Human Resource Services

Leading the rebound: Equity compensation in the spotlight*

2009 Global Equity Incentives Survey

Executive summary

Foreword

The current economic turmoil has shone an even brighter light on executive compensation. In addition to the many operational challenges companies face today, they must also address the political lightning rod of shareholder, regulatory and public sentiment regarding executive compensation policies and practices. First, a number of countries have enacted limits on executive compensation at companies receiving government assistance. And second—and farther-reaching—during the April and September 2009 G20 Summits, the Financial Stability Board (FSB) released proposed principles and standards in the respective areas of executive compensation governance, alignment of compensation and risk, and effective oversight of compensation. Following publication of the FSB standards, regulators in Australia, Germany, the Netherlands, Switzerland and the US either issued—or announced plans to issue—standards and principles of executive compensation.

In light of those and other pressures on executive compensation to conform to the new—and sometimes conflicting—sets of principles emerging from a broad group of shareholders, regulators and other stakeholders, organizations continue to rely on equity compensation as a critical mechanism for linking executive interest with shareholder and broader economic value. Indeed, our survey findings indicate that organizations continue to claim that the benefits of equity compensation are worth the costs. Further, many of those who support compensation strategies that manage company risk have touted the use of equity compensation in lieu of short-term incentives as a way of matching employee objectives and shareholder objectives. Although debated in political and public venues, equity compensation remains critical in a company's achieving strategic objectives, rewarding a global workforce and providing a means of deferring compensation in ways that are linked to longer-term company performance.

PricewaterhouseCoopers is pleased to share "Leading the rebound: Equity compensation in the spotlight." This Executive Summary provides key insights from the PricewaterhouseCoopers 2009 Global Equity Incentives Survey, the sixth in the survey series. Our survey is one of the most comprehensive studies available on the design and administration of equity incentive compensation plans for multinational companies. The 2009 survey covers new topics reflecting general trends in the mix of equity awards, in shifts in global grant practices, in shareholder activism and in continued adaptation to various tax compliance requirements around the globe. Indeed, equity compensation has a critical role to play in an environment where organizations must proactively recruit and retain executives and employees who can lead their companies out of these tumultuous times and into future periods of organizational and financial growth.

We hope you find the results from the 2009 Global Equity Incentives Survey useful as you look to the people of your organization to "lead the rebound" within your own business. We thank you for your interest in the 2009 survey and look forward to your continued participation in this important series of surveys.

Scott N. Olsen
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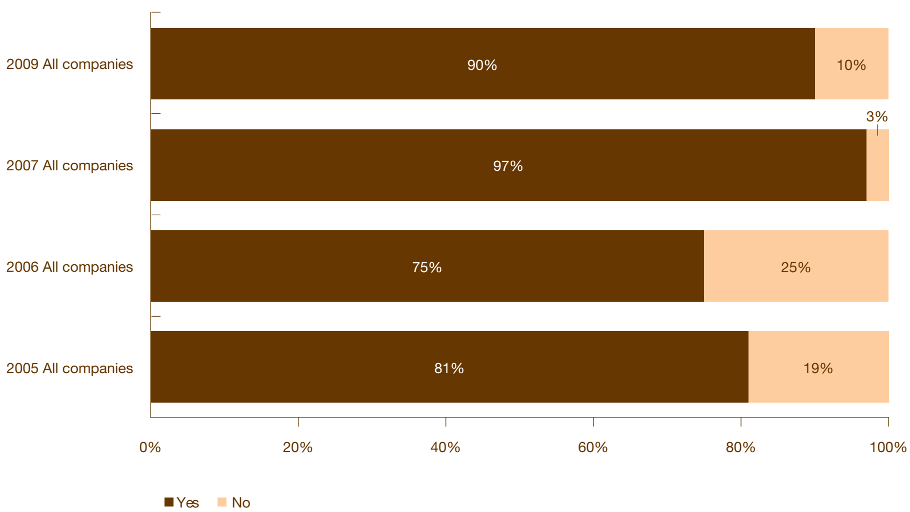
Human Resource Services

Implications of the market downturn on compensation

Any discussion about the global economic downturn of 2008–09 will ultimately reflect upon the downturn's depth and the relative lack of immunity in many organizations, particularly those that were beneficiaries of government intervention or increased regulations. Regulators, in particular, have examined the downturn and are focusing on the performance of key employees and executive management teams as part of a search for ways to help prevent similar market results in the future. The emergence of their influence, on top of continued shareholder attention, focuses on refining the pay-for-performance model to account for risk and sustainability.

The public debate over executive compensation payouts may continue, but the role of equity compensation as a critical tool for linking executive performance to corporate strategic objectives remains arguably more important than ever. The PricewaterhouseCoopers 2009 Global Equity Incentives Survey reveals trends and practices in executive compensation that are fluid in these turbulent times and indicative of where future practices may lead. While the context is very different from last year's, we believe the most telling survey result is the same as it was last year in answer to the question, Do the benefits of maintaining an equity compensation plan outweigh the cost? After consideration of the past year's events—such as stock price volatility, accounting compliance issues and increased shareholder activism—the resounding answer to this question is yes, there is tremendous value in properly designed and administered equity compensation plans.

