

Pensions & Investments

and



**Corporate Governance Survey
Participant Report**

Summary of Key Findings

March 2005

VIVIENT CONSULTING LLC

400 Continental Boulevard, 6th Floor

El Segundo, California 90245

Telephone (310) 426-2340 • Fax (310) 426-2001

www.vivient.com

Study Overview

Institutional investors believe that sound executive compensation policies and an active, dedicated and independent board are keys to good corporate governance, according to a survey conducted by Pensions & Investments newspaper and Vivient Consulting.

Participants believe that sound executive compensation policies involve:

- Establishing a strong pay-for-performance system. However, participants report that defining and measuring the performance link in executive compensation programs is a difficult task
- Requiring executives to hold their equity grants for a minimum period of time before selling, in order to encourage real equity ownership
- Favoring long-term cash incentive plans tied to specific financial goals over more commonly used vehicles, such as restricted stock and stock options

In regard to board structure, institutional investors want to see boards of directors that have a:

- Maximum number of independent directors
- Separate Chairman and CEO role
- Limit on the number of public company board seats held by individual directors

- Annual election for directors
- Performance appraisal system for individual directors to encourage accountability

While participants want to see active boards, they also want to have the right to vote on issues important to shareholders, such as poison pills and change-of-control arrangements.

This survey includes responses from approximately 100 pension funds, money managers and hedge funds regarding their views on governance practices at portfolio companies. Pension funds comprise 50% of the survey respondents, with most representing public money. The other half of the participants consist of money managers (20%), hedge funds (20%), and other types of firms (10%). More than half of the participants have greater than \$1 billion in assets under management.

The detailed survey results are included at the end of this report.

Study Findings and Observations

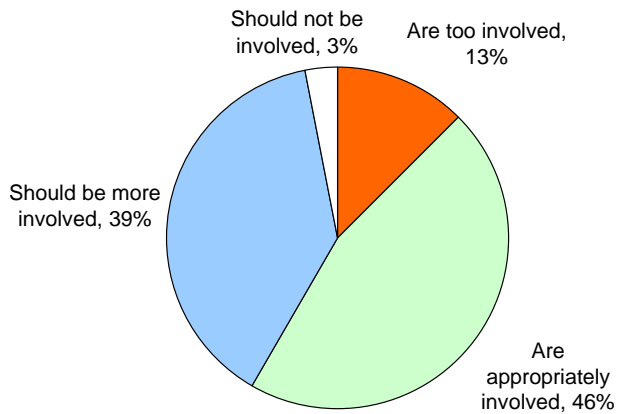
Involvement in Corporate Governance

When asked about the level of involvement in corporate governance activities, survey participants are split, with 46% responding that institutional investors are appropriately involved and 39% believing that institutional investors should be more involved (see [Exhibit 1](#)). Of the remaining participants, 13% respond that institutional investors are too involved in corporate governance

activities, and 3% indicate that investors should not be involved at all.

Exhibit 1

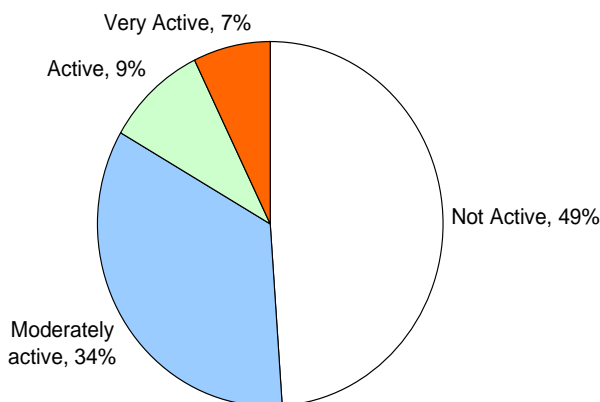
In regard to corporate governance activities, institutional investors...



When asked how active they are in corporate governance, the participants are also split, with half reporting not active and the other half reporting a moderate to high level of activity (see [Exhibit 2](#)). Proxy voting is the prevalent activity in which organizations engage.

Exhibit 2

How active is your organization in corporate governance?



When combining the responses to these questions, we observe that about half the participants believe that being inactive or being moderately active is an

appropriate level of involvement. However, about a third of the participants believe that they are not active enough. The remaining participants already report a high level of activity.

