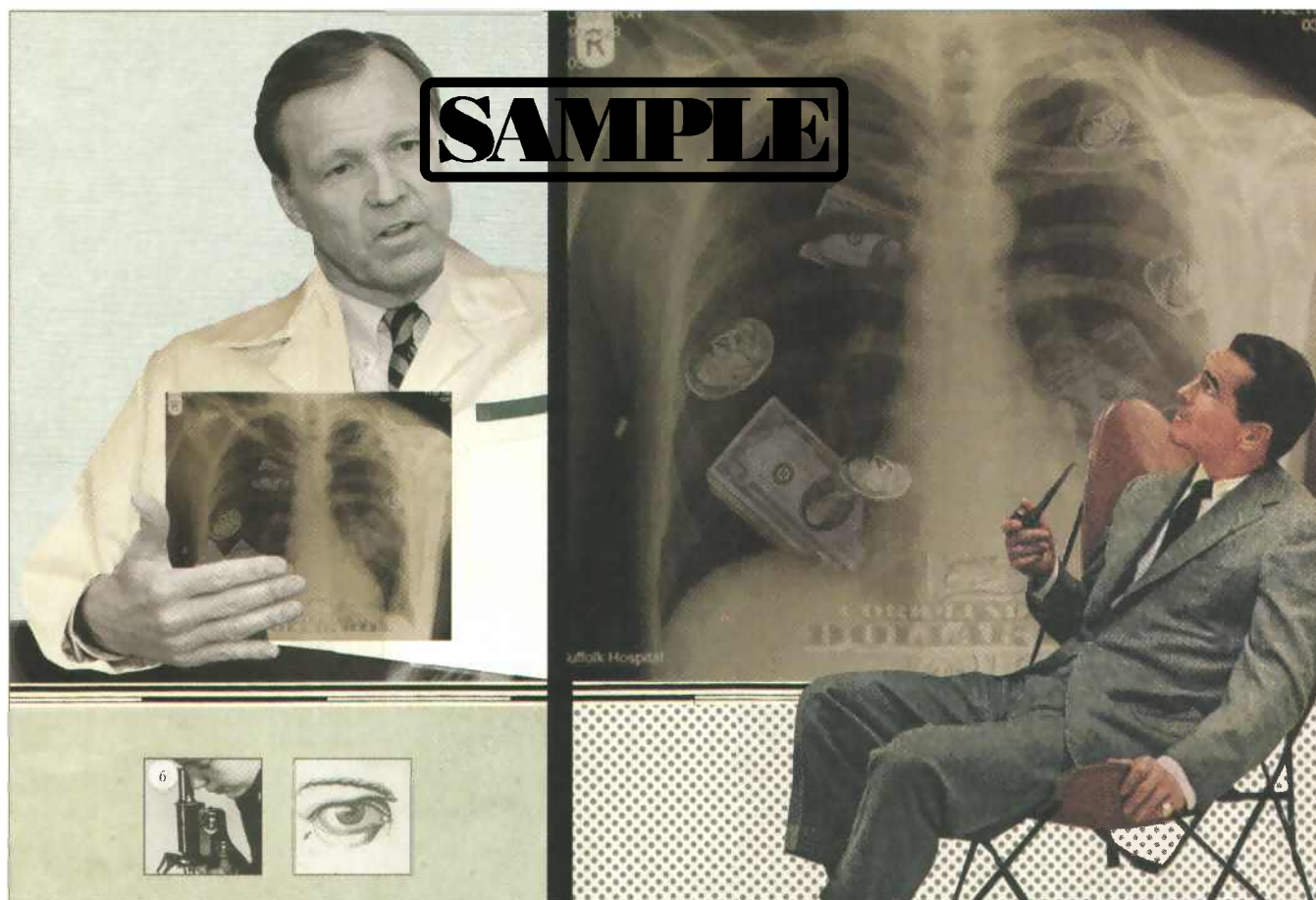


BY JOHN LABATE



Will Transparency Lead to a Little More Modesty in Pay?