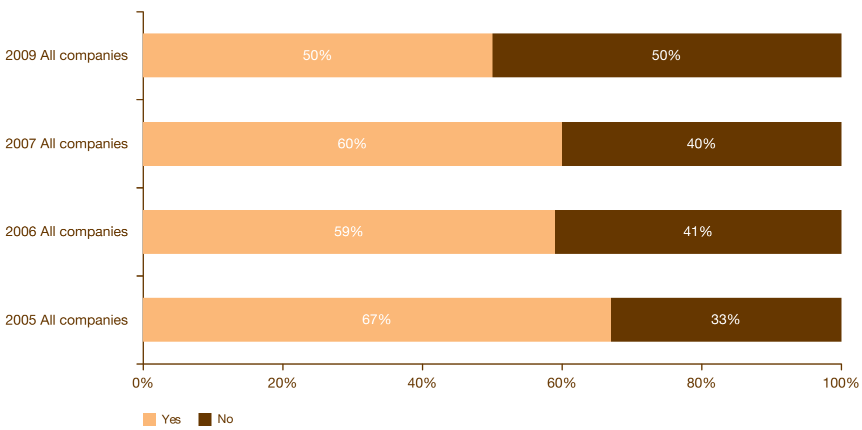
Plan benefits worth the costs



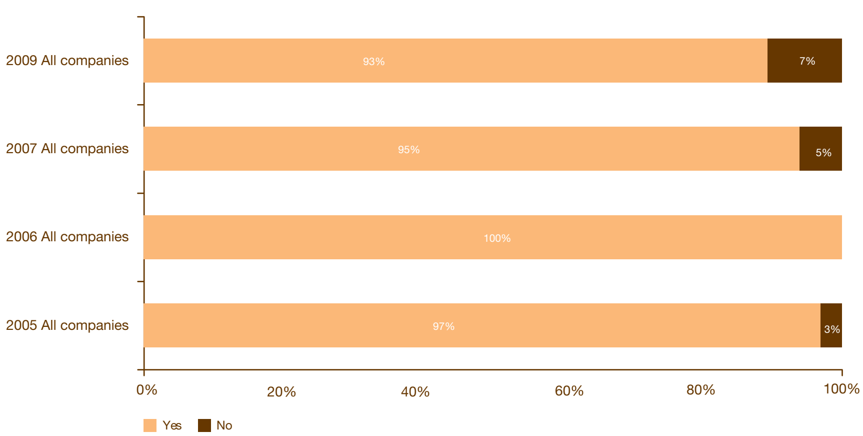
Government oversight of compensation and shareholder say on pay

The public backlash against executive compensation during the current economic crisis has heightened the focus on accountability in corporate governance and oversight. No industry has felt the weight of that increased scrutiny more than financial services. In many media accounts, a number of financial organizations' names have become synonymous with excessively risky and short-term executive compensation practices at the perceived expense of taxpayers.

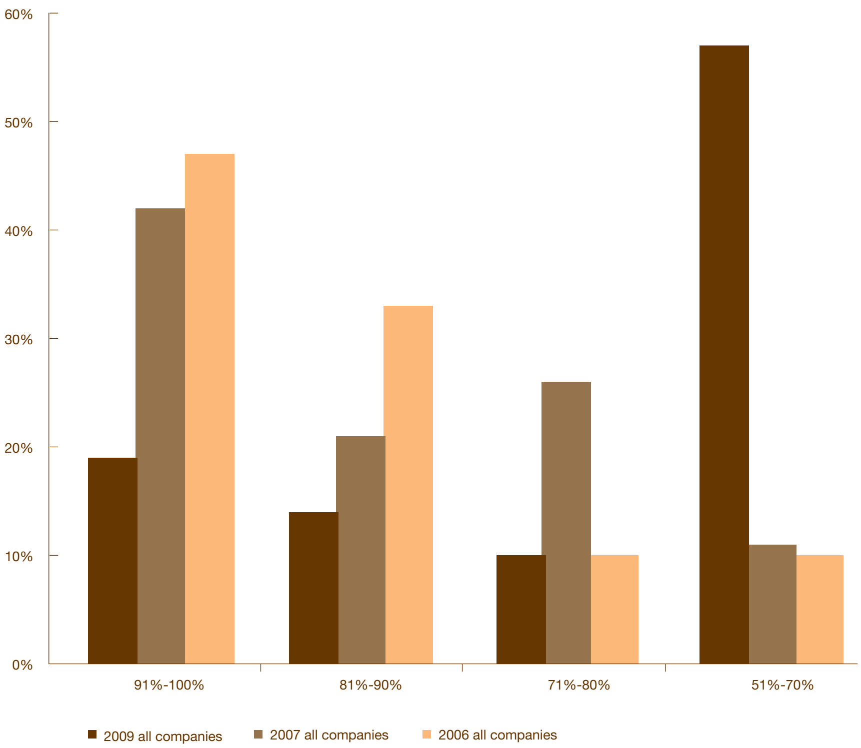
Companies that asked for shareholder approval for plans



Shareholders that approved equity compensation plans



Portion of yes votes received by shareholders



On one hand, public reaction—as it relates to executive compensation—has included legislative and regulatory initiatives in addition to heightened shareholder scrutiny of executive compensation. On the legislative side, a number of governments have instituted limits on executive compensation by companies both inside and outside the financial service industry that have received government assistance. Most of those limits, though, have limited durations, assuming the companies are able to pay back their respective governments.

On the other hand, regulators—particularly in the financial services industry—have focused on principles-based approaches to executive compensation reform. The Financial Stability Board (FSB) Principles for Sound Compensation Practices, endorsed by the G20 leaders in April 2009, set a new stage for regulation of compensation by focusing on governance, risk alignment and supervision. And national regulators in many markets have issued codes of conduct or guidance that share the same basic principles as those espoused by the FSB.

Shareholders have long had a voice in the executive compensation debate via their ability to withhold votes from directors serving on compensation committees, their ability in certain markets to approve the allocation of shares to company equity plans and, again, in certain markets, through an advisory vote on executive compensation, called say on pay. While nearly all of the survey participants who put equity compensation plans forward for shareholder approval in 2008 received that approval, the percentage of companies that report yes votes at the lowest margin reported (51%–70%) is at an all-time high of 57% compared with 11% in 2007.

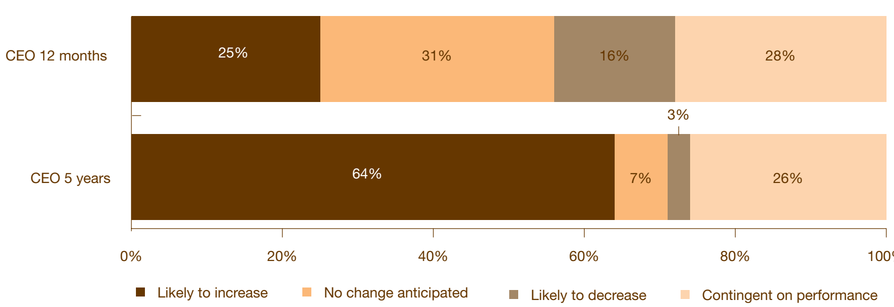
Shareholders are also taking note of the principles issued by regulators and are increasingly incorporating the concept of risk alignment into their executive compensation policies. The resulting impact on companies—with regard to their equity plans and executive compensation programs generally—is a raising of the bar in their engagements with third parties on executive compensation. In fact, companies are utilizing tools that go well beyond an annual proxy statement or shareholder circular by communicating the strategic intent of their executive compensation policies. And, not surprisingly, equity plans that facilitate alignment of shareholder interest with employee interest, are featured prominently in such communications.