In our opinion, institutional investors have room for improvement to become more active in corporate governance. Investors should be more active because of the voting power they have to represent the views of shareholders. Investors have a key role to play in encouraging the board to be more functional and represent shareholder interests, which will create a better organization for all stakeholders.

Voting Practices

Institutional investors overwhelmingly support having the right to vote on important issues. About 80% of participants either agree or strongly agree that shareholders should have the right to vote on annual re-election of directors, poison pills, golden parachutes, and by-law amendments. About two-thirds also agree or strongly agree with shareholders having the right to vote on term limits of directors.

When voting the proxy, participants tend to favor shareholder capitalism over stakeholder interests. Participants are very concerned about executive compensation policies, which is a theme seen throughout the survey results. Roughly 9 out of 10 participants assert that executive compensation policies are important or very important. About 50% believe that environmental and labor relations policies also are important or very important. Relations with local communities and policies regarding the labor standards of non-

U.S. suppliers are less important to survey participants.

Good Governance Practices

When asked to rank the importance of various board of directors' functions, participants view the key roles as reviewing company strategy, ensuring the integrity of financial reports, and selecting, evaluating and compensating the CEO.

When asked what sort of board structure supports good governance, participants report that director independence is a top concern. More than 90% of participants believe that it is important or very important to ensure the maximum number of independent directors. Participants report that they strongly support director accountability because they favor re-electing directors annually, limiting the number of public company board seats held by individual directors, and holding performance appraisals for directors.

When asked what executive compensation policies support good governance, participants favor equity ownership and pay for performance. More than 80% of participants think it is important or very important to require executives to hold their equity grants for a minimum period of time before selling, and to use a pay-for-performance system to compensate the top executives. About 60% of participants also think it is important to require stock ownership guidelines for executives.

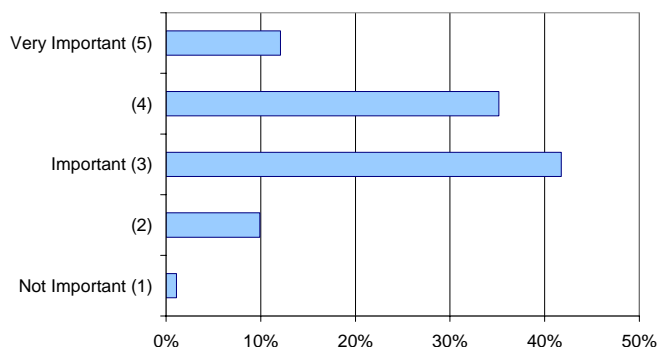
Executive Compensation

Almost 9 out of 10 survey participants think that the level of executive compensation is important or very

important when evaluating a company (see [Exhibit 3](#)).

[Exhibit 3](#)

When you are evaluating a company, how important is the level of executive compensation?



One of the more surprising responses is that participants view cash-based long-term incentives as more effective for motivating long-term performance than more commonly used vehicles, such as restricted stock and stock options. Even though cash-based long-term incentives are not as widely used by companies, we believe that participants favor this vehicle because compensation is tied to specific company performance measures rather than market fluctuations in the stock price. Another interesting result is that participants view indexed options as ineffective or only somewhat effective, probably because they are difficult to implement and are seldom used.

When asked about the methods used to evaluate the cost of employee equity grants, participants indicate that this issue is still being sorted out. Responses are varied, and several participants use more than one method. In our opinion, the cost of employee equity grants does matter to investors, but a consensus has not emerged on how to evaluate it. This issue will become even more important with the new FAS 123r accounting regulations.

Advisory Firms

More than half of participants subscribe to corporate governance rating services, with ISS being the most prevalent. Most participants indicate that rating services are of moderate value in terms of assisting with the evaluation of companies.

Open-Ended Questions

When asked what will be the single most important governance issue in the future, participants provided a breadth of responses to this open-ended question, indicating that corporate governance is an important and evolving area, and institutional investors are grappling with the complexity of the issues. The most prevalent issue of concern is executive compensation, followed by director accountability and the accuracy and transparency of financial reporting.