Companies and executives prepare for an anticipated overhaul in compensation disclosure, but it's the market keeping the numbers down this year

Will 2006 be remembered as the year that widespread executive compensation reforms took hold? Final rules have yet to be set, but the current proposals represent the biggest overhaul by the Securities and Exchange

Commission (SEC) in 14 years. Companies, of course, aren't being told how they should compensate senior executives, but the approach of letting more sunlight into the process of determining pay packages, and getting rid of much of the overly lawyered boilerplate, may be the regulators' best weapons. As SEC chairman Christopher Cox put it when he announced the proposed measures, "Our purpose ... is to help investors keep an eye on how much of their money is being paid to the top executives who work for them."

More certain is the fact that the final rules will add to the

to the top executives who work for them."

responsibilities of CFOs and put more emphasis on their own pay. Under the proposals, all public companies would be required to furnish a total compensation figure—as well as details including stock- and options-based rewards, perquisites, pensions and post-employment plans—for their CEO, CFO, the three other highest-paid executive officers and all directors. In addition, a new Compensation Discussion and Analysis (CD&A) section would replace the current Compensation Committee Report and Performance Graph. The CD&A would have to be filed with regulators, thereby requiring a sign-off certification by the CEO and CFO.

Even though this is likely to add to the burdens of already stretched CFOs, CFOs in general support the changes, which are seen as a solid advance for shareholder protection. According to a recent Financial Executives International (FEI) survey of 201 CFOs, 71% voiced support for the overhaul.

Off-the-shelf incentive plans are not setting challenging enough targets for compensation

—Corporate Library's Hodgson

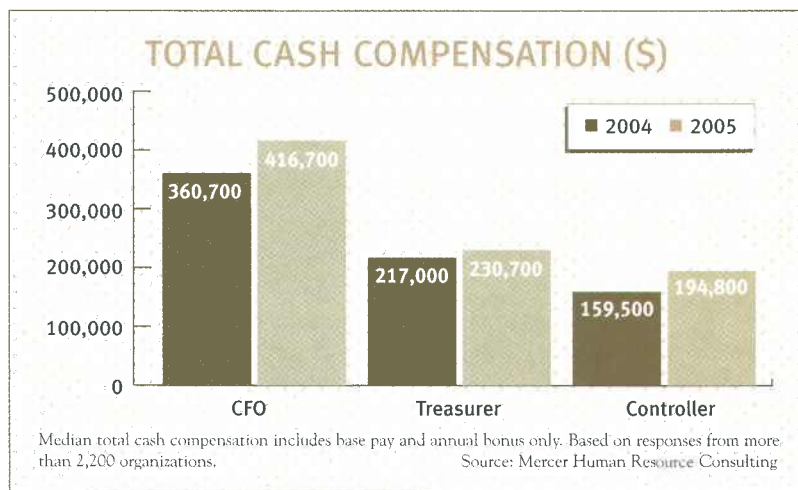
"CFOs are extremely aware of how incentive plans are designed and implemented and how company performance translates into compensation payments," says Paul Hodgson, senior research associate at the Corporate Library. Although it will remain the job of a compensation committee to make final pay determinations, no consultant or even board member knows a company's culture or business like the CFO and CEO, and knowing that their input has been included should be a positive sign for shareholders. "To have their imprimatur on it is actually a very valuable thing," says Hodgson.

Add to this the ongoing phase-in of options expensing, and the current period looks very much like a time of transition, albeit one without dramatic numeric changes yet. "It's been a pretty unremarkable year in terms of pay levels," says Paula Todd, a managing principal at Towers Perrin. "The big issue really is the disclosure rules and what impact they will have on the [compensation] programs and how they are received."