Anticipated changes in CEO compensation

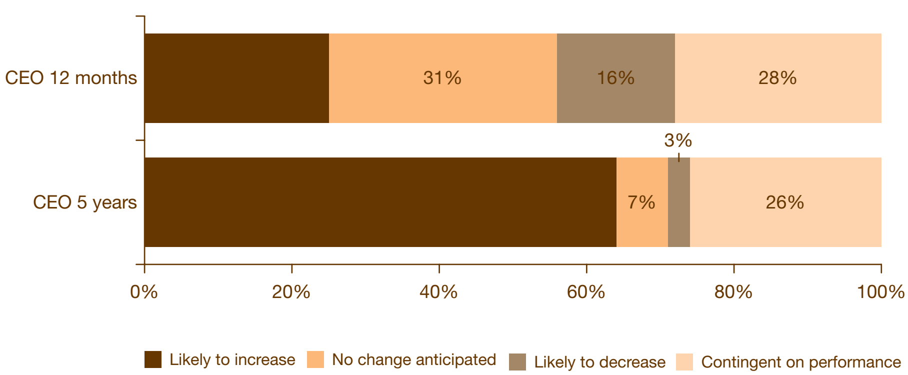
The impact of economic and market downturns, in conjunction with a heightened shareholder and regulatory environment, has had a predictable impact on CEO compensation. Contrary to results from previous years, the 2009 survey results indicate that nearly half of the participants believe either that CEO pay will not change or that CEO pay will decrease in the short term. Despite an apparent change in trend, we believe that those results are consistent with the larger trend of pay linked to performance and that in the current environment, participants have called attention to the fact that that link results in the freezing or the reduction of pay. In the long term, however, 2009 survey results show that most companies are optimistic, with nearly two-thirds of participants reporting that CEO pay will increase over the next five years.

We also expect that many organizations will have reviewed their equity award mix during 2009 in addition to reexamining the role of equity compensation in the overall total reward package, especially considering the aggregate impact of guaranteed pay and specific performance metrics on pay.

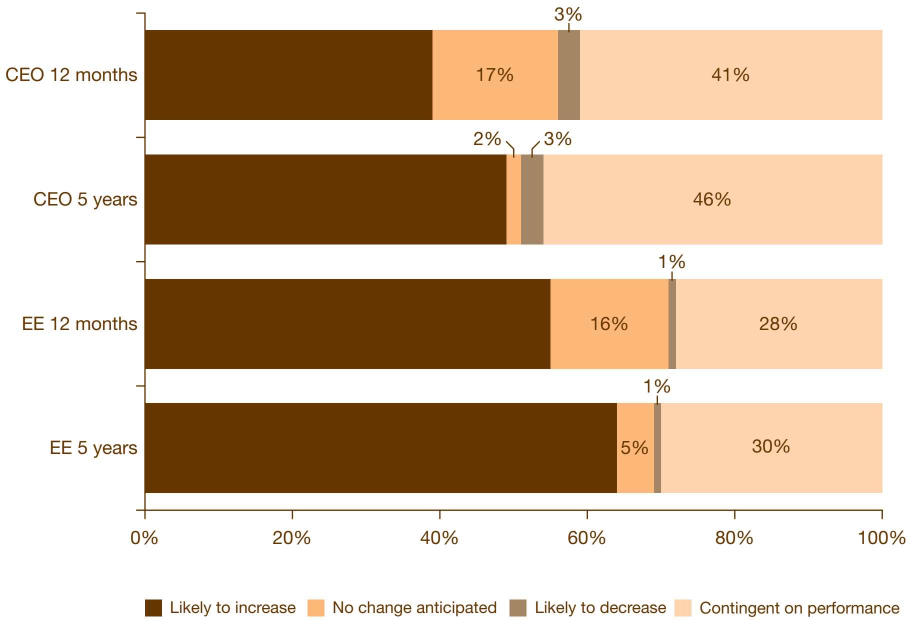
Anticipated changes in CEO compensation
2009—All companies



Anticipated changes in CEO compensation
2009—All companies



CEO and employee anticipated compensation 2007—All companies

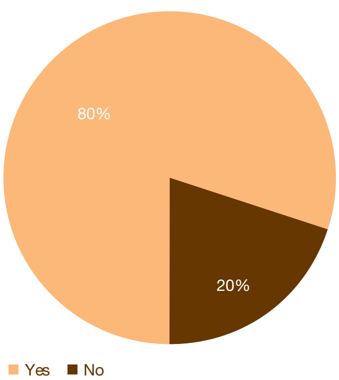


Underwater stock options

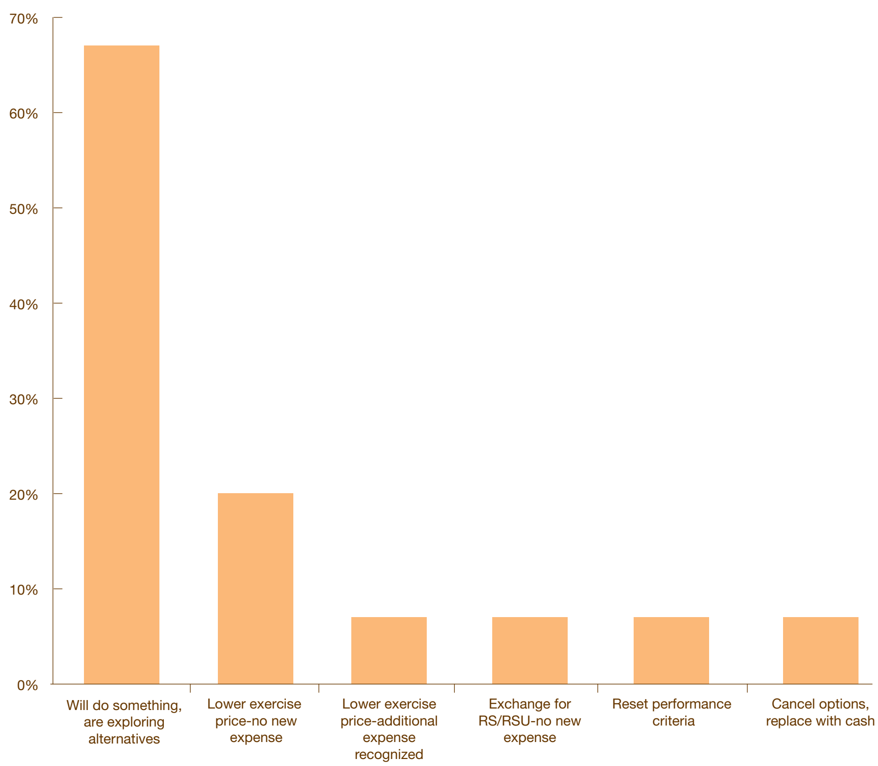
As organizations navigate the current economy and keep watch on potential government regulation of executive pay practices, they must also attract, retain and reward key talent to meet employee, organizational and shareholder needs. Of course, this means there is a premium on the design of equity compensation programs that drive earnings as much as or more than the dilutive impact of those programs on earnings per share. Executives must not lose sight of the optimal mix of types of equity compensation being granted.

