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February 26, 2009

Compensation trends (2009) Seminar



Seth Rosen
Mercer, Los Angeles
213 346 2254
seth.rosen@mercer.com

www.mercer.com

Current Environment and Implications on Rewards Programs

Environment

Depressed Stock Market

- The S&P 500 and the NASDAQ have tumbled by 35-40% since the beginning of 2008

Uncertain Labor Markets

- Employers slashed 533,000 jobs in November, the most in 34 years, and an additional 524,000 in December
- Unemployment rate rose to 7.2% in December - the highest level in over 15 years

Companies in Turmoil

- Collapse of large financial institutions
- Government has intervened to protect hardest hit industries, including financial sector and Big Three automakers
- Forecasts for 2009 performance have been revised downwards

Implications for Rewards Programs

2008 Incentives

- Economic conditions are wreaking havoc on 2008 performance versus established goals for annual and long-term incentive programs

2009 Goal Setting

- Uncertain economy is creating issues with 2009 incentive program goal-setting

Long-Term Incentives

- Depressed stock prices are forcing a choice between dramatic increases in annual share usage or reductions in long-term incentive grant values for 2009

Retention value

- Current equity values for executives have significantly declined, loosening retention hooks and diminishing alignment to future performance

As a result of the economic downturn, companies are evaluating several topics

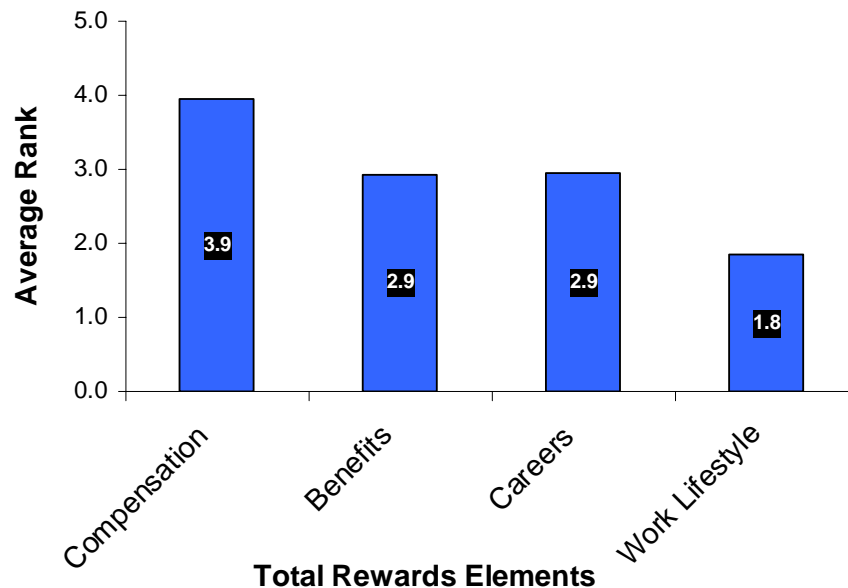
Topics	Challenges/Considerations
Employee Headcount	<ul style="list-style-type: none"> ▪ 2009 hiring ▪ Headcount reductions
Cash Compensation Levels	<ul style="list-style-type: none"> ▪ Salary freeze ▪ Salary reductions
Short-Term Incentives	<ul style="list-style-type: none"> ▪ 2008 payouts ▪ 2009 program design and goal setting
Long-term Incentives	<ul style="list-style-type: none"> ▪ 2009 program design, 2009 grants, and goal setting ▪ Underwater options and reduced equity values
Executive Talent	<ul style="list-style-type: none"> ▪ Identification of key talent and talent needs based on new business imperatives ▪ Differentiation of talent in rewards programs

Recent Mercer surveys explore how companies are addressing talent and rewards issues for 2009 in light of the economic uncertainty

- Surveys:
 - Mercer’s Global SnapShot Survey: Leading through unprecedented times (approximately 1,000 participants, including almost 200 large companies, conducted in early November)
 - Annual and Long-term Incentives Survey: Weathering the Storm: Decision 2009 (approximately 200 companies, conducted in late November)
 - “Grassroots” Leading Through Unprecedented Times – Southern California Survey (conducted January 2009)
- Results indicate that while many companies are still formulating their plans in response to the economic downturn, some have arrived at final decisions that may be indicative of broader trends
- The environment remains fluid – we anticipate that companies will continue to evaluate and finalize their plans into early 2009

Where are total rewards changes being made?

- The **majority of companies** are making the most changes to the area of **Compensation**
 - 20 participants (54%) ranked this area as the area of largest change, in dollars
- Overall, companies rank Work Lifestyle as the area least likely to experience large changes
 - 15 companies (41%) ranked this area as the lowest area of change



	Counts by Rank				
	High	5	4	3	2
Compensation	20	5	3	2	5
Benefits	3	10	11	5	7
Careers	3	8	11	8	4
Work Lifestyle	0	3	4	10	15
Other	0	1	0	0	2

The majority of participant respondents oversee both compensation and benefits, but compensation is still the area where respondents have made (or plan to make) the largest amount of change

Source: "Grassroots" Leading Through Unprecedented Times Survey

What value do ABC employees place on the Total Rewards program?

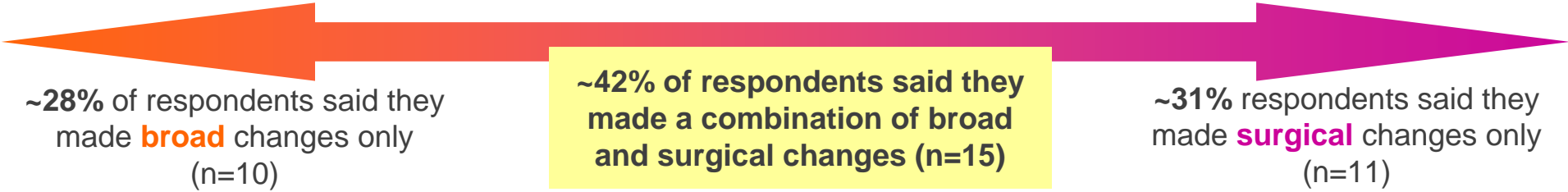
Differing points of view on the value of reward elements exist by generation; cost savings solutions should take these perspectives into account

	Traditionalists (60+)	Baby Boomers (43 to 60)	Generation X (30 to 42)	Millennials (18 to 29)
Compensation				
Base Pay	3	2	1	2
Short-Term Incentives	4	1	2	4
Long-Term Incentives & Deferred Comp	5	5	5	9
Recognition	8	7	7	3
Benefits				
Retirement	1	3	12	12
Health & Welfare	2	4	4	10
Perquisites	9	12	13	13
Careers & Development				
Performance Management	10	6	8	5
Career Pathing	12	8	3	1
Training Programs	11	10	6	6
Global Mobility	13	11	10	7
Work Lifestyle				
Time-off	7	13	11	11
Alternative Work Arrangements	6	9	9	8

