

**GOLDEN COFFINS:
AN EMPIRICAL ANALYSIS**

by

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A thesis submitted to the Faculty of the University of Delaware in partial fulfillment of the requirements for the degree of Honors Bachelor of Science in Finance with Distinction.

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ABSTRACT

This paper studies death benefit payments that would be made to the estates of CEOs who die while in office. I develop a model based on the theory of managerial rent extraction to separately test the explanatory power of two widely used governance indexes in predicting the size of these awards. I then test the model on a subset of 125 companies within the S&P 500 that reported these benefits in their 2008 proxy statements. The average size of the death benefit awarded to the CEO was \$22.2 million and I find that weaker governance structures as measured by the GIM Governance Index are associated with larger death benefits.

Chapter 1

INTRODUCTION

This paper focuses on “golden coffins”, the idiomatic name given to the compensation benefits awarded to CEOs who die while in office.¹ These death benefits are similar in structure to the “golden parachutes” received by CEOs whose firms are acquired, or “golden handshake” separation agreements awarded to CEOs who leave their firms through retirement or termination.² These posthumous payments awarded to the estate of the deceased can lead to increased agency costs and conflicts between shareholders, boards of directors, and CEOs. For critics, these golden coffins illustrate the ultimate example of a nonperformance-based benefit are a fundamental failure in oversight by the board of directors. These critics also argue that the payments, having not been based on past performance, should not be made for they will not impact the future performance of the company. Those in defense of the pay packages counter that death benefits serve to recruit and retain the most talented

¹ A June 4, 2008 article in *The Wall Street Journal* is cited for coining the term “golden coffin.”

² For example, if Ray R. Irani were to have died in office during the 2007 fiscal year Occidental Petroleum his estate would have received \$101.9 million in accelerated equity awards (options and restricted stock), \$13.3 million from life insurance policies, and \$335,000 in unused vacation pay.

executives available. Another argument in support of the arrangements is that the death benefit serves as a form of deferred compensation used for estate planning purposes.

While executive compensation arrangements such as golden parachutes and golden handshakes have been studied in depth by researchers,³ there have been to date no theoretical or empirical studies on the death benefits awarded to the estates of CEOs. The likely reason for this lack of research in this area is the fact that up until 2007, most companies did not report the benefits due to the CEO upon death because there was no rule that required them to do so. When companies chose to report these payments within their filings, complex legal narratives often obfuscated the true value of the compensation. Only recent amendments to SEC disclosure rules regarding executive compensation have forced companies to begin reporting these amounts on an annual basis within their proxy statements.

While golden coffins are not always large in size in relation to the wealth a CEO may have obtained throughout his or her career with a company, the payments represent a rather unique and previously unreported form of executive compensation that has not been explored in the literature. Golden coffins do not seem to conform to previously researched theories of severance pay. For instance, bonding theories suggest that CEOs are compensated ex ante for their human capital value and are

³ Two of the most widely cited studies on golden parachutes are Lambert and Larcker (1985) and Lefanowicz, Robinson and Smith(2000). Golden handshake agreements were the subject of a more recent study; see Yermack (2004)

promised a severance payment to insure this value. In this manner the severance agreement encourages CEOs to engage in risks that he might not otherwise take (Almazan and Suarez, 2004), and discourages him from entrenching himself in the position (Almazan and Suarez, 2004), or concealing harmful information about the firm (Inderst and Mueller, 2005). The bonding theory should not apply to golden coffins in that the theory addresses severance agreements as they relate to CEOs who fail due to poor performance. A second theory of severance pay that does not hold in the case of death benefits is pay as a damage control mechanism (Yermack 2004) used to protect corporate information, insulate the company from potential lawsuits, or prevent bad press from the airing of “dirty laundry” by the CEO. It would be unnecessary for the board to make a payment in this preventative nature for a CEO who is no longer living. The theory of managerial rent extraction (Bebchuk and Fried, 2004) as it relates to severance pay may however have some explanatory power in the awarding of death benefits.