SHAREHOLDERS AREN'T ALWAYS SMILING

Total compensation for CFOs—including salary, bonus, options and restricted shares—inched up 1% in 2005, according to an analysis by compensation consulting firm Equilar Inc. of the proxy statements of 215 S&P 500 companies filed between May 2005 and early April 2006. That compares to a 7.3% rise in total compensation for a similar-size group in 2004. Base salaries for the group rose 6.8% in 2005, while bonuses were up 1.6%. The value of option grants for the group was down 5.9%, based on Black-Scholes valuations, and restricted stock surged 15.9%. A separate survey of cash-based portions of finance department compensation (salaries plus annual bonuses only) found a rise of 15.5% for CFOs, while treasurers saw a 6.3% rise and controllers' pay surged 22%, according to Mercer Human Resources Consulting.

San Mateo, Calif.-based Equilar also provided *Treasury & Risk Management* with detailed analysis of CFO compensation for 50 companies. To see how well shareholders did relative to the finance chiefs, the analysis compares annual changes in total shareholder returns to changes in each executive's total compensation. Although there are other measures often used to gauge how well shareholders and their companies perform, it's worth noting when a CFO like Gary Crittenden from American Express Co. sees a 20.9% rise to \$9.6 million in compensation during a year when shareholder returns fell 7.9%, and Doreen Toben, CFO at Verizon Communications Inc., was awarded \$6.7 million, a rise of 12.8% from the previous year, while shareholders saw the company's stock price tumble 21.7%. In a year of continued turbulence for major airlines, UAL Corp.'s shareholder returns were down 26.9% as CFO Frederic Brace saw a 14.2% compensation gain, albeit to a comparatively low \$816,949. Brace was one of only two CFOs on our list whose compensation was below \$1 million; the other was Google Inc.'s George Reyes, whose \$814,375 was the lowest on the list, despite a 3.9% bump up from 2004. Meanwhile, holders of Google stock during the year got a much better deal, with returns up 115.2%.



FINANCE CHIEF COMPENSATION

Company	CFO	Total	% Change	Shareholder ¹ Return (1 Year)	Base Salary
AETNA INC.	ALAN M. BENNETT	\$5,350,197	66.8%	51.3%	\$550,000
ALCOA INC.	RICHARD B. KELSON ⁴	2,591,141	-40.9	-4.0	637,019
AMERICAN EXPRESS CO.	GARY L. CRITTENDEN	9,615,923	20.9	-7.9	569,231
AMGEN INC.	RICHARD D. NANULA	4,157,652	1.8	22.9	766,308
BANK OF AMERICA CORP.	ALVARO G. DE MOLINA ⁵	8,562,759	-48.1	2.3	700,000
BEAR STEARNS COS.	SAMUEL L. MOLINARO JR.	17,678,077	9.6	14.8	200,000
BELLSOUTH CORP.	RONALD M. DYKES ⁶	6,632,600	56.4	1.5	690,400
BEST BUY CO.	DARREN R. JACKSON	2,084,081	-54.4	2.2	514,136
BOEING CO.	JAMES A. BELL ⁷	5,261,826	164.1	37.6	640,962
CHUBB CORP.	MICHAEL O'REILLY	2,133,882	-28.8	29.2	626,251
CITIGROUP INC.	SALLY L. KRAWCHECK ⁸	10,071,075	N/A	4.4	500,000
COACH INC.	MICHAEL F. DEVINE III	5,305,104	118.8	48.5	446,667
COCA COLA CO.	GARY P. FAYARD	3,815,750	19.9	-0.5	566,475
COMCAST CORP.	JOHN R. ALCHIN ⁹	8,767,854	-8.6	-22.1	984,531
COMCAST CORP.	LAWRENCE S. SMITH	10,113,156	-8.2	-22.1	1,163,750
CONAGRA FOODS INC.	FRANK S. SKLARSKY ¹⁰	2,909,831	-8.0	-3.2	500,000
COSTCO WHOLESALE CORP.	RICHARD A. GALANTI	2,052,667	N/A	6.5	475,000
CSX CORP.	OSCAR MUNOZ	8,526,203	730.4	27.7	546,513
DUPONT E I DE NEMOURS & CO.	GARY M. PFEIFFER	2,205,510	-4.2	-10.4	580,196
FEDEX CORP.	ALAN B. GRAF JR.	5,446,973	2.2	21.9	752,118
FORD MOTOR CO.	DONAT R. LECLAIR JR.	1,596,730	N/A	-44.5	916,667
GAP INC.	BYRON POLLITT	3,385,326	-32.1	-16.9	675,000
GENERAL MILLS INC.	JAMES A. LAWRENCE	2,865,628	-7.8	10.2	556,431
GOLDMAN SACHS GROUP INC.	DAVID A. VINIAR	26,651,141	40.1	24.1	600,000
GOOGLE INC.	GEORGE REYES	814,375	3.9	115.2	175,000