Source: Mercer experience and studies on Total Rewards perspectives by generation

Using a level of segmentation to make total rewards changes has not yet been applied in a surgical manner by all organizations; most are still making broad decisions

Level of Segmentation	
Broad	Surgical
<ul style="list-style-type: none"> ▪ Effects a large population, therefore has a broader impact ▪ “One size fits all” approach for entire population ▪ More immediate and (possibly) large savings ▪ Egalitarian with potential to alienate certain segments 	<ul style="list-style-type: none"> ▪ Narrower but more directed impact ▪ Targeted approach, which segments the population (e.g., level, performance rating, geography, job family, generation or business unit) ▪ Potentially smaller immediate savings ▪ Requires more front-end diagnosis



39% of respondents are making surgical total rewards changes by tailoring actions specifically to Executives (n=14)

Source: “Grassroots” Leading Through Unprecedented Times Survey

Other factors to consider: Degree of Disruption (individual); Financial Impact

Levels of reduction, reallocation, and investment-focused changes are influenced by the client's position within this spectrum

Economic Impact on Performance

So Far, So Steady

▪ **Example Players**

- Low Cost Retailers: Walmart and Costco
- Select Energy Companies
- For-Profit Education Industry

▪ **Actions Taken**

- Cut the fat
- Reconsider workforce planning goals/needs
- Limit annual salary increases
- Accelerate variablization of TR mix
- Pick off previously difficult to attract talent
- Shift jobs to emerging, lower cost countries

Bend, But Don't Break

▪ **Example Players**

- Consumer Staples
- Pharmaceuticals

▪ **Actions Taken**

- Overall strategy: to stay the course
- Companies that do take action, do one or more of the following:
 - Institute salary freeze
 - Reduced bonus payouts
 - Decrease compensation budget
 - Install workforce management system
 - Rescind outstanding hire offers
 - Delay recruiting of new talent
 - Use more cost-effective training mediums (e.g., online)
 - Shift jobs to emerging, lower cost countries

Hardest Hit

▪ **Example Players**

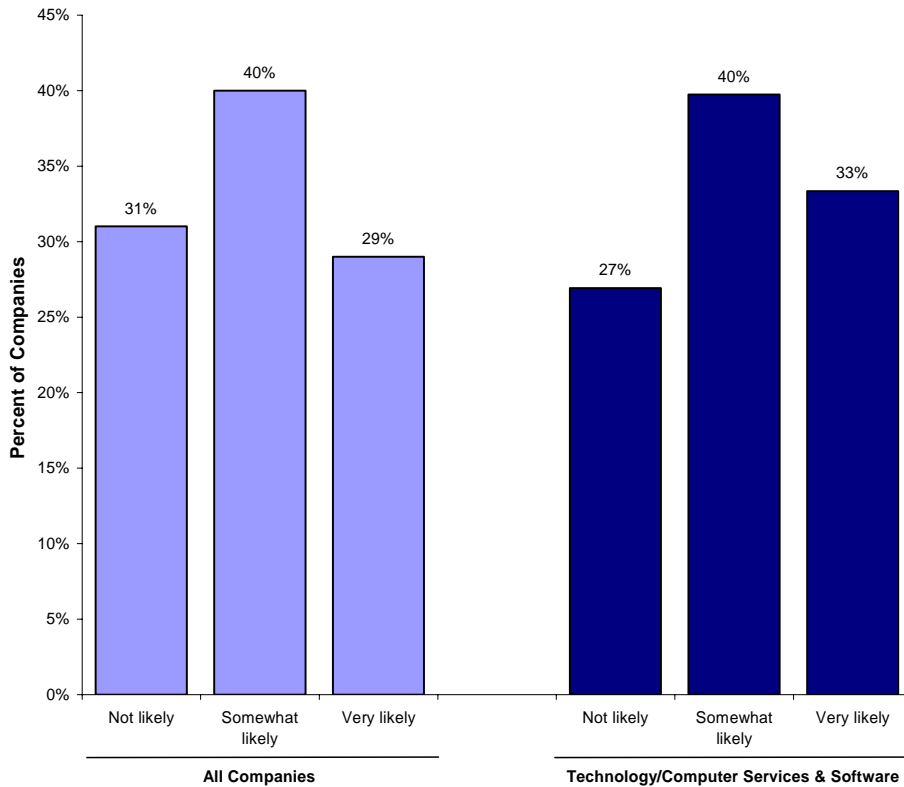
- Financials (Lehman Brothers)
- US Auto Industry (Ford, GM)
- Airline Industry (ATA, Frontier)

▪ **Actions Taken**

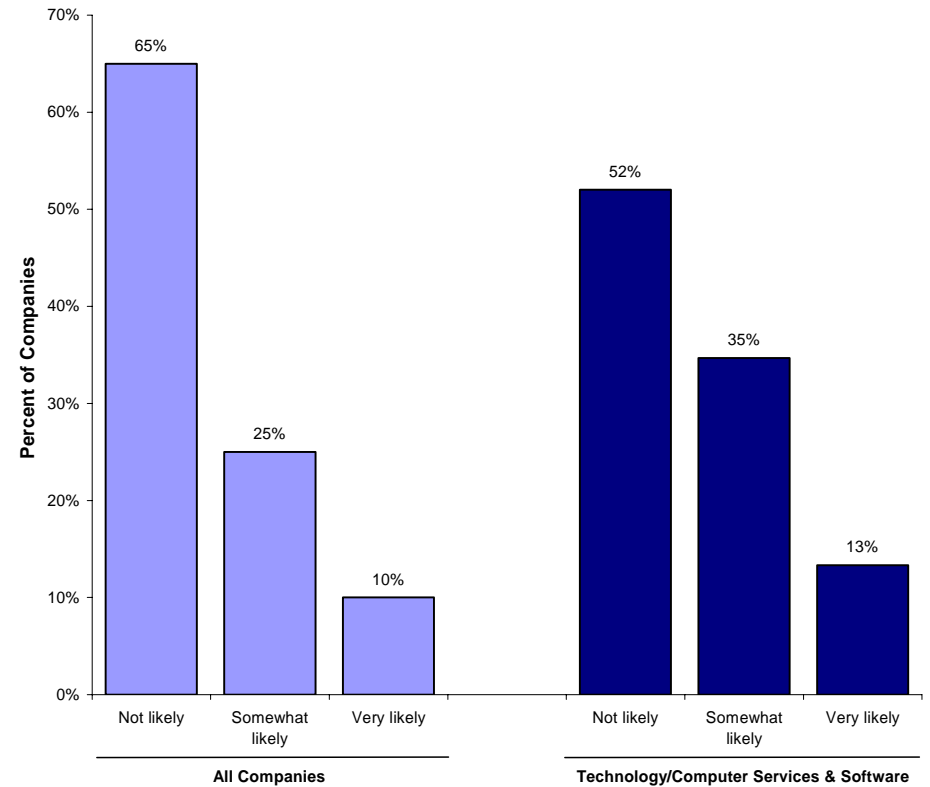
- Layoffs
 - Ford
 - eBay
 - BearingPoint
 - Deloitte
 - Schering-Plough
 - Pilgrim's Pride
 - PepsiCo
- Salary Freezes
- Minimal, if any, bonus payouts
- Option exchanges allow for retention and increased value of outstanding equity