The recent market downturn has led to a significant number of outstanding, underwater stock options. Many companies with significant underwater option positions have considered (1) repricing or exchange programs with the purpose of restoring the compensatory value to employees and/or better aligning compensation costs with employee motivation and (2) reducing the number of shares outstanding, thereby renewing the supply of shares available for future equity compensation grants. While some companies have already completed underwater option exchange programs, the prevalence of such actions is significantly lower than in past economic downturns. Many companies continue to consider exchange programs, even as stock prices and the economy begin to grow again. Some best practices that have evolved in connection with underwater stock option exchange programs include exchanging underwater options on a value-neutral basis (i.e., exchanging underwater options for a lesser number of at-the-money options or full-value shares), extending the service period requirement, limiting executive eligibility and removing exchanged shares from the pool available for future grants.

Are you making changes to outstanding equity grants based on current market conditions?



What changes will be made to outstanding equity compensation grants?

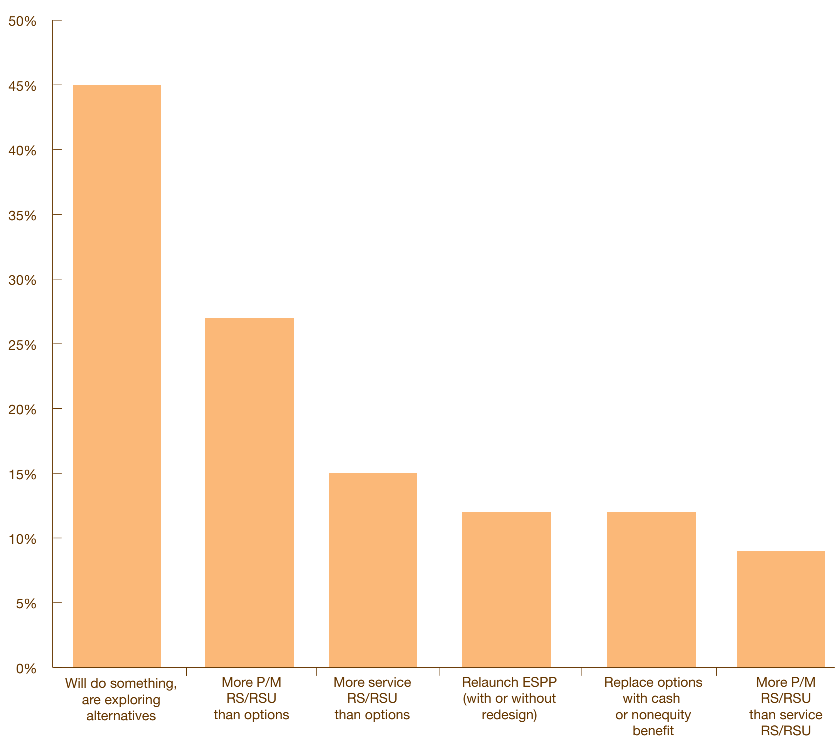


Changes in granting practices

Along with looking at outstanding grants, companies are reflecting on the economic downturn to reexamine their mix of equity compensation grants. While current grant practices show a slight decrease in the prevalence of performance-based grants in comparison to prior years, survey responses to questions about changes in granting practices as a result of the economic downturn are consistent with the larger trend to emphasize performance in equity compensation grants. Indeed, when companies have reported making changes in their future equity compensation grants based on current market conditions, the most frequently cited change is replacement of service-based grants with ones based on performance conditions.

Equity compensation will remain a critical component in organizations' leadership through the current economic downturn and to economic recovery. Organizations have long known that engaged employees with a sufficient stake in the game will deliver results that intersect with organizational objectives. Equity-based compensation continues to add value by creating a means for employees to have a stake in the game that strengthens employees' long-term connections to organizations and in turn fortifies relationships with customers and shareholders.

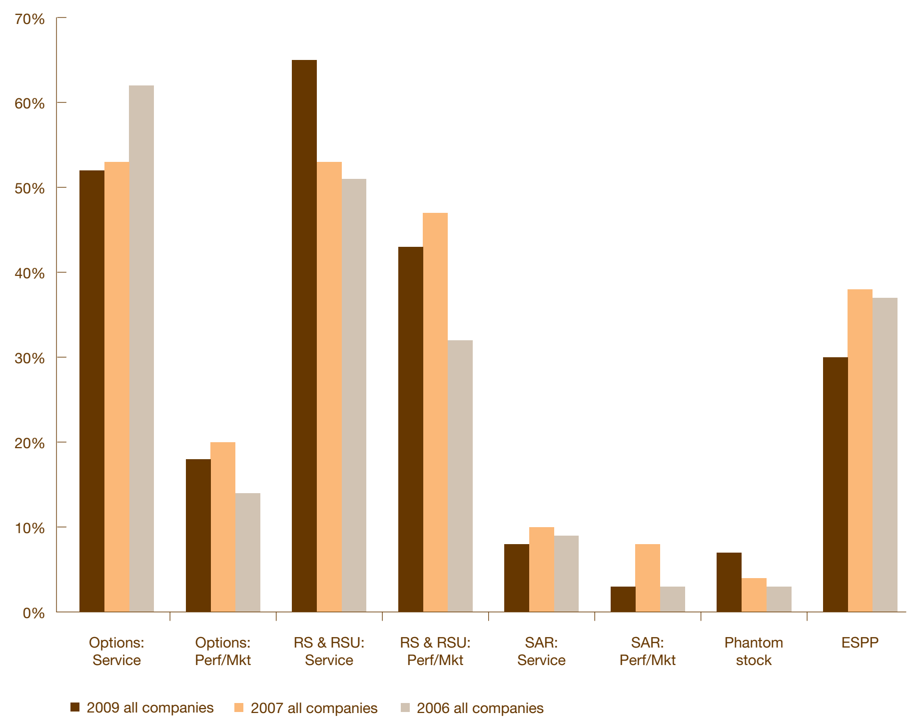
What changes will you make to granting practices in the upcoming year based on current market conditions?