This paper examines a data set of 125 CEOs of S&P 500 companies and their corresponding potential pay arrangements upon death as documented in 2008 company proxy statements. Nearly all of the CEOs in the data set were to receive some form of compensation should any have died in office during the prior year. The mean value for the data set was just under \$23 million and this included zero-observations. This amount represents various components of compensation including cash severance, salary continuation, accelerated vesting of equity awards, life insurance, and various perquisites that would be paid to the CEO’s estate. Nearly 84 percent of the death benefits in the data set are to be paid out pursuant to the terms of

an employment contract, while the remaining 16 percent are to be paid out based rather on individual company policies regarding the death of a named executive officer. I estimate a regression model for golden coffins based on a theory of managerial rent extraction (Bebchuk et al. 2004) that would suggest a negative association between death benefits and quality of a firm's corporate governance.

The remainder of the paper is organized as follows. Chapter 2 reviews the historical disclosure requirements regarding executive compensation as well as the current requirements of public companies under the new 2006 SEC disclosure regime. Chapter 3 discusses prior literature as well as the development of my hypothesis. Chapter 4 presents the methodology behind the selection of my data set, an overview of the variables, and the results of the regression. Chapter 5 discusses governance implications and what to look for going forward. Chapter 6 concludes the paper.

Chapter 2

EXECUTIVE COMPENSATION DISCLOSURE

2.1 Historical Perspective on Executive Compensation Disclosure

Prior to 1992, public companies were required to report executive compensation in their annual proxy statements but were allowed to choose the format in which they did so. This flexibility provided firms the opportunity to deliberately obfuscate compensation arrangements with executive officers. In October of 1992 the SEC made two significant rule changes. The first change addressed the reporting of executive compensation and another dealt with communication between shareholders.⁴ These efforts on the part of the SEC were meant to improve both the executive compensation and proxy system regulations that seemed outdated. The executive compensation amendment required companies to begin publishing a summary compensation table within the proxy statement that would highlight the annual compensation arrangements of the five named executive officers. The summary compensation table was to include salary, bonuses, and any other form of annual compensation to be paid to the five most senior officers of the company. The goal of

⁴ There were significant costs and interference associated with shareholder communication prior to the 1992 rule changes. All shareholders were required to submit notice to the SEC if circulating information or making statements in the press about proxy contests.

this requirement was to increase transparency for shareholders and eliminate the esoteric and legalistic descriptions of executive compensation that had been common prior to 1992. This represented a significant shift for the SEC under chairman Richard Breeden and meant that the commission had abandoned the view that executive compensation was considered ordinary business of the corporation (Prevost and Wagster, 1999).

While a number of later studies would question the ultimate effects of the increased executive compensation disclosure (Marilyn, Nelson and Shackell, 2001), it seems that 1992 represented a turning point for SEC policy on executive compensation. The Commission proved that it was committed to assist shareholders in understanding of the executive compensation practices at the companies in which they were investing. Then SEC chairman Richard Breeden said in a speech at the time on the new executive compensation regulations:

The Commission's proposals are intended to provide security holders with a clear and concise presentation of the compensation paid to principal executives. The new rules are also intended to make clear the directors' reasoning in making fundamental compensation decisions. Under the proposals the compensation committee would have to disclose the specific factors of corporate performance that formed the basis for the board's decisions on senior management compensation. Ultimately, compensation decisions must be made in the private marketplace. Market forces, and the views of all concerned parties -- management, directors and shareholders need to resolve these issues within each company in light of its specific circumstances~ The Commission's rules should help enhance the workings of the market by improving the quality of information on decision-making, and by allowing more open debate and discussion within the company. By strengthening market forces, the overall governance system should provide

meaningful accountability for poor results, and strong rewards for success.

Monks and Minow (2003) stress that the ability of the board to oversee compensation of top managers and align the interests of shareholders and management is of principal importance to investors in deciding whether to buy or sell a company's stock. The pair point out that the SEC's ultimate goal in adopting these rule changes was not to create more litigation, but rather to create a better evaluation process and accountability mechanism for directors. While the 1992 rule changes demonstrated the SEC's ability to adapt its disclosure rules to a governance environment undergoing fundamental change, it would be another fourteen years before the SEC would again alter the rules on executive compensation disclosure.