Many companies are considering curtailing hiring to below replacement levels and others are considering significant headcount reductions

Curtail Overall Hiring to Below Replacement Levels



Reduce Your Workforce by Significant Numbers



Examples

Headcount reductions

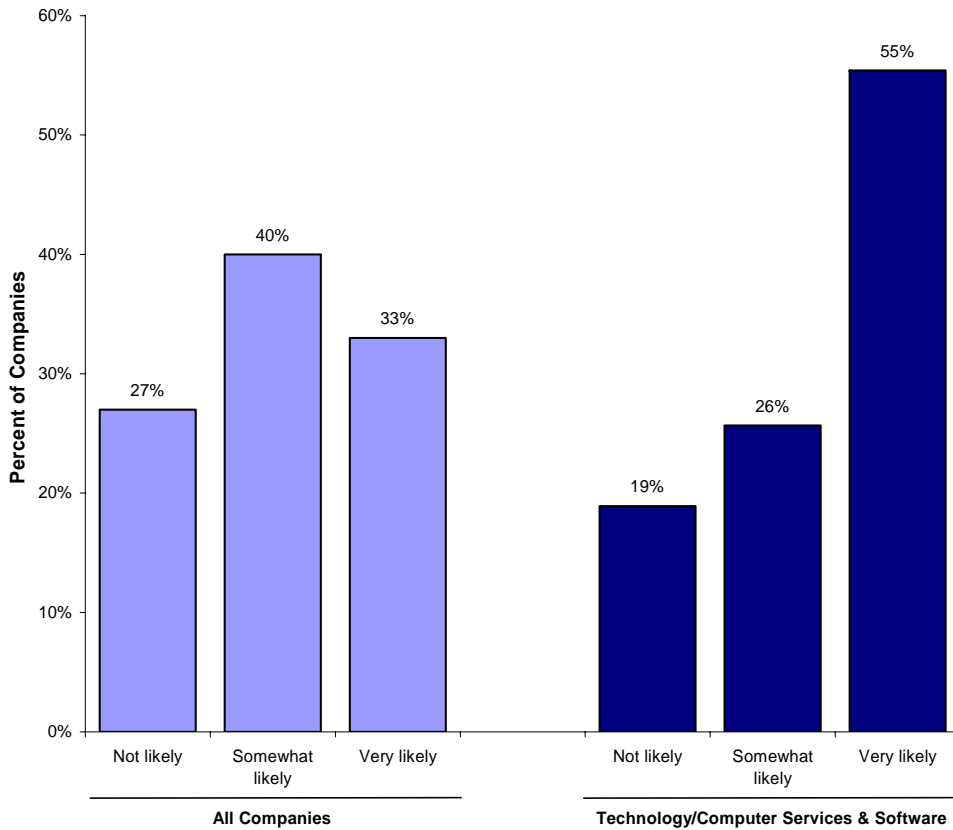
Motorola: Announced 3,000 job cuts (Oct 08). Announced additional 4,000 job cuts (Jan 09)

EMC: Announced 2,400 job cuts

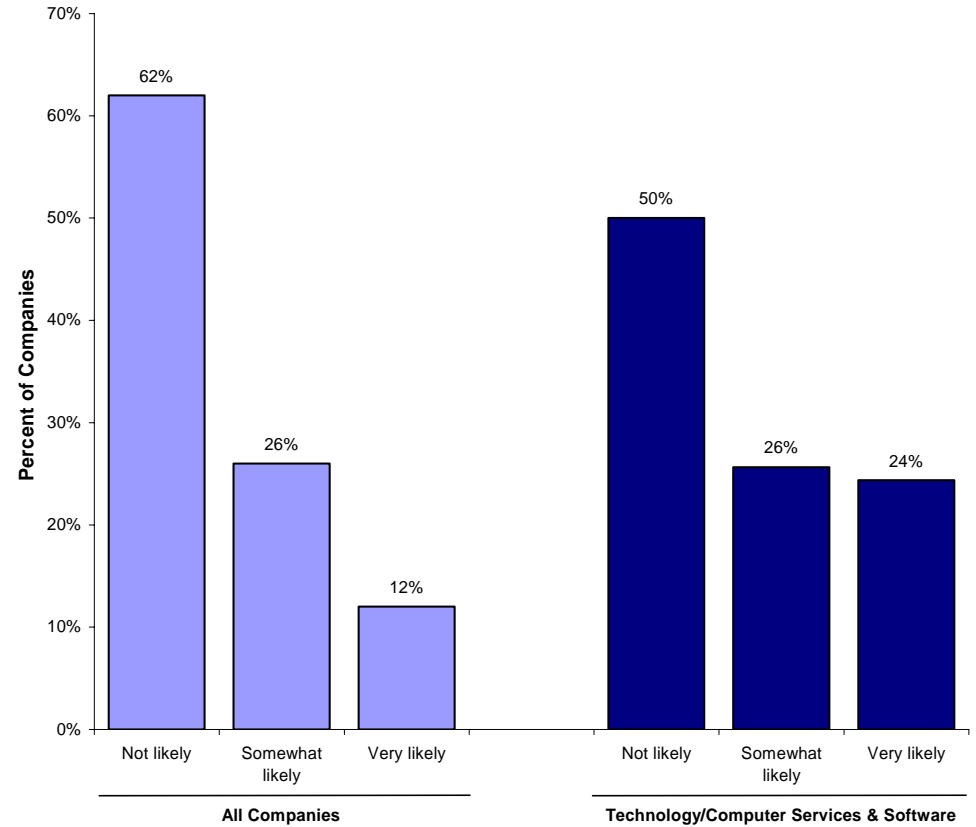
Source: Mercer Global Snapshot Survey: Leading Through Unprecedented Times

Technology companies are more likely to make adjustments to 2009 salary levels than the general industry

