

TIAA-CREF Policy Statement on Corporate Governance

Summary: On December 19, 2003, TIAA-CREF published their newly updated "Policy Statement on Corporate Governance" which urges companies to use equity-based incentive plans that emphasize restricted stock awards over option grants. The new policies are expected to receive significant attention because copies are being sent to CEOs of all of the companies included in the fund's \$300 billion portfolio (including some outside of the U.S.), and many other institutional investors model their own governance and voting policies after those of TIAA-CREF.

The report covers a range of governance issues including the structure and responsibilities of the board of directors, shareholder rights and responsibilities, social responsibility issues and the role of independent advisors, as well as updated voting guidelines. This memo provides a bulleted summary of the TIAA-CREF corporate governance policies which are relevant to executive compensation.

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On December 19, 2003, TIAA-CREF published their newly updated "Policy Statement on Corporate Governance." TIAA-CREF is a large retirement system for higher education and research employees which has historically been an influential institutional investor and advocate for corporate governance issues. The new Policy Statement covers a range of governance issues including the structure and responsibilities of the board of directors, shareholder rights and responsibilities, social responsibility issues and the role of independent advisors, among others. In addition to general governance guidelines, the Policy Statement includes TIAA-CREF's updated voting guidelines. This newly published statement reflects the organization's fourth edition of its Policy Statement on Corporate Governance.

While the suggestions made in the TIAA-CREF Policy Statement are not binding for portfolio companies, it is expected to receive significant attention. Copies are being sent to CEOs of all of the companies included in the fund's \$300 billion portfolio (including some outside of the U.S.) and many other institutional investors model their own governance and voting policies after those of TIAA-CREF. The entire 33 page Policy Statement can be found at http://www.tiaacref.org/pubs/pdf/governance_policy.pdf. This memo provides a brief bulleted summary of the TIAA-CREF corporate governance policies which are relevant to executive compensation.

Compensation Plans

- According to TIAA-CREF, compensation plans should be:
- reasonable and fair by prevailing industry standards
 - able to withstand the critical scrutiny of investors, employees and the public at large
 - understandable
 - appropriate to the corporation's size, complexity and performance
 - designed to encourage employees to achieve performance objectives and in so doing, create long-term shareholder value subject to appropriate consideration of the firm's reputation, integrity and ethical standards

- objectively linked to appropriate parameters of company performance which are within the control of the executives who will receive the pay
- based on a performance measurement cycle that is consistent with the business cycle of the corporation

The following should be considered when setting compensation and incentive opportunities:

- Comparative industry pay levels
 - “However, surveys should be considered cautiously”
 - Overall company performance
 - An individual’s experience, expertise, responsibilities, goals and objectives
- Executive compensation programs should be fully disclosed, enabling a “reasonably sophisticated investor to evaluate and assess the total compensation package as well as particular elements.”

Equity-Based Awards

Equity-based plans should emphasize restricted stock awards

Stock options should be used “judiciously”

- When stock options are used, the plan should include performance features (e.g., performance-based options, premium options, indexed options)

Companies should require that stock acquired through option exercises be held for “substantial periods of time, apart from sales permitted to meet tax liabilities produced by such exercise”

The cost of equity-based plans should be disclosed and “charged to the income statement”

- Disclosure should include “size of grant, potential value to recipients, cost to company, plan provisions that could have a material impact on the number and value of shares distributed”

All equity-based plans should be approved by shareholders

Mega-grants should be prohibited

- TIAA-CREF describes mega-grants as “grants of stock options of a value, at the time of grant, greater than a reasonable and explainable multiple of the recipient’s total cash compensation”

There should be no opportunity to time the granting of stock or stock options to “take advantage of non-public information with significant short-term implications for the stock price”

Potential Dilution from Stock-Based Plans

“The board should develop an equity policy that reflects its broad philosophy regarding the proportion” of company stock to be used for compensation purposes

Limits should be established for the number of shares to be used for stock option grants, “as measured by potential dilution”

The equity policy and option limits should be disclosed to shareholders

Executive Perquisites and Benefits

The following principles should be considered for supplemental executive retirement plans (SERPs):

- “SERPs should not be used to enhance retirement benefits beyond that which is reasonable”
- Terms, eligibility and estimated costs should be fully disclosed
 - Disclosure should include “value of supplemental payment for each proxy-level executive and the total cost of the plan as a whole”

- "Constructive credit" should not exceed full service credit
- Lump-sum distributions should be allowed ("assuming an appropriate discount rate is used")

Executive contracts and their costs should be disclosed

Perquisites should be reasonable, both during and following employment

Severance should not be paid for executives who are terminated for misconduct, gross mismanagement or other "for cause" reasons

Director Compensation

Equity awards for members of the board should include grants of restricted or unrestricted stock

The use of stock options is discouraged for directors

Directors should have a "direct, personal and material investment" in company stock

Role of Independent Advisors

Advisors, such as public accountants, law firms, investment bankers and consultants should:

- "provide advice and support in the best interests of the corporate client as a whole; and
- avoid any actual or appearance of conflict of interest or undue influence of senior management"

If the advisors feel that their engagement or advice is being used inappropriately, they should make the independent directors aware of the situation

- If they are not satisfied with the response, they should withdraw from the engagement

Board Practices

A "substantial majority" of directors should be independent

- The following is TIAA-CREF's definition of independence:

"We believe independence means that a director and his or her immediate family have no present or former employment with the company, nor any substantial connection of a personal or financial nature (other than equity in the company or equivalent stake) to the company or its management that could in fact or in appearance compromise the director's objective and loyalty to shareholders. To be independent, the director must not provide, or be affiliated with any organization that provides goods or services for the company if a reasonable, disinterested observer could consider the relationship substantial."

- The independent directors of the board should meet in executive session on a regular basis

Directors should be elected to the board annually

The board should be comprised of directors who:

- Can contribute business judgment to board deliberations and decisions
- Reflect a diversity of background and experience
- Are prepared to devote substantial time and effort to board duties

The board should conduct regular evaluations of its performance and that of the board committees

- Individual director evaluations should be considered

The board should establish a retirement policy for directors

The decision regarding the separation of the positions of CEO and board chair should be left to the board

- If the positions are not separated, there should be a lead or presiding director who:
 - is designated by the board
 - presides over executive sessions
 - participates actively in the preparation of the board agendas

Each board committee should publish a charter which specifies its role and responsibilities



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