2.2 2006 Executive Compensation Disclosure Regime

In July 2006 for the first time in fourteen years, the SEC adopted amendments to the disclosure requirements regarding executive compensation. The new principle-based rules were meant to address executive compensation programs that had evolved in many ways since 1992. John White, director of the SEC's Division of Corporate Finance, said at the time the rules were released, "Executive compensation has changed substantially since 1992, but disclosure rules have not, so chasms in disclosure have resulted, and at the same time what the SEC did require has drifted toward boilerplate and legalese." Among the specific changes, the SEC began requiring a compensation discussion & analysis (CD&A) designed to explain company pay policies, disclosure of performance targets, a new total pay column in the

summary compensation table, information about the timing of stock option awards, available perquisites, the role of the company's compensation consultants, and also a clear picture of retirement and post-employment pay. These changes to the SEC rules drew over 20,000 comment letters to the SEC in the summer of 2006 as investors and the business community weighed in on what each view as an important issue.⁵

The SEC conducted an assessment of these changes to executive compensation disclosure in October 2007 by reviewing the filings of 350 companies. Both the SEC and investors seemed to be in agreement that the language, format and clarity of proxy statements needed to be improved further. John White, in assessing the first year of disclosure under the new regime said, "Far too often, meaningful analysis is missing---this is the biggest shortcoming of the first-year disclosures." Investors seemed to echo this sentiment and complain that there seemed to be too many pay tables and not enough rationale behind the pay in the tables. A study by Mercer Consulting at this time found that after assigning certain "readability measures" to proxy statements, "disclosures were more difficult to read than the Bible, the U.S. Constitution, and the *New York Times*."

⁵ In 1992 chairman Richard Breeden noted that the Commission had received more public comments on its study of executive compensation and proxy voting than any issue in its history. Interestingly, chairman Christopher Cox would make the same statement fourteen years later with the release of the 2006 study and rule changes to executive compensation disclosures.

The area of the 2006 amendments with which I am concerned is the disclosure of post-employment compensation.⁶ Previously, company requirements for reporting post-employment pay were minimal and oftentimes only represented by the appearance of a pension plan table. Among the additional disclosures required by the new rules were the values of potential payments upon retirement, a change-in-control, termination, disability, and death. The SEC recognized that there was a shortage of information on the obligations of the companies to their CEOs once he or she had the role or the company altogether. Many companies had started using executive compensation mechanisms such as supplemental employee retirement plans, deferred compensation plans, post-retirement perquisites and consulting contracts in order to “camouflage” payments to senior executives (Bebchuk and Fried, 2004). The new rules sought to clarify these pay arrangements by requiring that not only additional amounts be specified in tabular form within the proxy but also that they be addressed within the compensation discussion and analysis.

⁶ The SEC also made another rule change on December 24, 2006 regarding the stock option disclosure by directing companies to use amounts disclosed in financial statements under FAS123(R). This marked a reversal of the rule change the SEC had enacted in July that required firms to report the total value of option grants in the year in which they were awarded.

Chapter 3
LITERATURE REVIEW AND
HYPOTHESIS DEVELOPMENT

3.1 Literature Review

Under the optimal contracting approach a board negotiates pay with executives in such a manner that shareholder value is maximized and agency costs are minimized (Mirlees (1976)). The board seeks to minimize agency costs by aligning the interests of management and shareholders through an appropriate compensation plan that includes both cash and equity incentives. The theory of managerial rent extraction of Bebchuk et al. (2002) posits that powerful managers have significant influence over the board of directors in negotiating their own compensation. This influence can only be limited by certain “public outrage” costs. The theory of managerial rent extraction suggests that managers have significant influence over their own pay. The extent to which a CEO has an ability to extract rents is largely a function of his or her level of entrenchment, as represent by the Bebchuk et al. (2005) entrenchment index.

The entrenchment index is derived from a paper by Gompers, Ishii, and Metrick (2003) in which the authors established a broad governance index based on 24 governance provisions followed by the Investor Responsibility Research Center

(IRRC). The governance index assigned equal weight to each of the 24 provisions and higher governance index scores were negatively correlated with shareholder returns and firm value (Tobin's Q). The entrenchment index breaks down the 24 provisions of the governance index in order to establish which of the provisions matter most in corporate governance detracting from firm value and shareholder returns. The six provisions that make up the entrenchment index are staggered boards, limits to shareholder bylaw amendments, supermajority requirements for mergers, supermajority requirements for charter amendments, poison pills, and golden parachutes. Much of the literature on the governance index and entrenchment index have focused on explaining how each are correlated with various shareholder return metrics and firm value metrics.⁷

3.2 Hypothesis Development

I am interested in the relationship between these entrenchment index and the size of the total death benefits payable to the CEOs as it relates to the theory of managerial rent extraction. This theory would suggest a positive relationship between these two variables, as the higher the index indicates a CEO better able to influence his or her own pay.

