

II. EXECUTIVE SUMMARY OF FINDINGS

■ **Grasso Received Unreasonable Levels of Compensation and Benefits**

During his tenure as Chairman and CEO of the NYSE, Grasso received excessive levels of compensation and benefits, far beyond reasonable levels. In total, Grasso received approximately \$144.5 million to \$156.7 million in excessive compensation and benefits. Attached as Exhibit 1 is a chart showing the excess compensation and benefits.

➤ **Excessive Compensation**

For the eight-year period from 1995-2002, Grasso received more than \$97.8 million in annual compensation, approximately \$81.5 million of which was awarded for the four years from 1999-2002. Even assuming that Grasso performed at a consistently outstanding level during this period, his compensation was more than double what was reasonable in this four-year period. Grasso's total in excess annual compensation was approximately \$43.1 million.

For the years 2000 and 2001, Grasso's compensation was grossly excessive, approximately three to four times what was reasonable. In those years, his annual compensation reached approximately \$26.8 million and \$30.6 million, respectively. A conservative estimate of what Grasso's yearly compensation should have been in this period is \$4-6 million, based on the median level of an appropriate peer group. Even assuming outstanding performance by Grasso, a generous annual compensation level would have been in the range of about \$8-9 million. Grasso's compensation level was several times that amount for 2000 and 2001.

➤ **Excessive Benefits**

The level of benefits that Grasso accumulated during this period was excessive by any reasonable standard. By August 2003, before his 2003 employment contract was approved or executed, Grasso's Supplemental Executive Retirement Plan ("SERP") benefit translated into a lifetime annuity of at least \$7.4 million per year, and could have been substantially higher than that depending on various factors. This translated into a total lump sum present value pension benefit in August 2003 of about \$126.4 million. About \$82.9 million of these pension benefits accumulated in the last four years.

Grasso's total level of pension benefits was several times more than what a reasonable pension would have been. Applying appropriate executive compensation analysis and benchmarking criteria, an appropriate pension for Grasso would have been in a range of about \$875,000 per year, which would translate into a lump-sum pension benefit of about \$12.8 million. Even under the most favorable analysis and assumptions, Grasso's pension should not have exceeded an annuity of about \$2.1 million or a lump sum of more than \$25 million. Accordingly, under his employment contracts with the NYSE, Grasso accumulated total excess pension benefits of between \$101.4 million and \$113.6 million.

Large portions of Grasso's accumulated pension benefits were paid out to Grasso on three separate occasions while Grasso remained employed at the NYSE. First, in June 1995, in connection with the negotiation of his first employment contract as Chairman and CEO, Grasso asked for and received his total accumulated SERP benefits as of that date, a total of about \$6.6 million.

Next, in May 1999, when he signed his second employment contract as Chairman and CEO, Grasso was allowed to transfer from his SERP account to his Supplemental Executive Savings Plan ("SESP") account a total of about \$29.9 million. That amount represented Grasso's total accumulated SERP benefit at that time, excluding: (1) the approximately \$6.6 million in SERP benefits that previously had been paid out to him in 1995; and (2) an amount of about \$5.2 million that Grasso agreed to forego at that time through a change in the mortality table used to calculate his SERP benefit.

Finally, pursuant to his third employment contract as Chairman and CEO, which was executed on August 27, 2003, Grasso was to receive additional SERP benefits, including: (1) an immediate payout of about \$51.6 million in SERP benefits; (2) an immediate payout of the approximately \$29.9 million in SERP benefits that had previously been transferred to his SESP account in 1999 and by August 2003 had grown to about \$33.6 million; (3) a right to additional scheduled payments of SERP benefits totaling about \$28.6 million over four years, from 2004 through 2007; (4) a right to other potential amounts of SERP benefits, depending on various facts and circumstances regarding his employment; and (5) additional payouts of deferred compensation and additional rights to other amounts of deferred compensation. Thus, Grasso not only accumulated excessive amounts of pension benefits, he was allowed to withdraw them repeatedly from his retirement accounts while still employed at the NYSE.

■ **Grasso's Excessive Compensation and Benefits Were the Result of a Multi-Flawed Executive Compensation Process**

Grasso's excessive compensation and benefits were the product of multiple flaws in the compensation and benefits process employed by the NYSE, including the following:

➤ **Failure to Adequately Design, Monitor, and Oversee Grasso's SERP Benefits**

Grasso's SERP benefits, which were provided to him pursuant to his employment contracts, were not subject to any reasonable limits or caps that would have prevented their growth to unreasonable levels. Further, Grasso's accumulation of SERP benefits was not monitored sufficiently over the years. The Compensation Committee did not examine and consider the level of Grasso's SERP benefits accumulation when making its compensation decisions for Grasso on a yearly basis, and awarded large bonuses to Grasso without fully analyzing the impact of those bonuses on Grasso's accumulation of SERP benefits.