1. Shareholder return was calculated by Equilar Inc. on a non-reinvested dividend basis for the reported fiscal year. 2. Stock option values were calculated using the Black-Scholes valuation method. 3. "Other" includes other compensation and LTIP payouts. 4. Kelson retired as CFO on 12/31/05. 5. De Molina was named CFO in Sept. 2005; the % Change in total compensation was calculated based on former CFO James

Bonus	Restricted Stock	Stock Options ²	Other ³
\$540,000	\$0	\$3,299,326	\$960,871
520,000	360,195	972,260	101,667
1,660,000	2,417,375	3,330,154	1,639,163
1,210,000	0	2,004,398	176,946
3,050,000	3,479,022	1,080,774	252,963
8,052,654	6,327,544	1,573,140	1,524,739
800,000	1,548,900	0	3,593,300
293,139	289,223	981,557	6,026
550,000	2,019,492	0	2,051,372
825,500	624,969	0	57,162
5,280,000	4,253,333	0	37,742
335,000	0	4,448,880	74,557
1,565,000	0	1,636,506	47,769
1,307,900	2,277,330	3,571,827	626,266
1,563,100	2,583,240	4,129,280	673,786
850,000	1,370,000	0	189,831
61,838	0	1,468,628	47,201
835,313	0	0	7,144,377
458,000	391,000	758,908	17,406
1,310,286	491,170	1,384,034	1,509,365
0	161,374	405,983	112,706
0	0	2,140,776	569,550
518,817	559,286	1,199,705	31,389
12,245,500	6,679,578	6,839,819	286,244
636,881	0	0	2,494

Hance's TDC for 2004. 6. Dykes retired on 12/31/05. 7. Bell served as interim president and CEO from 3/06/05 to 6/30/05. 8. Krawcheck became CFO effective 11/05/04. Source: EQUILAR INC.

Companies are continuing to reduce option grants in favor of other forms of compensation as they become subject to the new expensing rules. "During the last year, I've really seen a lot more of it, and in the last six months even more," says Ellen Williams, a senior client partner at Korn/Ferry International. "A lot of companies are in transition with their compensation plans." But this change is not entirely attributable to the SEC's expensing requirements; the stock market played a role as well. "Companies whose stock prices are depressed are turning to restricted shares from options because the restricted shares have value," says Allen Geller, a managing director at executive recruitment firm Raines International. With many key finance executives sitting on underwater options, these companies are favoring restricted shares over options as a way to keep their best people from straying. "The issue is, 'how can we [encourage] them to stay while other organizations are doing well?'" says Geller.

For most companies, the road to a new approach to compensation is a long one, but changes are being seen in the most recent proxies that appear to anticipate the new compensation rules. "There's a group of companies that really want to be on the leading edge," says Todd of Towers Perrin. In its 2006 proxy, Pfizer Inc. completely overhauled the presentation of executive compensation, using a tally sheet approach to break out components of compensation for its top five officers (which did not include CFO Alan Levin). The company eliminated meeting fees on committee retainers for its directors and introduced a new executive long-term incentive program.

