty-one of the Top 100 Companies pay an additional retainer to the lead director, compared with 55 of the Top 100 Companies surveyed in 2009 and 31 in 2007. The fees paid to lead directors range from $5,000 to $80,000.*



*Data was not collected prior to 2007. Data for 2007 and 2009 combines lead directors and non-executive chairs.

Non-Executive Chair Retainers

Of the 30 Top 100 Companies that have non-executive chairs, 20 pay enhanced fees to the chair. The aggregate fees paid range from $90,000 to $844,651.**

** Prior to 2010, data was aggregated with lead/presiding director retainers.

Survey Methodology

For the purposes of this Survey, the corporate governance practices of the 100 largest US public companies (as ranked in Fortune magazine's Fortune 500® list, by revenue, for the most recently ended fiscal year) that have equity securities listed on the NYSE or NASDAQ were reviewed (the *"Top 100 Companies"*). Generally, the annual proxy statements and corporate governance guidelines on the companies' web sites available as of June 1, 2010 were reviewed for the companies listed on this page.

Wal-Mart Stores, Inc.
Exxon Mobil Corporation
Chevron Corporation
General Electric Company
Bank of America Corporation
ConocoPhillips
AT&T Inc.
Ford Motor Company
JPMorgan Chase & Co.
Hewlett-Packard Company
Berkshire Hathaway Inc.
Citigroup Inc.
Verizon Communications Inc.
McKesson Corporation
American International Group, Inc.
Cardinal Health, Inc.
CVS Caremark Corporation
Wells Fargo & Company
International Business Machines Corporation
UnitedHealth Group Incorporated
The Procter & Gamble Company
The Kroger Co.
AmerisourceBergen Corporation
Costco Wholesale Corporation
Valero Energy Corporation
Archer-Daniels-Midland Company
The Boeing Company
The Home Depot, Inc.
Target Corporation
WellPoint, Inc.
Walgreen Co.
Johnson & Johnson
Medco Health Solutions, Inc.
Microsoft Corporation
United Technologies Corporation
Dell Inc.
The Goldman Sachs Group, Inc.
Pfizer Inc.
Marathon Oil Corporation
Lowe's Companies, Inc.
United Parcel Service, Inc.
Lockheed Martin Corporation
Best Buy Co., Inc.
The Dow Chemical Company
SUPERVALU INC.
Sears Holdings Corporation
PepsiCo, Inc.
MetLife, Inc.
Safeway Inc.
Kraft Foods Inc.
Sysco Corporation
Apple Inc.
The Walt Disney Company
Cisco Systems, Inc.
Comcast Corporation
FedEx Corporation
Northrop Grumman Corporation
Intel Corporation
Aetna Inc.
Prudential Financial, Inc.
Caterpillar Inc.
Sprint Nextel Corporation
The Allstate Corporation
General Dynamics Corporation
Morgan Stanley
The Coca-Cola Company
Humana Inc.
Honeywell International Inc.
Abbott Laboratories
News Corporation
Sunoco, Inc.
Hess Corporation
Ingram Micro Inc.
Time Warner Inc.
Johnson Controls, Inc.
Delta Air Lines, Inc.
Merck & Co., Inc.
E.I. du Pont de Nemours and Company
Tyson Foods, Inc.
American Express Company
Rite Aid Corporation
Philip Morris International Inc.
Raytheon Company
Express Scripts, Inc.
The Hartford Financial Services Group, Inc.
The Travelers Companies, Inc.
Amazon.com, Inc.
Staples, Inc.
Google Inc.
Macy's, Inc.
International Paper Company
Oracle Corporation
3M Company
Deere & Company
McDonald's Corporation
Tech Data Corporation
Motorola, Inc.
Fluor Corporation
Eli Lilly and Company
Coca-Cola Enterprises Inc.

The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association are governed by a congressional charter and therefore have not been included in this Survey.

The practices of International Assets Holding Corporation were not examined because the requisite documents to adequately compare it to the Top 100 Companies were not available.

The practices of nonpublic companies, including General Motors Company, State Farm Mutual Automobile Insurance Company, New York Life Insurance Company, Liberty Mutual Group Inc., HCA Inc., Teachers Insurance and Annuity Association–College Retirement Equities Fund, CHS Inc., Massachusetts Mutual Life Insurance Company and Publix Super Markets, Inc., were not examined.

The practices of Enterprise GP Holdings L.P. were also not examined because it is a limited partnership with no board of directors and no requirement to hold annual meetings.

This Survey and our companion survey regarding general governance practices are available on the Shearman & Sterling LLP web site at www.shearman.com/corporategovernance.

Eighty-five of the Top 100 Companies are listed on the NYSE and 15 are listed on NASDAQ (compared to 88 and 12, respectively, in 2009).

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