⁷ Both Gompers, Ishii, and Metrick (2003) and Bebchuk et al. (2005) found that the higher scores on each index was associated with a significantly lower firm values and shareholder returns

Hypothesis: I predict higher entrenchment index scores will be positively correlated with larger potential CEO death benefits as based on the theory of managerial rent extraction.

I will first run model for the entrenchment index in order to test my hypothesis will then run a second test using the larger governance index. I expect the governance index to have a stronger correlation with the size of CEO golden coffins payments.

This can be attributed to the fact that the provisions of the entrenchment index are only a subset of the 24 governance index provisions. The eighteen provisions not included in the first model might have some explanatory power relating to the total size of golden coffins.

Chapter 4
DATA SELECTION, VARIABLES, AND
REGRESSION RESULTS

4.1 Data Selection

I analyze the death benefits of 125 S&P 500 CEOs as disclosed in each company's 2008 proxy statements. Beginning with a list of firms in the S&P 500 on January 1, 2008, I narrow this group to include only firms that provide the amount that would have been paid to the CEO if he or she were to have died in office the previous year. Most of the companies within this group provided the benefits in tabular form while the remainder discussed the item in the compensation discussion or footnotes to tables. From within this group I then take a sample of 125 firms and observe the potential payments to the CEO. It should be noted that this data set is not a random sample of firms within the S&P 500 for 2008, but rather a data set representative of firms reporting the value of the CEO's death benefit for the year. The data set does include several zero-valued observations but only if the company stated in its filings that the CEO would receive no payments upon death. There is a high degree of variation between companies in reporting the amounts owed to the CEO upon death. Literature on CEO turnover typically classifies observations into "voluntary" and "forced" subsamples, however this is unnecessary in the case of a death.

Table I presents descriptive statistics for the 125 firms in my data set. The mean age of CEOs is 55 years with an average tenure of 7.5 years. CEOs owned a mean of 1,856,400 shares in company stock and this represented an average voting power 0.79% in the firm. Annual compensation for the prior year taken from the Standard & Poor's ExecuComp database gives a mean value of \$6.1 million for the prior year and is equal to the sum of salary, bonus, options, restricted stock awards, and other compensation such as perquisites. Eighty-four percent of the CEOs in the data set have employment contracts that outline the death benefits. This is a notable statistic in that these death benefits are written into contracts that the CEO and firm have both agreed upon. Employment contracts are required to be paid by the company and difficult to modify without cooperation from the executive. CEOs without employment contracts are not necessarily without a benefit, but rather the benefit will be paid according to firm-specific compensation policies. Lastly, the table includes information relating to the governance indexes of each company in the data set. The GIM governance index has a mean of 9.62 and the Entrenchment Index has a mean of 2.33.

4.2 Elements of Golden Coffins

I disaggregate data about golden coffin arrangements into the following eight categories. Table II presents descriptive statistics about each category and the values received by the 125 CEOs in the data set. The eight compensation components into which I disaggregate the golden coffins are:

- *Cash:* These are mostly one-time payments of annual salary and bonus to the estate of the CEO. However there are numerous instances in which CEOs negotiate a salary continuation, the terms of which are normally dictated in an employment contract.
- *Accelerated Stock Options:* Companies award stock options to CEOs as a performance incentive that gives the CEO the right to purchase the company's stock at a set "strike price" in the future. The grants are also subject to a period set by the company wherein the CEO is not allowed to exercise the option until the grant vests. However many companies allow for the immediate vesting of stock option awards to the estate of the CEO in the assumption that he or she would have lived until the vesting of the awards.
- *Accelerated Restricted Stock Awards:* Companies also have policies for the treating of restricted stock should the CEO die while in office. Like option grants, the vesting periods on restricted stock are normally removed following the death of a CEO.
- *Life Insurance:* Companies will often times pay life insurance premiums on behalf of the CEO so that his or her estate would be able to collect the amount outlined in the policy.
- *Performance Unit/Share Plans:* These plans are long-term incentive plans that are paid contingent upon the achievement of certain goals. Awards can be paid

in cash or in company stock and require no investment on the part of the executive.