Reduce 2009 Salary Increases from those Originally Planned



Freeze Wages at 2008 levels

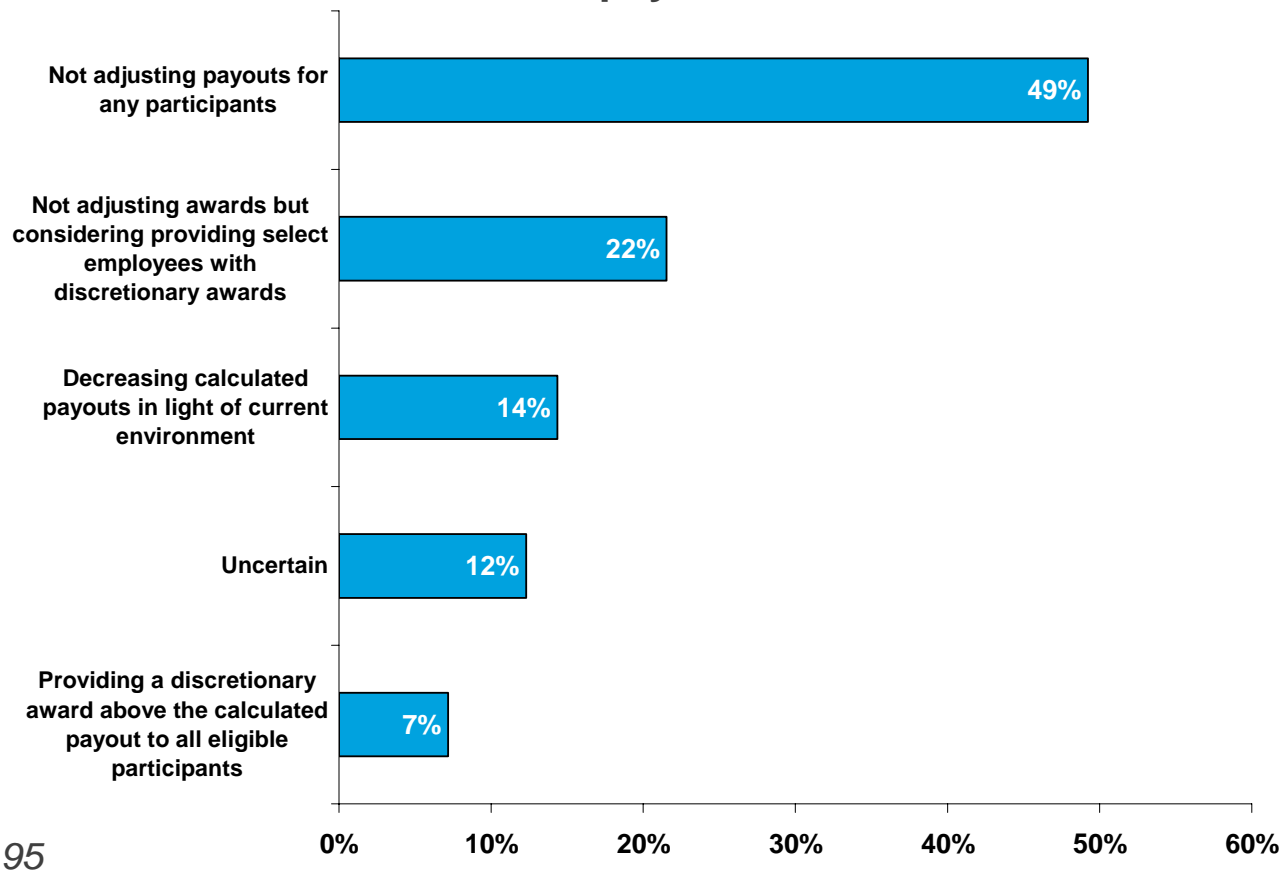


Source: Mercer Global Snapshot Survey: Leading Through Unprecedented Times

Annual Incentives

Approximately 71% of companies do not plan to adjust annual incentive awards for 2008; 29% are planning or considering discretionary awards

What adjustments, if any, are you considering to your annual incentive payout levels?



Source: Mercer Annual and Long-term Incentives Survey, *Weathering the Storm: Decision 2009*

Annual Incentives

Many companies are planning to implement or are considering at least one change to their annual incentive programs for 2009

What actions do you plan to take in relation to your annual incentive program for 2009?

Anticipated changes	Planning to Implement	Considering	Not Considering	Have Not Addressed Yet
Change in performance measures	17%	26%	46%	11%
Change in the range of performance	11%	33%	44%	12%
Allow for increased discretion related to payouts	9%	22%	56%	13%
Use of more absolute performance measures	14%	16%	56%	14%
Use of more relative performance measures	8%	20%	60%	12%

n = 193

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Mercer expects there to be major shifts in equity compensation in 2009 due to the current economic situation

- Most companies express equity grant guidelines as a dollar value. With the dramatic decrease in stock prices, many companies would have to grant significantly more shares to maintain a similar value to prior years
- Similarly, companies with share-denominated guidelines are faced with granting significantly less value to employees due to reduced stock prices
- Calculate potential awards using two methods:
 - Assuming delivery of the same **number of shares** as the prior year award using the current stock price and Black-Scholes value
 - Assuming delivery of the same **value** as the prior year award using the current stock price and Black-Scholes value
- To address these issues, companies are using a number a different approaches:
 - Managing to a target run rate
 - Reducing equity values by a fixed percentage
 - Using an average stock price volatility to calculate grants (e.g., 3, 6 , or 12 months)
 - Allowing the number of shares granted to shift within a defined range or “collar” (e.g., up to a 25% increase in the number of shares granted vs. the prior year)
 - Calibrating grants in light of company financial and operational performance
- While many companies are still in the planning stages, early data suggests that companies plan to reduce equity award value by 10% - 30%⁽¹⁾
- Additional anticipated changes include remixing LTI components, using special retention awards and reducing LTI participation

(1) Mercer survey: *Weathering the Storm: Decision 2009 Annual and Long-Term Incentives* (December 2008)



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Appendix

Base salaries

- There is no clear, up to date market data available to provide companies with guidance on salary increases for 2009
- Earlier this year, companies were predicting salary increases in the range of 3-5 percent in most geographies
- We now hear ranges of 0-2 percent, and many are freezing all senior executive salaries at current levels
- In sectors which have particularly suffered in the downturn, such as financial services, broader employee groups are receiving small or no increases
- From November through mid-January, 59 publicly traded companies announced salary reductions for executive officers⁽¹⁾

Examples

Salary freezes

Yahoo!: Announced that it will impose a salary freeze in 2009. Pay raises possible for promotions

EMC: Freezing salary levels for 2009

Salary reductions

- AMD: Board approved a 20% reduction in the annual salaries of Executive Chairman and CEO
- Seagate: Reducing executive salaries by as much as 25%
- Samsung: Plans to cut top managers' salaries by 20 percent