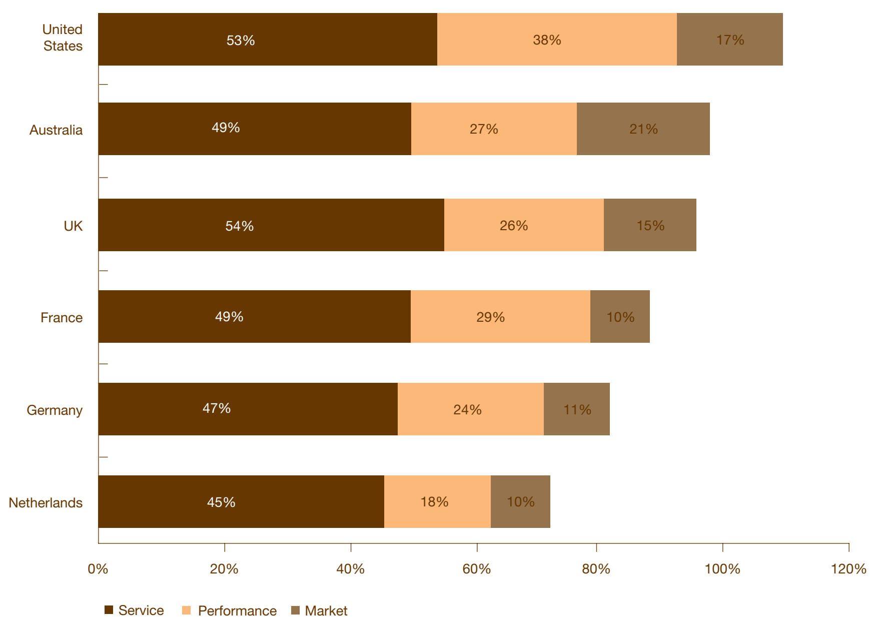
Equity compensation mix

Results from the 2009 Global Equity Incentives Survey reflect continuation in the trend toward the decreasing prevalence of service-based stock options since 2006. That shift is accompanied by another—namely, movement toward other award types: most notably, service-based and performance-based restricted stock units (RSUs) and restricted stock (RS). Responses to the 2007 Global Equity Incentives Survey indicated an increase in the prevalence of performance-based stock equity; however, that trend apparently lost a little momentum in 2009 as companies increased their use of service RS/RSUs—likely due to the uncertainty around near-term economic performance. The latter trend may also reflect companies' goals to motivate and retain critical or pivotal talent in spite of declining market prices, and it may prove to be a short-term strategy for bridging to the market turnaround and ensuring the necessary key talent is in place to lead organizations.

Equity compensation mix—Last three years
Employees in the **US**

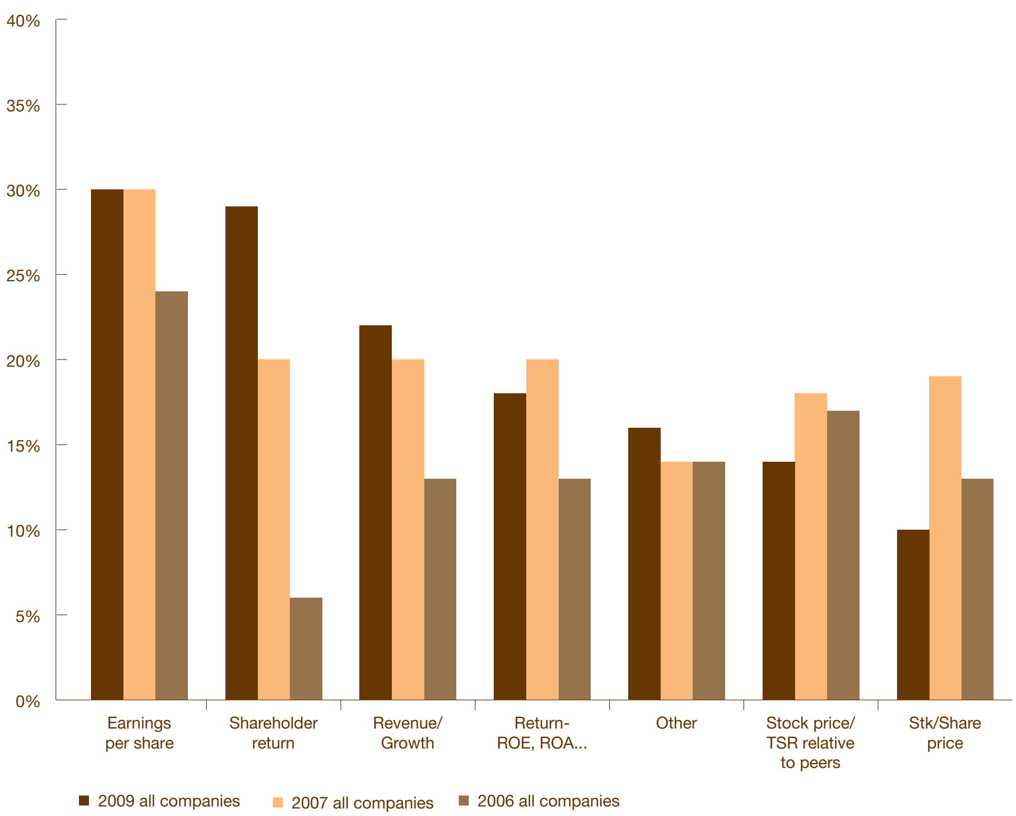


2009 Prevalence of service, performance & market based plans



We expect that the decrease in the use of performance-based grants in 2009 will turn out to be a temporary reversal of the larger trend related to the increase in performance-based grants. Indeed, the recent attention given to risk-adjusted performance metrics, as well as uncertainty around the duration of the market decline, has led many companies to take their performance grants back to the drafting table. For example, traditional key performance metrics such as earnings per share have been undermined by the extreme volatility in the market over the past 12 months. In rethinking performance metrics, companies are looking at the length of a performance period and combining individual and business unit or company financial and operational targets. Additionally, certain companies are attempting to realign performance-based compensation plans with their organizations' risk appetites.