When asked about determining whether a company's compensation is truly pay-for-performance, about 20% of respondents maintain that it is too difficult to determine. Some of the participants responded that it is easier to identify what is not pay-for-performance than the other way around.

The remaining respondents proposed several ideas for evaluating pay-for-performance. We grouped the responses into three main categories:

- A quantifiable, measurable and transparent linkage between performance and compensation.
- The use of industry peer comparisons to evaluate a company's pay-for-performance. Most of these responses

recommend using historical stock price performance (greater than one year) to evaluate performance versus peers.

- The use of “meaningful measures” such as return on investment and return on equity over stock price and measures that can be easily manipulated such as earnings per share.

The creativity of responses indicates that no easy answer is available to the pay-for-performance question.

About Pensions & Investments

Every other Monday, Pensions & Investments delivers critical financial news to executives responsible for the investment of large institutional assets such as pension funds, endowments and foundations. It reaches top corporate executives and government leaders, pension fund managers, investment advisors, consultants, and financial institutions. It is the leading international newspaper for institutional investors.

About Vivient Consulting

Vivient Consulting LLC is an independent provider of compensation and performance measurement consulting services. Based in El Segundo, CA, Vivient serves public and private companies across a broad range of industries, including financial services, high technology, real estate, manufacturing, energy, transportation and consumer products.

Vivient's primary service areas are:

- Compensation strategy development and benchmarking;
- Incentive plan design (e.g., bonus plans, real and phantom equity plans, and long-term cash plans);
- Performance measurement selection;
- Goal-setting; and
- Board of director advisory services.

For more information about this study, send an email to info@vivient.com or call (310) 426-2340.

Corporate Governance Survey Results

Involvement - Section 1 of 7

1. With which of the following statements do you most strongly agree?	(%)
Institutional investors are <i>too involved</i> in corporate governance activities	13%
Institutional investors are <i>appropriately involved</i> in corporate governance activities	46%
Institutional investors <i>should be more involved</i> in corporate governance activities	39%
Institutional investors <i>should not be involved</i> in corporate governance activities	3%
2. How active is your organization in corporate governance?	(%)
Not Active	49%
Moderately active	34%
Active	9%
Very Active	7%
3. In which of the following activities does your organization regularly engage?	(%)
Proxy voting	68%
Voting against a management- or Board-sponsored equity/bonus incentive plan	30%
Participating in a shareholder lawsuit	26%
Communicating directly with management or Board of owned companies	23%
Voting against directors who permit auditors to do non-audit work	23%
Advocating separation of CEO and Chairman positions at owned companies	18%

Voting Practices - Section 2 of 7

4. Please rate your attitude toward shareholders having the right to vote on the following:

	Disagree Strongly	Disagree	Neutral	Agree	Agree Strongly
Annual re-election of directors	1%	5%	10%	32%	51%
Adoption of poison pill	6%	5%	9%	30%	49%
Golden parachutes	3%	9%	9%	29%	49%
By-law amendments	0%	4%	15%	40%	42%
Term limits of directors	1%	9%	24%	31%	34%

5. When voting the proxy, how important is a company's performance in the following areas:

	Not Important	Somewhat Important	Important	Very Important
Executive compensation policies	1%	10%	43%	46%
Policies concerning environmental impact	12%	38%	41%	9%
Labor relations policies	14%	37%	45%	4%
Labor policies/standards of non-U.S. suppliers	19%	45%	32%	4%
Relations with (impact on) local communities	20%	49%	28%	3%

Good Governance Practices - Section 3 of 7

6. Please rank the importance of the following Board of Directors' functions (1= Most Important, 2= Next Most Important, . . . , 6= Least Important)

	<u>Average Rank (*)</u>	
Review company strategy	2.3	<i>Most important (avg.)</i>
Ensure integrity of company's financial reports	2.9	
Select, evaluate and compensate the CEO	3.2	
Monitor company performance	3.5	
Review company's annual operating budgets/plans	4.0	
Engage/evaluate external auditors	4.6	<i>Least important (avg.)</i>

(*) Please note that 1=most important, etc; lower values indicate greater importance