At no time did the Committee examine whether Grasso's SERP benefits accumulation was reasonable or conduct any market or peer group analysis to gauge whether Grasso's SERP benefits accumulation was consistent with the market level or a peer group level of pension benefits. And in 2000 and 2001, when at least some on the Committee became concerned, in a general manner, about the growth of Grasso's SERP benefits accumulation, the Committee did not take sufficient action to analyze or determine what the precise accumulation was, or what the precise effect of further large bonuses for Grasso would be on his SERP benefits accumulation. The Committee also approved of several payouts and transfers of Grasso's SERP benefits while he was still employed at the NYSE, effectively turning a pension into a cash compensation device.

To rectify these problems, the NYSE should consider implementing caps or limits on SERP benefits accumulation, eliminating or revising the lump-sum option for SERP benefits, and requiring that the Compensation Committee, as part of its yearly analysis of compensation for senior management, review

and consider the benefits to which such executives are entitled and monitor their accumulation of SERP benefits.

➤ **Faulty Mechanics/Process Used to Determine Grasso's Yearly Compensation**

The process by which Grasso's annual compensation was determined was flawed in many respects. The Compensation Committee used an inappropriate comparator group for benchmarking Grasso's compensation levels, comparing Grasso to CEOs of large, profit-making institutions that are vastly different from the NYSE. Such organizations are much larger than the NYSE in numerous key respects including revenue, net income, number of employees, assets, and other factors, making them inappropriate companies to use in benchmarking Grasso's compensation. The Committee also obtained only incomplete data about the comparator group it used and then used that data in unconventional ways to create unreliable and inflated benchmarks for Grasso's compensation. Further, the Committee arbitrarily departed upwards from its own inflated benchmarks, in some years awarding Grasso more than twice those benchmarks.

To address these problems, the NYSE Compensation Committee should reevaluate and improve its process for benchmarking executive compensation, and should have consultants play a more substantive role in the executive compensation process.

➤ **Lack of Appropriate Involvement of Consultants in Connection with Grasso's Compensation and Benefits**

The consultants employed by the Compensation Committee did not have the appropriate level of involvement in, or input regarding, the compensation and benefits process. Consultants performed no analysis of Grasso's SERP benefits accumulation to examine whether it was reasonable or consistent with the market, and did not analyze whether Grasso's contractual SERP benefits, or the NYSE's SERP, should be subject to caps or other limitations so that the benefits remained at reasonable levels.

The consultants also were not sufficiently involved in, and therefore did not attempt to correct, the flawed process employed by the Committee in making its annual compensation decisions for Grasso, including the Committee's use of an inappropriate comparator group and faulty benchmarking formulas and the Committee's unreasonable compensation awards for Grasso that were well above the benchmarking in some years.

As noted directly above, compensation experts should be more substantively involved in the executive compensation process at the NYSE.

➤ **Lack of Transparency/Disclosures Regarding Compensation**

Only a handful of people knew about Grasso's pension accumulation, and Grasso's compensation awards were not disclosed outside the Board. Many Board members agreed that, had Grasso's compensation and benefit levels been disclosed outside the Board, they would never have reached such excessive levels. Annual disclosure of top executive compensation, which the NYSE already has implemented under its newly adopted corporate governance practices, should address this issue.

➤ **Lack of Continuity/Dedication on Compensation Committee/Board**

The NYSE's large Board during Grasso's tenure as Chairman and CEO, coupled with the high level of turnover of Board and Committee members from year to year and the failure to adequately train and share historical NYSE knowledge with new Board and Committee members, may have created an environment that was conducive to overcompensation. The high turnover and lack of training caused a lack of continuity on the Committee and the Board, which resulted in Board and Committee members not having a complete frame of reference for executive compensation decisions. The large Board led to at least some on the Board feeling less responsibility or less accountability for executive compensation decisions, and caused them to give complete deference to others on those matters.

The smaller NYSE Board created after Grasso resigned should be helpful in addressing this issue. In addition, going forward, close attention should be paid to training new Board and Committee members and providing them with important historical information relating to executive compensation.