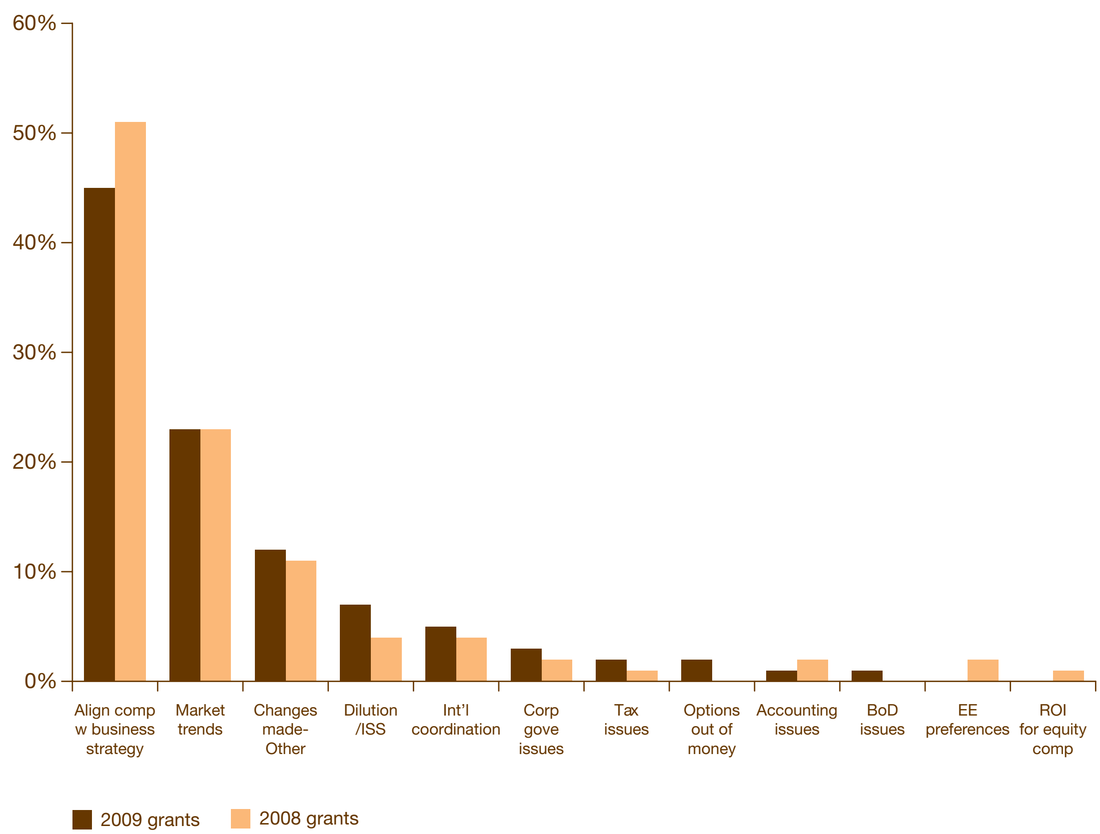
Basis for performance/Market targets
Most frequently cited



Further, we expect to see companies increase grants of service-based stock options after the close of the 2009 survey, in anticipation of stock price rebound. Certainly, the performance of markets during the latter half of 2009 featured rebounding stock prices. However, the strength of the economy remains uncertain. As signs of sustainable growth emerge and take form, organizations will need to continuously realign their strategic equity compensation practices so as to enable their organizations to launch their own rebounds.

The recent market downturn has led to difficulties with the traditional ways of linking broad employee groups to company performance. Echoing the decreasing prevalence of service-based stock options among broad employee populations, we are seeing some trends in the declining use of employee stock purchase plans (ESPPs), a popular vehicle for instilling shareholder mind-set in broad employee populations. Paradoxically, while the 2009 survey indicates that the percentage of companies that include ESPPs in their benefits programs decreased in 2009, those companies that continue to use ESPPs see an increase in the percentage of employees who take advantage of the benefit. Further, whereas in prior years we saw a general decrease in the use and duration of look-back periods (to six or three months), in 2009 we saw that among companies that have a look-back feature in their ESPPs, the look back was more frequently 12 months, thereby enabling employees to benefit despite stock price volatility. Finally, we saw that in some countries, ESPPs actually became more prevalent in 2009 than in 2007—in particular, in emerging markets, where such plans are being offered for the first time.

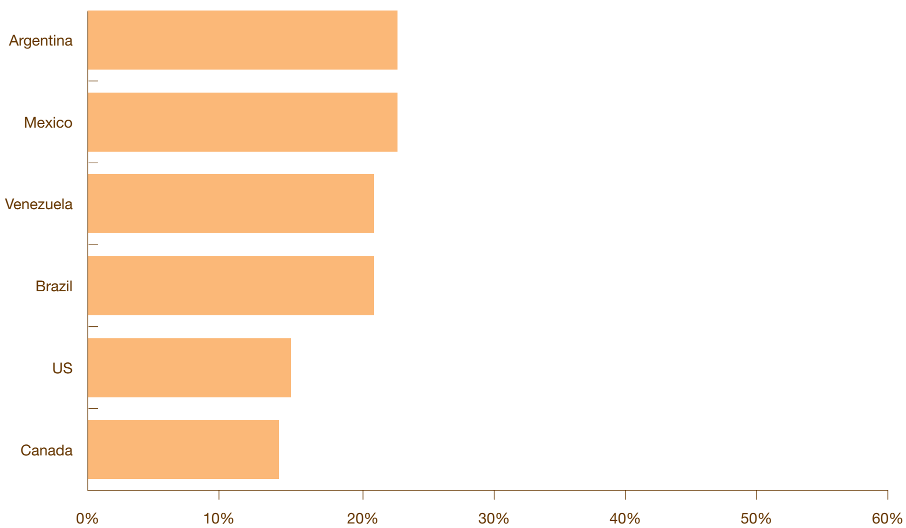
Driver of changes in equity comp



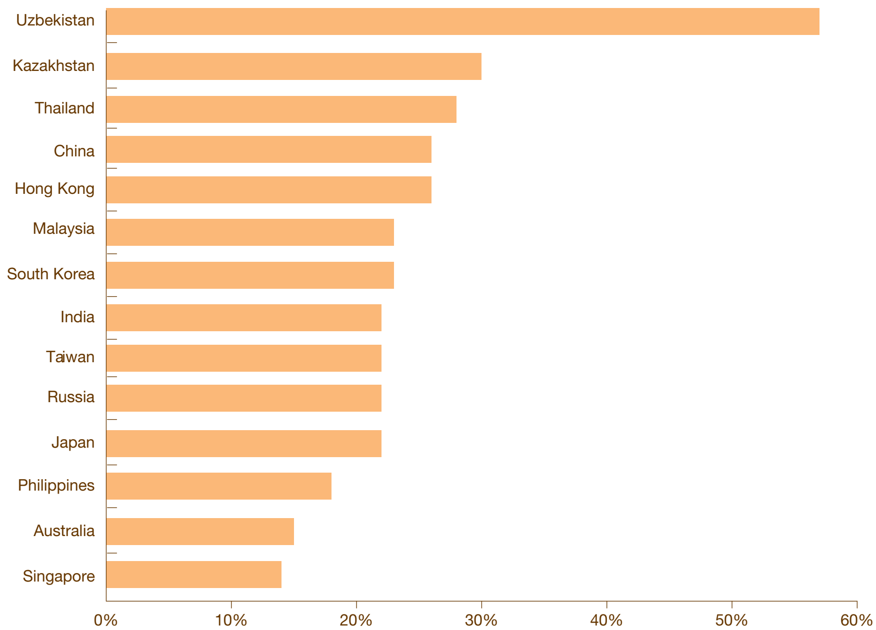
Emerging markets

The divergence in trends related to ESPPs in both more-developed countries and emerging markets is not isolated but is reflected in other trends in equity compensation. While the majority of companies are not planning to increase in 2009 the number of countries where equity compensation is granted, some companies report strategic decisions to start making grants to employees in certain countries in Asia Pacific, the Middle East and Latin America, including Uzbekistan, Kuwait, Saudi Arabia, Argentina and Mexico. Many of those countries have seen gains from commodity prices over recent years, and the disparate equity compensation practices there likely reflect the unique recruiting and retention goals in that industry. Overall, service-based grants tend to be the primary vehicles used in emerging markets, although performance-based grants are used for upper-level executives in those countries.