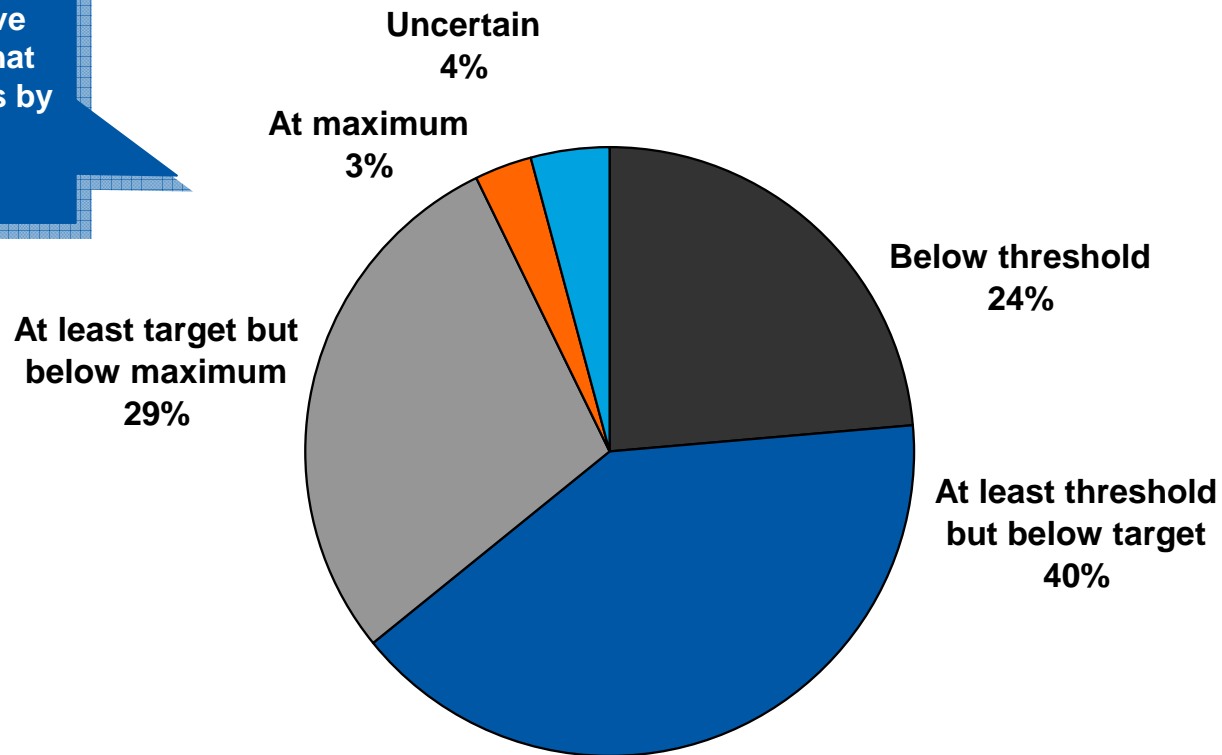
(1) Source: Dow Jones Factiva "Cuts should be just the 1st change in CEO pay" Jan 26, 2009

Annual Incentives

A majority of companies expect below target annual incentive payouts for 2008

What is your estimated performance versus established goals for your 2008 annual incentive program?

Almost 1/3 of companies expect target or above payouts, indicating that the environment varies by sector or even by company



64% of companies expect payouts below target

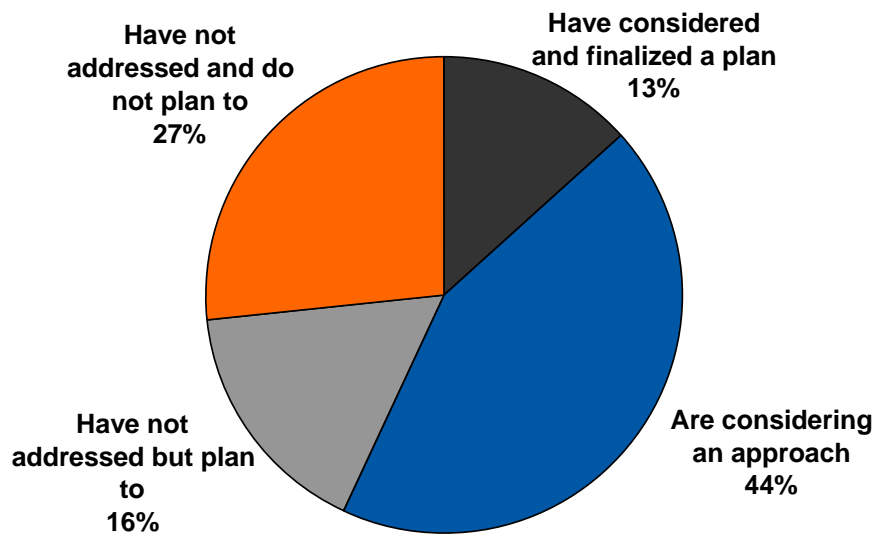
$n = 195$

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

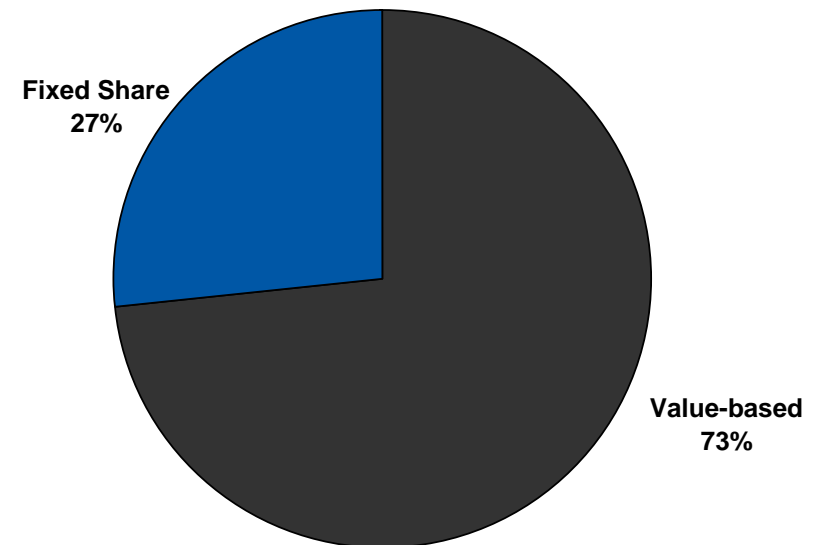
Long-term Incentives – 2009 Grants

- Approximately 60% of companies are still in the process of finalizing their plans for the 2009 LTI grants
- Almost three-quarters of companies surveyed denominate their guidelines as a fixed value

At what stage are you in addressing the impact of the recent stock market volatility on 2009 LTI grant practices?



Do you have fixed-share or value-based guidelines for LTI?



