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Regulatory Issues and Evolving Marketplace Trends in Compensation Strategy

The following highlights the regulatory issues and evolving marketplace trends relative to developing an executive compensation strategy in 2005 / 2006:

- The impact of the Sarbanes-Oxley Act and shareholder concerns regarding excessive executive compensation demands companies more closely link executive compensation and long-term financial performance. As a result, performance-based awards have become more prevalent in the marketplace.

- While most of the focus of the new FASB fair value accounting has been on the technical aspects of equity accounting, the long-term impact is the broad shift in equity grant practices. Competitive norms in terms of magnitude and grant characteristics are changing. Companies are considering long-term incentive instruments based on *efficiency* (i.e., providing awards so that the value of each award to the recipient is greater than the cost of the award to the company). Stock appreciation rights, restricted stock, restricted stock units, cash plans and performance unit plans should become more common.

- Overall equity compensation overhang levels (stock option shares outstanding plus shares available for grant) will continue to decrease as companies take more conservative and efficient approaches in equity awards.

- Executive ownership guidelines are becoming more prevalent as companies seek to further align executive compensation with shareholder interests.

- Executive long-term incentives will be benchmarked by assessing the value of equity flowing out of the company to executives as a percentage of market capitalization.

To date, while certain trends have appeared in analyses of public disclosures and credible survey sources, there has been a significant "bubble" of planning that will foster a rapid change in equity compensation practices once the new fair value accounting rules become effective.