➤ **Grasso's Control Over the People and Processes that Determined His Compensation**

Against proper governance practice, Grasso was involved in or connected to the process that determined his own compensation. For example, he personally selected which Board members served on the Compensation Committee, and some directors he selected were those with whom he had friendships or personal relationships. He also had a strong influence on who was appointed to the Board, which approved the compensation awards that the Committee recommended for him each year. In addition, Grasso determined, in his discretion, the "Chairman's Award" component of the annual NYSE performance evaluation process, which the Committee used in part to determine the annual bonus awards for NYSE employees generally, as well as to benchmark Grasso's own compensation.

The issues concerning selection of Board members and Committee members have now largely been addressed through the newly revised structure of the NYSE's Board and Compensation Committee. The Chairman should not select members of the Compensation Committee. The Committee should adopt procedures by which, in the future, the "Chairman's Award" is not used directly to create benchmarks for, or actual awards of, the CEO's compensation.

▪ **The Approval of Grasso's 2003 Employment Contract Was Based on Incomplete and Inaccurate Information and Was Made Without Adequate Deliberation**

Grasso's 2003 contract was approved by the Compensation Committee and the Board based on incomplete and inaccurate information. Despite being presented with information to the contrary, a number of the Committee members who voted to recommend the 2003 contract to the Board incorrectly believed that the payout of approximately \$139.5 million to Grasso under that contract resulted in terminating all of Grasso's future benefits under SERP and the NYSE's Capital Accumulation Plan ("CAP"). In fact, the contract provided for \$48 million in scheduled future payments of SERP benefits, CAP benefits, and deferred compensation, and also provided that additional SERP benefits could be paid out in the future under certain circumstances.

The entire Committee also believed, incorrectly, that the \$139.5 million payout to Grasso under the contract was fully vested. In fact, his right to approximately \$13 million in CAP benefits that were part of the \$139.5 million had not yet vested, and was not scheduled to vest until 2005.

The Committee members failed to advise the Board of some of the essential terms of the proposed contract, including the \$48 million in scheduled future payments under the contract, the potential additional SERP benefits that possibly could accrue under the new contract, and the payment of \$13 million in unvested CAP benefits. In fact, the Committee gave the Board contrary information, leading the Board to believe there were no future payments under the contract.

Finally, neither the Committee nor the Board conditioned its approval of the proposed contract on an actual review of a written contract, which had not been drafted at the time the Board voted on the proposed contract. Instead, the Board approved of the proposed contract in concept based on unclear and incomplete term sheets and oral discussions. The contract ultimately was signed by the Committee Chairman without being fully reviewed.

■ **Grasso's Excessive Compensation and Benefits Have Had a Detrimental Impact on the NYSE**

Grasso's excessive levels of compensation and benefits have negatively affected the NYSE in at least three fundamental ways. First, the large amounts of excess compensation and benefits have had a negative impact on the NYSE's financial capability to serve its purposes. At the time of his resignation in September 2003, Grasso had been paid about \$43.1 million in excessive compensation. Also as of that time, Grasso had received payments of more than \$88 million in pension benefits (valued at \$95.1 million with interest on earlier payments considered), and approximately \$70.1 million to \$82.3 million of that amount was excessive. Thus, Grasso received from the NYSE in the range of \$113.2 million to \$125.4 million in excess compensation and pension benefits. The NYSE could have used that money to serve its interests and purposes in a variety of ways, including for the benefit of its members, its listed companies, or the investing public.

Second, Grasso's excessive compensation and benefits have had a detrimental impact on the brand and goodwill of the NYSE. Unquestionably, the firestorm that has surrounded Grasso's excessive compensation and benefits has, to some extent, tarnished the reputation and image of the NYSE. As a result, the NYSE is now in the process of undertaking to rebuild the trust and confidence of members, investors and listed companies.

Finally, as a result of the excessive compensation and benefits, the NYSE has been required to spend its resources dealing with this issue. NYSE employees and agents have been required to perform a variety of work that they otherwise would not have been required to perform had Grasso not been overcompensated, including being required to respond to an inquiry from the Securities and Exchange Commission on matters relating to Grasso's compensation. None of these corporate resources would have been spent in the absence of the overcompensation.²

² There are a number of legal issues that the NYSE may wish to consider in light of our Investigation and Report. This Report, while providing a summary and analysis of the information and facts gathered in the investigation, does not directly address the legal issues relating to those facts or provide any legal advice or analysis on those issues. We will separately provide the NYSE with legal advice and analysis on issues that the NYSE wishes to consider relating to the matters addressed in this Report.

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