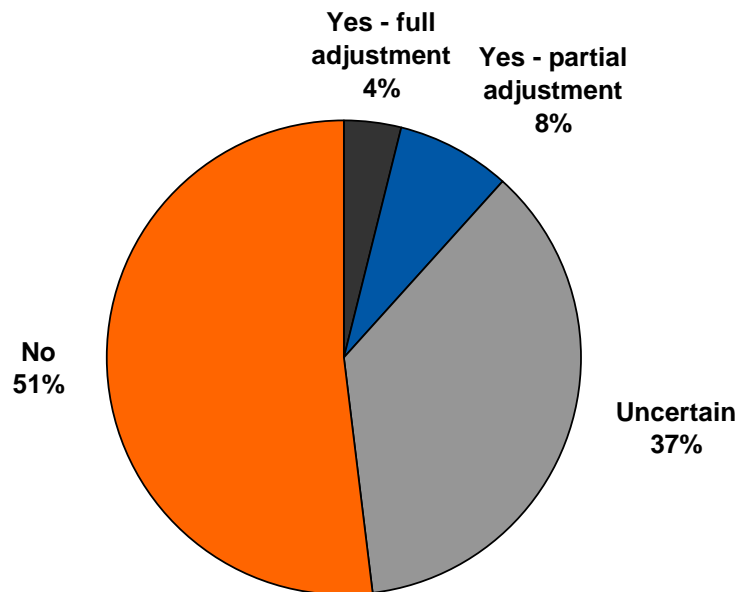
n = 195

Source: Mercer Annual and Long-term Incentives Survey, *Weathering the Storm: Decision 2009*

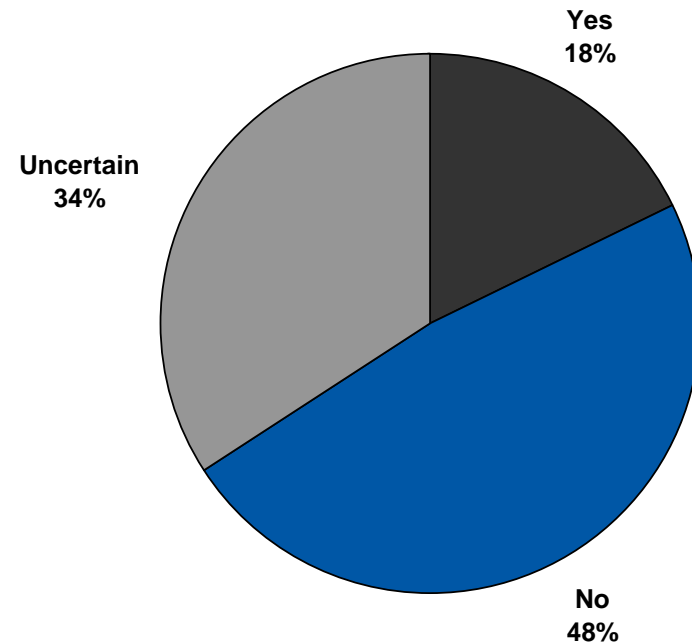
Long-term Incentives – 2009 Grants

- Approximately half of companies with fixed share guidelines are not planning to adjust their guidelines for 2009
- Approximately 52% of companies with value-based guidelines are either formulating their approach or plan to reduce their grant levels for 2009

Are you adjusting your fixed share guidelines for the 2009 grant?



Do you expect to reduce grant levels provided under your value-based guidelines for the 2009 grant?



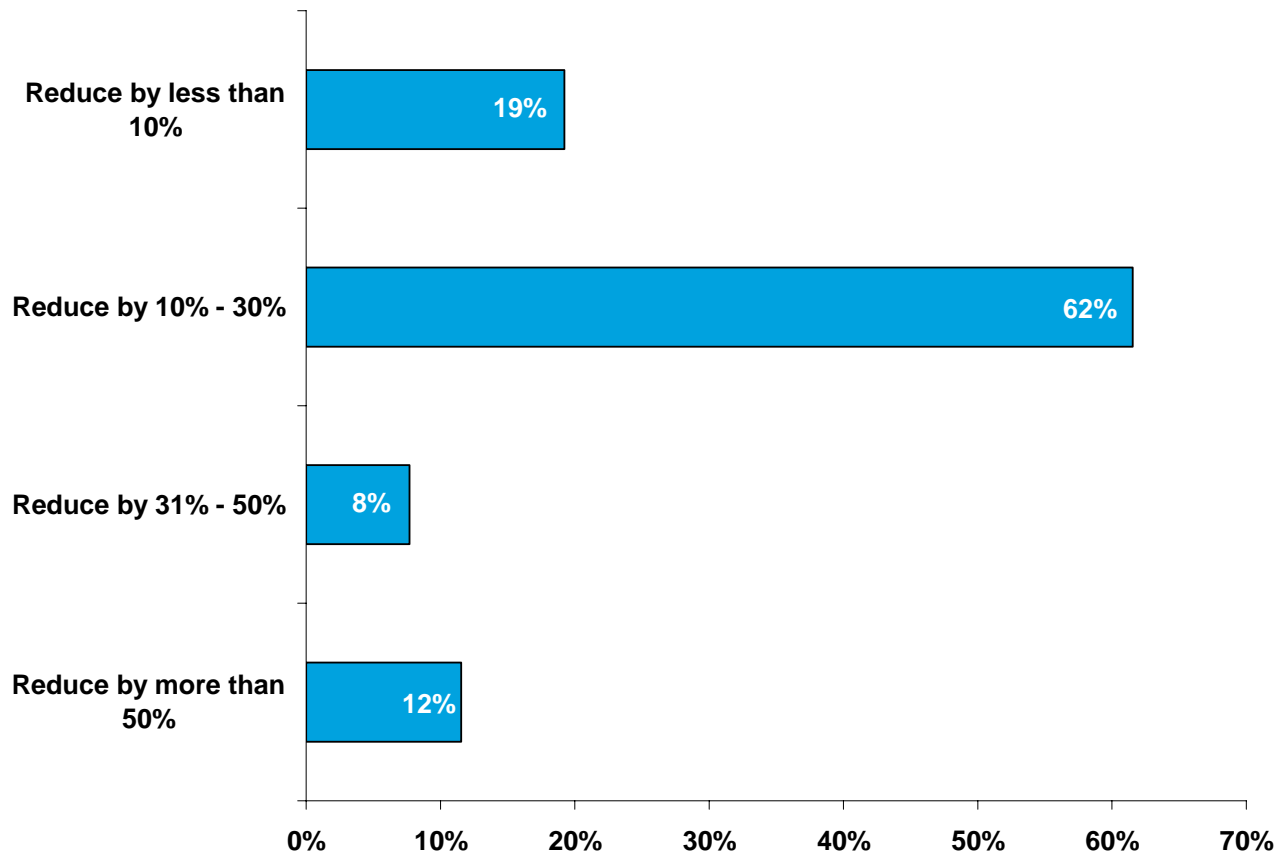
$n = 52$

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – 2009 Grants

Of those companies that have decided to reduce their grant levels, about two-thirds expect the reduction to be 10% - 30%

By how much do you expect to reduce the grant levels relative to your value-based guidelines?