- *Non-Equity Incentive Plans:* These plans are for all intents the same type of compensation as performance unit plans except with no possibility for the executive to be paid in stock. In proxy statements they can often be found under the title “LTIP,” or long-term incentive plan.
- *Pension Augmentations:* Most CEOs receive some sort of defined benefit pension plan dependent on factors such as age and years of service. The death of a CEO can trigger additional benefits or even the early withdrawal of full pension benefits.
- *Perquisites:* Many companies promise the estate of the CEO certain benefits upon an individual’s death. The most common perquisites observed in the data set were financial planning services, accrued or unused vacation pay, and continuation of medical benefits. The 2006 SEC rule changes mandated that all perks in excess of \$10,000 must be disclosed and qualified in certain situations.

4.3 Variables

The independent death benefit variable that I study in this paper is total size.

While I disaggregate the data and provide descriptive statistics on various components, the independent variable can be defined as:

- *Total Size*, the total amount payable to the CEO should he or she die in office. This is the cumulative of cash, accelerated stock options, accelerated restricted stock awards, life insurance, performance unit plans, non-equity incentive plans, pension augmentations, and perquisites.

The determinants of the total size of the independent death benefit variable are proxies for:

- *CEO Vote Power %*, the percentage of the CEO's total voting power in the firm relative to all other shareholders.
- *CEOAge*, the age of the respective company's CEO (rounded down to the nearest whole year).
- *CEOTenure*, the number of years the CEO has been in his or her position (rounded down to the nearest whole year).
- *LogCEOCompensation*, the logarithm of total compensation as reported in SEC filings for the 2007 prior year.
- *Log Total Firm Assets*, the logarithm of total firm assets.
- *Log Total Shares Held*, logarithm of the total shares held by the firm's CEO

4.4 Regression

A statistically significant correlation between a firm's entrenchment index and the size of potential golden coffins would allow shareholders to observe how these six

governance provisions not only amount to lower firm value and shareholder returns, but also significantly greater benefits for management as predicted by the managerial entrenchment theory. Unfortunately, the relationship between the two is not significant. The governance index on the other hand does exhibit a statistically significant correlation. This can be interpreted to mean that the cumulative effect of the eighteen governance provisions not included in the entrenchment index contributes significantly to the size of the golden coffin benefits. It is not possible however to determine which of the eighteen provisions are most responsible for driving the size of the compensation.

Chapter 5
RECENT DEVELOPMENTS AND
CONCLUDING REMARKS

5.1 Recent Developments

Golden coffins were on the radar screens of many investors in early 2008 following their disclosure by public companies and subsequent articles in popular press.⁸ However the current economic and political environment has cast significantly more scrutiny on these pay arrangements that many view as corporate excess. The latter half of 2008 brought about the largest economic downturn in America since the Great Depression and the meltdown of financial markets required unprecedented government intervention. The acceptance of government funds by public companies, particularly financial companies, led to a number of restrictions on executive compensation at these companies. The changes to executive compensation for these companies included limiting golden parachutes, adopting clawback provisions, requiring a risk review of incentive awards to prevent excessive risk-taking, and a cap on tax-deductible compensation at \$500,000 per year. This legislation has significantly increased the scrutiny under which all boards of directors operate and

⁸ While some companies did publish death benefits of CEOs in their 2007 proxy statements, many were able to hold off the disclosure until the release of their 2008 proxy statement.

places an even greater emphasis on the pay-for-performance philosophy that has become a point of emphasis for investors in recent years.

So far in 2009 activist investors have submitted nonbinding resolutions at fourteen companies in an effort to pressure boards to limit these golden coffins.⁹ Pat McGurn, special counsel to RiskMetrics Group, says that these nonbinding resolutions are drawing a great deal of support from shareholders thus far, especially considering they are appearing on proxies for the first time. For instance, shareholder proposals at Johnson Controls and Shaw Group seeking votes on executive death benefits received 42% and 67% support, respectively, at recent annual meetings. While these resolutions are not binding, some boards appear willing to examine and adjust the size of the arrangements. Occidental Petroleum Corp. agreed to provide shareholders with an advisory vote on compensation in 2010 in response to the uproar over CEO Ray Irani's death benefit. In February, Brian L. Roberts, CEO of Comcast Corp., decided to surrender his estate's rights to a salary and bonus continuation in the five years following his death because he "felt it was not appropriate" to keep the death benefit in the current environment.¹⁰

⁹ This represents the number of nonbinding resolutions submitted as of March 9, 2009.