7. From the perspective of good governance, how do you view the importance of each of the following?

	<u>Not Important</u>	<u>Somewhat Important</u>	<u>Important</u>	<u>Very Important</u>
<u>Board Structure</u>				
Ensuring the maximum number of independent directors	0%	9%	41%	51%
Re-electing directors annually	15%	26%	37%	23%
Separating the Chairman and CEO roles	5%	22%	46%	27%
Limiting number of public company board seats held by directors	8%	24%	49%	19%
Holding performance appraisals for individual directors	12%	27%	46%	15%
Instituting term limits for directors	26%	38%	22%	15%
Limiting the size of the board (total number of directors)	10%	41%	44%	5%
<u>Executive Compensation</u>				
Using pay-for-performance system to compensate top executives	2%	16%	40%	42%
Requiring executives to hold their equity grants for a minimum period before selling	1%	16%	47%	35%
Requiring officers to own a minimum amount of company stock	6%	35%	38%	20%

Executive Compensation - Section 4 of 7

8. When you are evaluating a company, how important is the *level* of executive compensation?

(1) Not Important	(2)	(3) Important	(4)	(5) Very Important
1%	10%	42%	35%	12%

9. Please rate the effectiveness of the following compensation vehicles in providing incentives for management to improve long-term corporate performance:

	Ineffective	Somewhat Effective	Effective	Very Effective
Cash-based long-term incentive	1%	21%	55%	23%
Restricted stock	2%	35%	51%	12%
Stock options	11%	41%	43%	5%
Indexed options (e.g., strike price indexed to S&P 500)	33%	34%	22%	11%

10. How do you evaluate the cost (or dilutive impact) of executive/employee stock options and restricted stock awards? (check all that apply)

	(%)
Use the "as-reported" accounting expense number (FAS 123)	26%
Look at the option run-rate (number of options granted as % of shares outstanding, or burn rate)	22%
Look at the equity overhang (number of shares available for grant plus options outstanding)	21%
Rely on the <i>expense number</i> calculated by a third-party (e.g., S&P Core Earnings)	20%
Rely on an <i>economic value</i> calculation provided by a third-party (e.g., ISS' shareholder value transfer)	18%
We ignore or don't pay specific attention to this dilution	13%
Calculate our own expense number based on our own assumptions	10%
We use some other approach	5%

Advisory Firms - Section 5 of 7

11. To which of the following corporate governance rating services do you subscribe? (check all that apply)

	(%)
Institutional Shareholder Services (ISS)	27%
Standard & Poor's (S&P) Corporate Governance Scores	7%
Glass-Lewis	3%
Egan-Jones	3%
Proxy Governance	2%
The Corporate Library	1%
GovernanceMetrics International	0%
Other	13%
None	45%

12. How valuable are corporate governance rating services in terms of assisting with the evaluation of a company?

(1) Not Valuable	(2)	(3) Valuable	(4)	(5) Highly Valuable
11%	30%	30%	20%	8%

Open Ended Questions - Section 6 of 7

13. What do you think will be the single most important governance issue in the future?

	<u>(%)</u>
Executive compensation	34%
Director accountability/oversight/qualifications	15%
Financial reporting (accuracy and transparency)	13%
Director independence	9%
Shareholder access to Director nominations	6%
Compliance with all the regulations	4%
Shareholder activism	4%
Management integrity/ethics	4%
Other	11%

14. How do you determine whether a company's compensation is truly pay-for-performance?

	<u>(%)</u>
Quantifiable, measurable and transparent link between performance and compensation	28%
Industry peer comparisons	28%
Difficult to determine	19%
Incentives based on meaningful performance measures that can't be easily manipulated	14%
Other	11%

Demographics - Section 7 of 7

Type of Firm:	<u>(%)</u>
Pension fund	51%
Money Manager	20%
Hedge fund	20%
Other	10%

Assets under management (AUM):	<u>(%)</u>
Less than \$25 million	10%
\$25 to \$99.9 million	3%
\$100 million to \$999.9 million	29%
\$1 billion to \$9.9 billion	40%
\$10 billion and over	17%

Among pension fund respondents:	<u>(%)</u>
Corporate	32%
Public	64%
Taft-Hartley	4%

Among money manager respondents:	<u>(%)</u>
Index	NA
Enhanced Index	NA
Semi-Active	4%
Active	79%
Mixed	17%
Other	NA