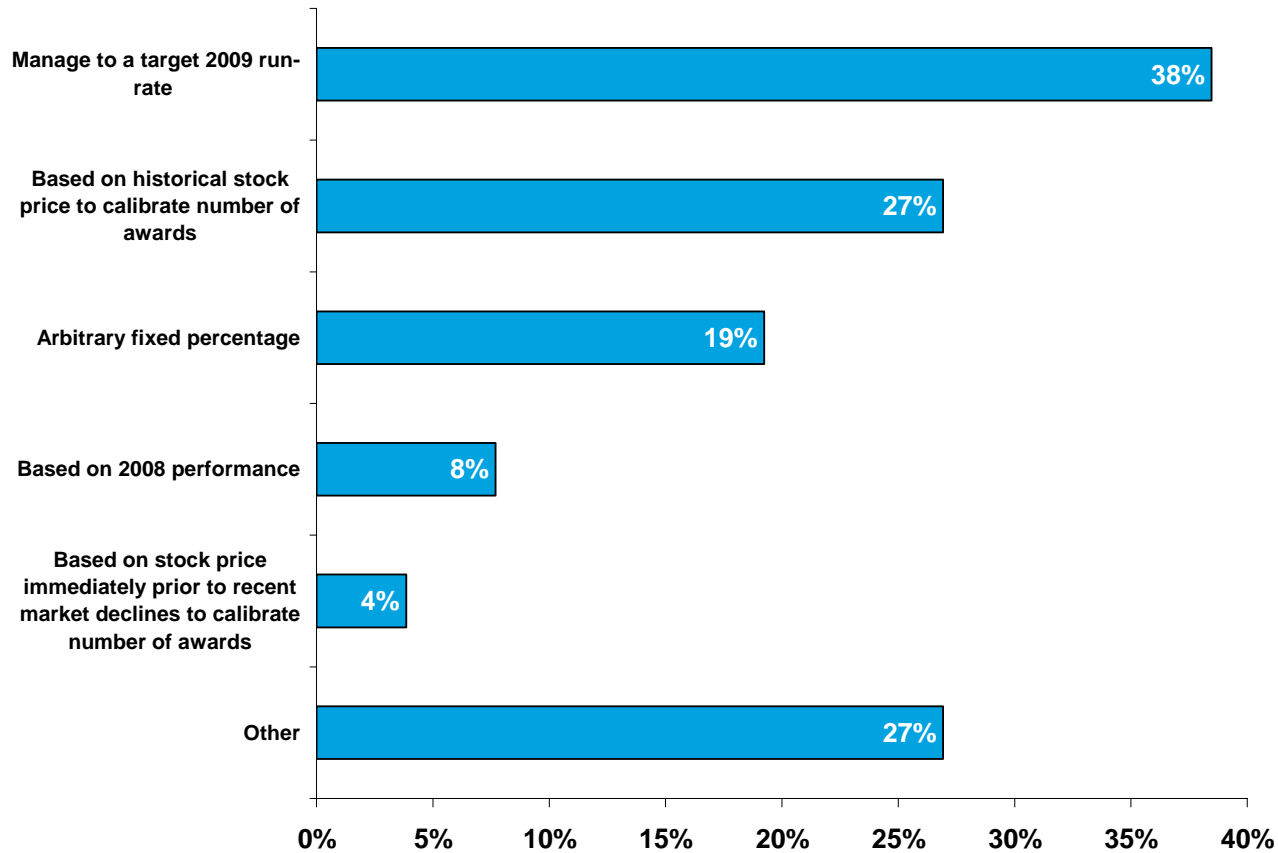
$n = 26$

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – 2009 Grants

For those companies reducing grant levels, a range of factors is being considered in making decisions

How are you determining the amount by which to reduce the guidelines?



$n = 26$

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – 2009 Run-Rate

Approximately 27% of companies are expecting run-rates to increase by more than 10% when compared to 2008; 28% are uncertain

How do you expect your 2009 run-rate to compare to 2008?

Response	% of Companies
Will decrease	6%
About the same	28%
Will increase by 1% - 10%	12%
Will increase by 11% - 30%	13%
Will increase by 31% - 50%	7%
Will increase by 51% - 100%	5%
Will increase by more than 100%	2%
Uncertain	28%

n = 195

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – Design Changes

Approximately 73% of companies are planning to implement or are considering at least one change to their LTI programs in 2009

What actions do you plan to take in relation to LTI for 2009?

Anticipated Changes	Planning to Implement	Considering	Not Considering	Have Not Addressed Yet
Use special retention awards	10%	36%	42%	12%
More emphasis on service-vested full-value shares for participants below senior executives	10%	23%	55%	12%
More emphasis on service-vested full-value shares for senior executives	8%	22%	56%	14%
Reduce LTI participation	8%	21%	62%	9%
Discontinue/decrease emphasis on stock options	9%	18%	63%	11%
Use more cash for LTI	8%	18%	59%	15%
Discontinue/decrease emphasis on performance shares/units	5%	15%	66%	14%
Shift value from LTI to annual incentive	4%	8%	75%	13%