¹⁰ The salary and bonus continuation given up by Mr. Roberts had a present value of \$20,392,840 in 2007

5.2 Concluding Remarks

While golden coffins have been a component of executive compensation for years, only recently have the size of these death benefits been disclosed. In this paper I sought to test the relationship between a firm's entrenchment index and the size of the death benefit payable to the estate of the CEO upon death. While the entrenchment index is not significantly correlated with higher golden coffin benefits, the GIM governance index is negatively correlated with larger benefits. The results suggest that certain IRRC provisions not included in the entrenchment index are better predictors of compensation in this form. Finding which individual provisions correlate with greater death benefits is a possible starting point for future research in this area. An event study of golden coffins measuring abnormal returns on disclosure dates to test shareholder reaction to the payments would be an interesting study. A theoretical framework should also be put forth in order to help establish optimal death benefit awards for CEOs. Executive compensation is sure to become an even more politicized issue than it already is as a result of the current economic environment. This should lead to more research in the field of executive compensation and on death benefits as they become more transparent.

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“Shareholder Communication and Executive Compensation,” opening statement of Richard C. Breeden, chairman of the Securities and Exchange Commission at the open meeting of the Commission, Oct. 15, 1992.

Appendix

Table I

This table presents descriptive statistics for the data set of 125 S&P 500 companies and the corresponding death benefits. Annual compensation in prior year was obtained from ExecuComp and includes salary, bonus, options, restricted stock awards, and all other compensation as reported in SEC filings. GIM governance index for all firms was obtained from RiskMetrics company database. Entrenchment index represents each firm's 2006 index (2007 only recently released).

	Full Sample
Observations	125
Age of CEO	55
Years tenure in office	8
Annual compensation in prior year (millions)	\$6.1
Has employment contract	84.0%
Number of shares held	1,856,400
Voting Power	0.79%
Total Assets (billions)	\$6.5
Dual Class Stock	2.4%
Entrenchment Index	2.33
GIM Index	9.62

Table 2

These are descriptive statistics for each of the eight components I disaggregate from the golden coffin arrangements of the 125 firms in the S&P 500 data set. All options values have been computed according to Black-Scholes method. All values given are in millions.

Compensation Type	Frequency	Mean	Median	Maximum
Cash	42%	\$1.98	0	60.66
Options	57%	\$4.63	0.40	79.15
Restricted Stock	73%	\$6.67	2.91	77.81
Life Insurance	27%	\$2.78	0	223.00
Performance Unit Plans	35%	\$2.17	0	25.43
Non-Equity Incentive Plan	21%	\$0.93	0	28.30
Supplemental Pension	36%	\$2.10	0	26.10
Other	46%	\$1.69	0	70.94

Table 3

This table presents estimates of variables in the entrenchment index model for the 125 firms in my data set. Compensation variables are provided in millions of dollars and firm variable of total assets is in billions.

Variables	Prediction	Coefficient	t-stat
Entrenchment Index	+	1.98	0.94
CEO Vote Power %		0.39	4.54**
CEO Age		0.25	0.58
CEO Tenure		-0.61	-1.48
Log_CEO Compensation		-2.39	-0.83
Log_Total Firm Assets		9.79	4.08**
Log_Total Shares Held		0.35	0.19

Significant at 1% (**) and 5% (*) levels.

Table 4

This table presents estimates of variables in the GIM governance index model for the 125 firms in my data set. Compensation variables are provided in millions of dollars and firm variable of total assets is in billions.

Variables	Prediction	Coefficient	t-stat
GIM Governance Index	+	2.13	2.09*
CEO Vote Power %		0.38	4.47**
CEO Age		0.18	0.43
CEO Tenure		-0.57	-1.41
Log_CEO Compensation		-1.95	-0.69
Log_Total Firm Assets		10.3	4.52**
Log_Total Shares Held		0.65	0.36

Significant at 1% (**) and 5% (*) levels.