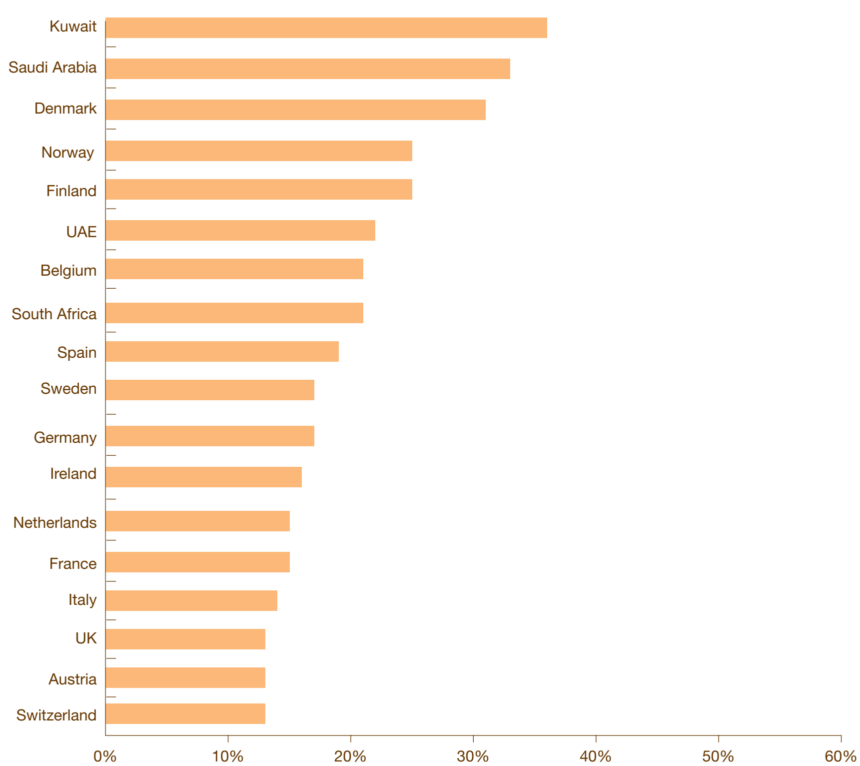
Companies that have employees in each country and plan to offer equity for the first time in 2009—**Americas**



Companies that have employees in each country and plan to offer equity for the first time in 2009—**Asia Pacific**



Companies that have employees in each country and plan to offer equity for the first time in 2009—**Europe, Middle East, Africa**



IFRS compliance and convergence

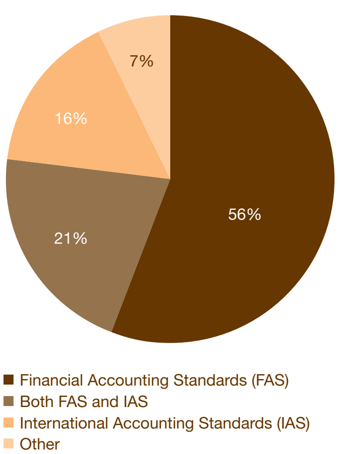
International Financial Reporting Standards (IFRS) are now required in many countries, and US convergence is expected in the future. With that context in mind, we know our survey participants are adjusting to the unique accounting requirements under IFRS as they build processes and controls related to IFRS compliance throughout their organizations.

As IFRS and US GAAP (generally accepted accounting principles) converge, standards are being introduced that will drive accounting changes that have immediate impacts on compensation structures and practices. Many companies will need to make significant changes in order to become able to comply with stock-based-compensation accounting under IFRS. Some of the key areas that merit analysis are:

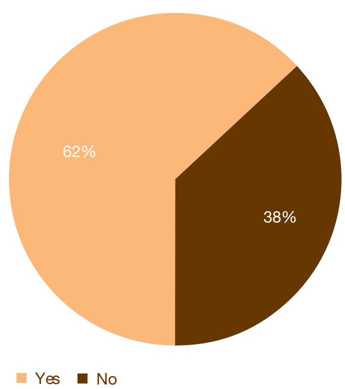
- Changes to valuation and expensing
- Equity-versus-liability classification
- Accounting for income tax effects

Those differences will require continued collaboration between finance, tax, legal and human resources functions. For example, when employee withholding tax is paid through shares withheld for that purpose, finance will need to account for the expenses of those shares under variable accounting; and stock market volatility will need to be reflected in the balance of deferred tax asset on the books for outstanding grants of equity compensation.

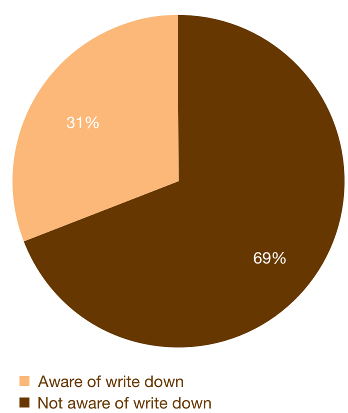
Applicable accounting standards 2009—All companies



IFRS: Is expense for shares withheld to cover social tax based on variable accounting?