MOVING OUT IN FRONT EARLY

Pfizer is also ahead of the game when it comes to listing details of executive perquisites, including incremental costs for personal use of company aircraft, cars and drivers. The SEC disclosure proposals in their current form would reduce the dollar amount for disclosing perks and other personal benefits for each executive officer from \$50,000 (or 10% of total salary and bonus) to \$10,000. Although Pfizer was recently highlighted in the Corporate Library's *Pay for Failure* report for not doing enough to align executive pay with shareholder interests, the company appears to be more than willing to expand on its disclosures well before the rules are made final.

Whether the eventual SEC disclosure rules compel companies to tie executive pay to long-term performance goals that better reflect shareholder return remains to be seen. "Two areas that are always quite difficult for companies are making sure they have the right measures and being able to set appropriate goals," says Seymour Burchman, managing principal at Semler Brossy Consulting Group. While many firms continue to struggle to find the right balance, Burchman advises clients to focus on their long-term plans and those factors that drive the value of a company. For instance,

FINANCE CHIEF COMPENSATION

Company	CFO	Total	% Change	Shareholder ¹ Return (1 Year)	Base Salary
HEWLETT-PACKARD CO.	ROBERT P. WAYMAN ¹¹	\$9,544,798	79.9%	52.0%	\$ 975,000
HONEYWELL INTERNATIONAL INC.	DAVID J. ANDERSON	5,258,185	-13.9	7.5	726,466
INTEL CORP.	ANDY D. BRYANT	4,434,380	-7.5	8.1	330,000
JOHNSON & JOHNSON	ROBERT J. DARRETTA	6,097,471	-3.3	-3.2	983,846
ELI LILLY & CO.	CHARLES E. GOLDEN ¹²	4,211,170	-16.7	2.4	841,600
MARRIOTT INTERNATIONAL INC.	ARNE M. SORENSON	3,427,441	-63.9	7.0	580,000
MERCK & CO.	JUDY C. LEWENT	2,549,535	-17.1	3.7	788,500
MERRILL LYNCH & CO.	AHMASS L. FAKAHANY ¹³	19,124,434	26.9	14.6	350,000
MOTOROLA INC.	DAVID W. DEVONSHIRE	6,757,265	-22.8	32.3	625,000
NEW YORK TIMES CO.	LEONARD P. FORMAN	1,597,725	3.4	-33.6	595,590
NEWS CORP.	DAVID F. DEVOE	10,375,275	59.0	-4.6	2,603,750
OCCIDENTAL PETROLEUM CORP.	STEPHEN I. CHAZEN	26,436,903	87.3	39.1	720,000
PEPSICO INC.	INDRA K. NOOYI	5,596,499	-45.5	15.1	837,067
SCHLUMBERGER LTD.	JEAN-MARC PERRAUD	2,991,035	-1.2	46.4	600,000
CHARLES SCHWAB CORP.	CHRISTOPHER V. DODDS	3,235,440	24.3	23.4	550,000
ST PAUL TRAVELERS COS.	JAY S. BENET ¹⁴	4,804,672	82.2	23.0	575,000
STARBUCKS CORP.	MICHAEL CASEY	1,171,879	-88.8	10.2	571,827
SUN MICROSYSTEMS INC.	STEPHEN T. MCGOWAN	1,963,345	-17.3	-13.9	598,050
SUNOCO INC.	THOMAS W. HOFMANN	4,579,509	74.5	93.7	475,000
TIME WARNER INC.	WAYNE H. PACE	8,429,176	4.9	-9.8	1,000,000
TRIBUNE CO.	DONALD C. GRENESKO ¹⁵	1,645,452	-55.9	-26.5	524,692
UAL CORP.	FREDERIC F. BRACE	816,949	14.2	-26.9	498,254
VERIZON COMMUNICATIONS INC.	DOREEN A. TOBEN	6,736,800	12.8	-21.7	825,000
WALT DISNEY CO.	THOMAS O. STAGGS	4,910,099	-23.1	8.1	987,500
WENDY'S INTERNATIONAL INC.	KERRI B. ANDERSON	3,394,292	175.2	42.2	479,433
WHOLE FOODS MARKET INC.	GLENDA FLANAGAN CHAMBERLAIN	1,170,663	52.8	57.7	299,000

9. Alchin and Smith are co-CFOs. 10. Sklarsky became CFO and EVP in Nov. 2004; % Change in total compensation was calculated based on former CFO James O'Donnell's TDC for fiscal year 2004. 11. Wayman served as interim CEO from Feb. through March 2005. 12. Golden retired effective 4/30/06. 13. Fakahany served as CFO until March 2005. 14. Benet began as CFO on 4/01/04. 15. Grenesko is principal financial officer.