n = 187

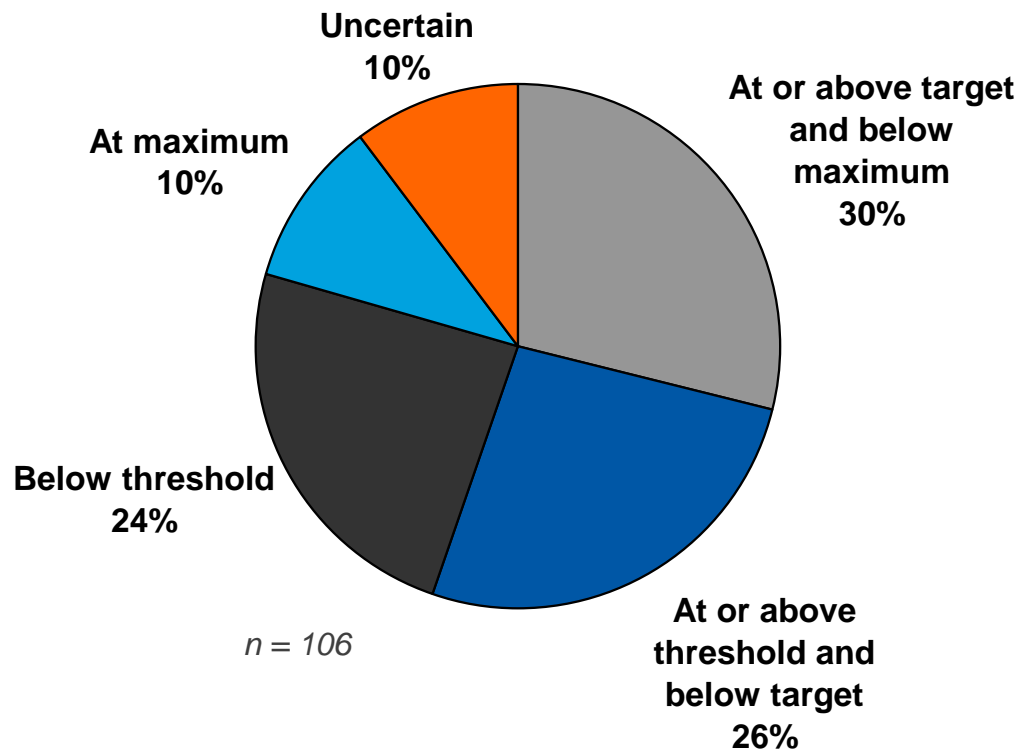
Anticipated changes include remixing LTI components, using special retention awards and reducing LTI participation.

Source: Mercer Annual and Long-term Incentives Survey, *Weathering the Storm: Decision 2009*

Long-term Incentives – PSU/Cash LTIPs

Approximately one-half of companies expect their PSU/cash LTIPs to pay out below target for the cycle ending in 2008

What is your estimated performance versus established goals for your PSU/cash LTIP cycle ending in 2008?



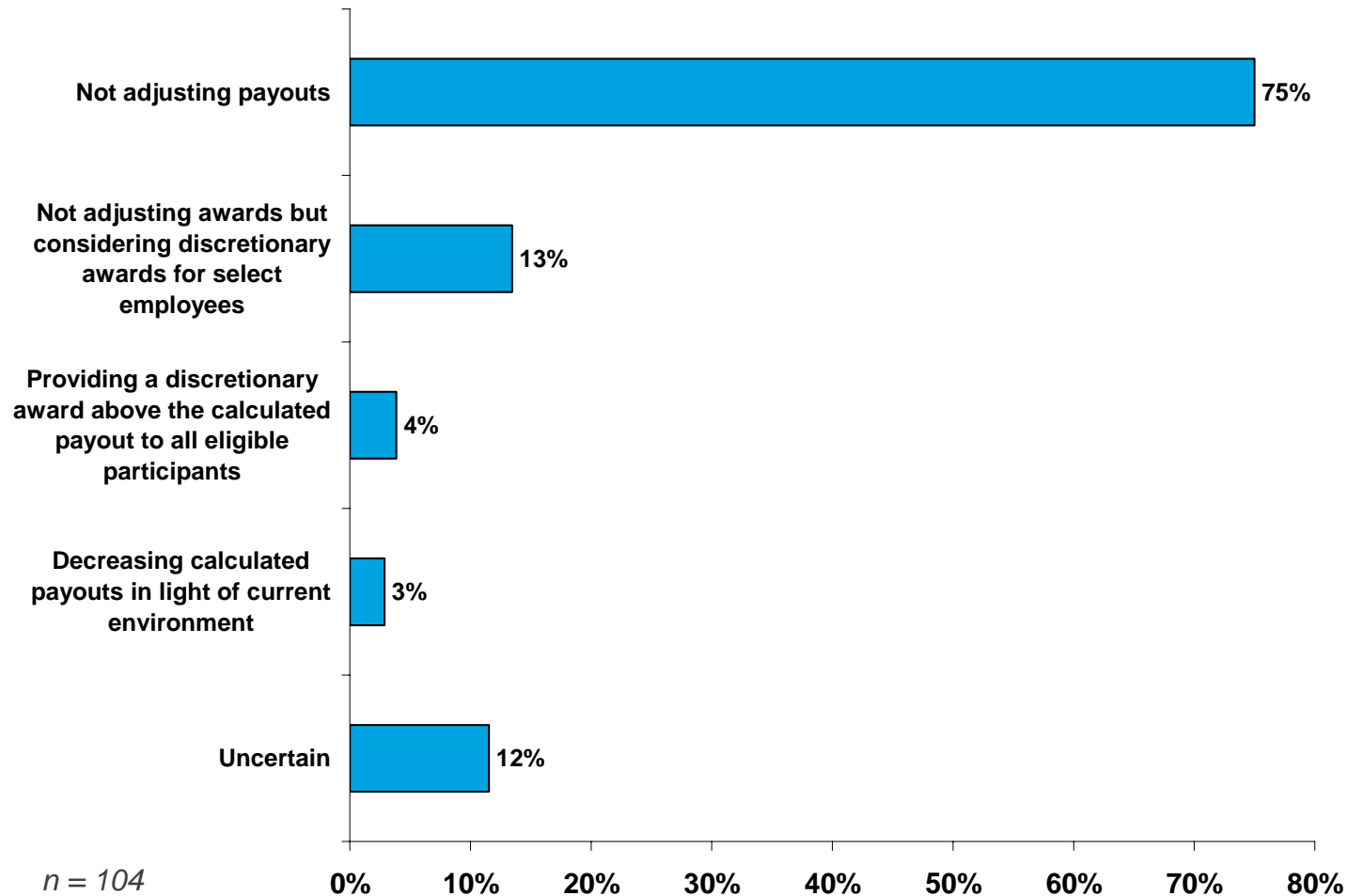
54% of companies reported having a PSU program and/or a cash LTIP.

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – PSU/Cash LTIPs

A majority of companies do not plan to adjust calculated payout levels

What adjustments, if any, are you considering to your 2008 PSU/cash LTIP payout levels?



Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

Long-term Incentives – PSU/Cash LTIPs

Approximately 30% of companies are planning to implement or are considering changes to their PSU/cash LTIPs for 2009

What actions do you plan to take in relation to your PSU program/cash LTIP for 2009?

Anticipated Changes	Planning to Implement	Considering	Not Considering	Have Not Addressed Yet
Change in performance measures	9%	20%	56%	15%
Change in the range of performance	8%	28%	46%	18%
Use of more absolute performance measures	6%	16%	63%	15%
Use of more relative performance measures	4%	16%	63%	16%
Allow for increased discretion related to payouts	5%	8%	71%	16%
Move to shorter performance periods	2%	7%	73%	18%

n = 104

Most commonly companies are changing the range of performance or are examining the performance measurement framework.

Source: Mercer Annual and Long-term Incentives Survey, Weathering the Storm: Decision 2009

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