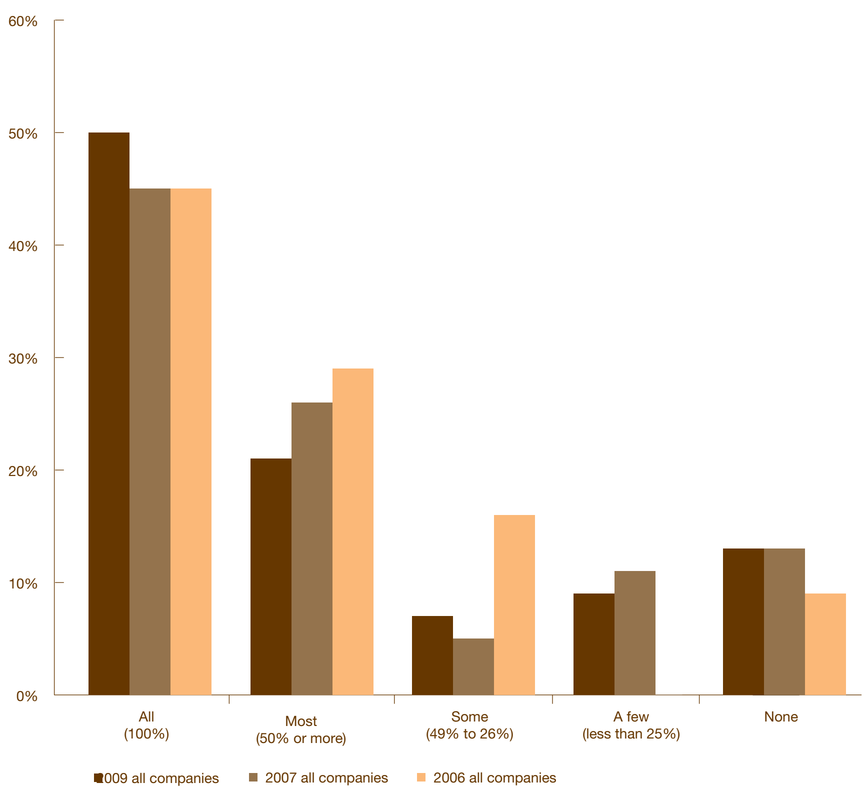
IFRS: Award of DTA write down with stock price decrease



Tax compliance

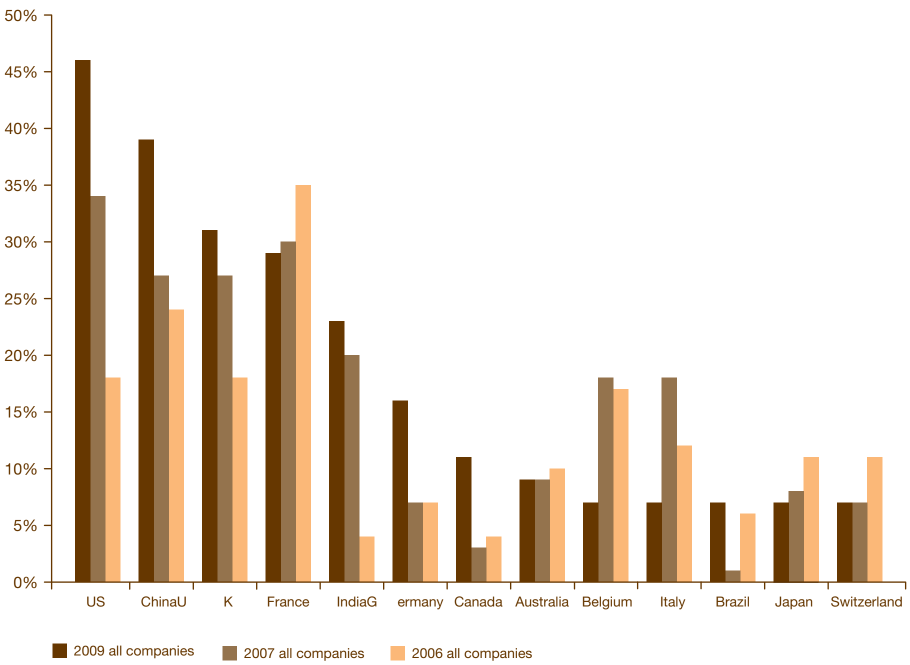
One of the biggest challenges to companies that grant equity in more than one country is the diversity of tax rules related to equity compensation across countries. As we know, those rules are not static, and they can change several times—sometimes dramatically—over the life of a stock option grant. For example, variation exists in the timing of a tax event (e.g., grant, exercise, exit from the country or sale of underlying shares), in the tax basis (e.g., average price over a month in Italy or closing pricing on the date of the transaction in China and Taiwan) and in the sourcing rules (e.g., grant to vest or exercise, and impact of a tax treaty); and withholding tax rules and social tax rules may vary from income tax rules. Additionally, an often lamented difference between compliance for book and tax purposes is that for tax purposes, there is no so-called materiality threshold shielding companies from penalties on inaccurately reported or inaccurately paid tax or from the hassle of an audit by the tax authorities.

Extent of internal compliance reviews



The recent economic decline has exacerbated those situations, with the taxing authorities in several countries announcing new revenue-generation programs for equity compensation (e.g., United Kingdom, United States, China, Japan and South Korea). For example, in the UK, HM Revenue & Customs has pulled together a team dedicated to the auditing of the tax treatment of share-based payments by certain foreign-based companies. In the US, the Internal Revenue Service announced its most comprehensive review of federal employment tax since 1984, hiring 200 new agents charged with the task of auditing approximately 6,000 companies during 2010. Despite those initiatives, nearly half of survey participants indicate they have not performed compliance reviews in all countries where equity compensation is offered.

Countries with most challenging tax compliance for companies with employees in...



Concluding remarks

Results from the 2009 Global Equity Incentives Survey indicate that companies have considered broader economic conditions with respect to global equity compensation policies and practices. The hotbed of issues related to compliance and personal accountability for equity compensation only escalated in 2009, and equity compensation remains the single-most-cited tool for enlisting talent throughout to guide companies' resurgence. Even as the economic climate of 2008–09 refocused the attention of regulatory bodies and shareholders alike on compensation practices and the role of equity compensation in the overall pay mix, companies are positioning themselves for recovery and it is clear that the benefits of equity compensation continue to outweigh their costs.

PricewaterhouseCoopers

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Human Resource Services

As a leading provider of HR consulting services, PricewaterhouseCoopers (PwC) brings together a broad range of professionals working in the human resource service arena—compensation, benefits, retirement, HR strategy, international assignment, regulatory compliance, tax, process management, culture and change, communications and financial planning—affording our clients a tremendous breadth and depth of expertise, both locally and globally.

PwC's Human Resource Services (HRS) practice assists clients in improving the performance of all aspects of human capital (HC) and the HR organization through technical excellence, thought leadership and innovation around four core business issues: Financial Management, Risk Management and Compliance, Operational Excellence and Transaction Effectiveness.

Our expertise in tax, accounting, actuarial, finance, operations and compliance; our leadership in human capital management, measurement and program development; and our disciplined approach to execution and change sets us apart. With more than 6,000 HRS practitioners in offices across 75 countries, PwC helps to align human capital strategies with business strategies and drive shareholder value for our clients.

Industry–specific Survey results

If you are interested in a customized report geared toward a specific industry, contact:

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