Bonus	Restricted Stock	Stock Options ²	Other ³
\$ 4,513,688	\$ 0	\$ 3,913,560	\$ 142,550
880,000	0	2,153,370	1,498,349
1,765,000	0	2,239,080	100,300
891,000	674,994	2,272,508	1,275,123
826,872	1,127,453	1,363,998	51,247
499,496	0	2,129,403	218,542
750,000	398,750	602,835	9,450
8,050,000	10,600,070	0	124,364
800,000	0	3,523,360	1,808,905
238,409	327,000	405,990	30,736
5,778,000	0	1,987,225	6,300
1,200,000	10,494,520	11,221,800	2,800,583
2,093,373	1,033,505	1,389,502	243,052
882,000	0	1,392,395	116,640
962,500	0	1,712,190	10,750
1,125,000	1,662,445	1,352,216	90,011
574,138	0	0	25,914
177,013	0	1,181,000	7,282
665,000	0	812,965	2,626,544
2,700,000	1,341,750	3,005,750	381,676
102,800	0	956,738	61,222
271,788	0	0	46,907
977,600	4,331,500	0	602,700
2,135,650	500,000	1,231,029	55,920
0	2,785,620	0	129,239
170,000	0	701,663	0

Source: EQUILAR INC.

as is often the case with technology start-ups, growing earnings is often more challenging than top-line growth, so for tech firms, aligning compensation targets to bottom-line results may be most beneficial. Compensation goal setting should also include market or investor expectations and consideration of the company's historical performance.

The timing of the compensation metrics selected could also be important. "A lot of public company CEOs, CFOs and management are rewarded by how the year ended up, and that doesn't drive consistent and reliable behavior," says Stephen Payne, president of Hackett-REL total working capital, a division of the Hackett Group. "They induce seasonality or volatility into a business organization," says Payne, who argues that companies should consider average performance metrics on a monthly basis. "It forces people to say, 'let's do the right thing every day.'"

PAYING FOR MEDIOCRITY

The Corporate Library's Hodgson believes that, on the whole, U.S. companies could be doing a much better job in aligning compensation with shareholder interests. "I would caution companies from using off-the-shelf incentive plans like everybody is using," says Hodgson. Some plans use the same metric to award annual bonuses as they do long-term incentives, giving double rewards for the same results. Many use metrics compared to peer group companies at a very low threshold, so executives are compensated for mediocre or below-average results. "That's a typical off-the-shelf plan and it's not setting challenging enough targets for compensation," says Hodgson. But there are a handful of innovative companies Hodgson points to that are moving in the right direction. At Whole Foods Market, cash payouts to executives, including bonuses, are subject to a "salary cap policy," set in 2005 at 14 times the average cash compensation of all full-time employees. Whole Foods also makes options grants available to all full- and part-time employees, and says about 93% of options granted under its current plan have been given to employees who are not executive officers. The alignment seems to fit for CFO Glenda Flanagan Chamberlain, whose \$1.17 million total compensation rose 52.8%, just under the 57.7% rise in shareholder returns.

Another standout is Costco Wholesale, which used peer-company comparisons when determining executive compensation, and ended up setting their pay below that of many peer executives. Costco emphasizes long-term incentives over shorter-term cash and bonuses and its executive bonus program includes metrics such as sales, controllable expenses, pre-tax income and inventory shrinkage. Since the company didn't meet its pre-tax income goal for 2005, requested bonuses by President and CEO James Sinegal and Chairman Jeffrey Brotman were halved to \$100,000.