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**Review of Compensation and  
Benefits Provided to  
President Ladner  
American University**

**MERCER**

Human Resource Consulting

Prepared for Arnold & Porter LLP

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# 1

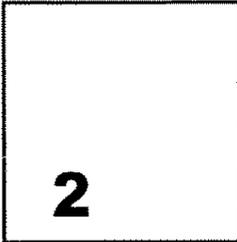
## **Introduction**

The Board of Trustees of American University values highly the enhanced academic standing and financial stability the University has achieved since Dr. Ladner became its President. As a result, various elements of pay and benefits have been added to Dr. Ladner's remuneration package since 1997

- in recognition of his job performance,
- to remain competitive with the rising rate of pay for university presidents, and
- in response to the realization that Dr. Ladner is an attractive candidate to other universities.

In 2001, the Board adopted an Executive Compensation Program for Dr. Ladner that is intended to be "appropriate, fair, and competitive." By the terms of this plan, the Compensation Committee is charged with reviewing and making recommendations to the Board with respect to Dr. Ladner's compensation. This includes determining that Dr. Ladner's compensation is reasonable in its entirety when compared to that of other university presidents.

The remainder of this report contains data which can be used in making that determination.



## Key Elements of Dr. Ladner's Compensation and Benefits

The key elements of Dr. Ladner's remuneration for 2004 are shown on the chart below.

Description	2004 Value
1. Salary	\$458,000
2. Incentive Compensation Plan (maximum = 45% of annual salary)	\$175,000
3. Supplemental Retirement Compensation Plan (retirement plan contribution on pay that exceeds IRS limit for qualified retirement plans)	\$21,749
4. Deferred Compensation Plan (additional retirement contribution equal to 25% of annual salary)	\$110,750
5. Split-Dollar Life Insurance Policy (increase in cash value) (death benefit of \$3.6 million)	\$101,767 <u>\$7,233</u>
<b>TOTAL</b>	<b>\$874,499</b>

Dr. Ladner had additional contributions to employee benefit plans valued at \$35,239, auto expense of \$805, and housing expense of \$5,842 as reported on IRS Form 990. These expenses are consistent with those provided by other university Presidents and will not be further referenced in this report.

# 3

## **The Comparator Group**

When determining whether a tax-exempt organization is providing reasonable compensation, IRS regulations state the following, “the value of services is the amount that would ordinarily be paid for like services by like enterprises under like circumstances.” In order to meet this standard, the Board should rely on appropriate data from comparable institutions when establishing Dr. Ladner’s remuneration.

American University updated its list of peer/comparable institutions in 2002 based on an analysis of competition for students, enrollment, revenue, endowment, and organizational complexity. This peer group of universities was used by Towers Perrin in 2004 when it conducted a review of the competitiveness of Dr. Ladner’s compensation.

In order to validate the appropriateness of data from that peer group, Mercer compared the Towers Perrin survey data to that of the following additional peer groups:

- All universities with the same Carnegie Classification as American University “Doctoral/Research – Extensive”,
- A subset of “Doctoral/Research – Extensive” universities that have scope measures similar to that of American University (e.g. annual budget, number of students), and
- A peer group of universities identified by Mercer that have at least 5 of 8 factors similar to those of American University.

In total, the peer groups comprise 41 universities, and there is overlap between the peer groups.

A list of schools in each peer group is shown on the following pages.

**American University  
Peer Groups**

University	Towers Perrin Survey <sup>1</sup>	Mercer Survey <sup>2</sup>	All Doctoral/Extensive <sup>3</sup>	Subset Doctoral Extensive <sup>4</sup>	Peer Group Representation
[REDACTED]		X			1
[REDACTED]		X			1
Boston University	X		X		2
Brandeis University			X	X	2
[REDACTED]		X	X	X	3
California Institute of Technology			X		1
[REDACTED]		X	X		2
[REDACTED]		X	X		2
Columbia University			X		1
Cornell			X		1
[REDACTED]	X	X			2
[REDACTED]		X	X		2
Emory			X		1
[REDACTED]	X	X	X		3
[REDACTED]		X	X		2
[REDACTED]		X			1
Harvard			X		1
Howard			X		1
Johns Hopkins			X		1
[REDACTED]	X	X	X	X	4
[REDACTED]		X	X		2
[REDACTED]		X	X		2
Northeastern University			X	X	2
Northwestern University			X		1
Princeton University			X		1
[REDACTED]		X	X	X	3

University	Towers Perrin Survey <sup>1</sup>	Mercer Survey <sup>2</sup>	All Doctoral/Extensive <sup>3</sup>	Subset Doctoral Extensive <sup>4</sup>	Peer Group Representation
Rice			X	X	2
[REDACTED]	X	X	X	X	4
Stanford			X		1
Syracuse	X		X		2
[REDACTED]		X			1
Tufts	X		X		2
[REDACTED]	X	X	X	X	4
University of Chicago			X		1
University of Denver	X		X		2
University of Miami			X		1
University of Notre Dame			X		1
University of Pennsylvania			X		1
University of Rochester			X		1
[REDACTED]		X	X		2
Wake Forest	X				1
[REDACTED]		X	X		2
[REDACTED]		X	X		2
Total (43)	10	20	37	8	

<sup>(1)</sup>Comparative universities as specified by American University

<sup>(2)</sup>Schools that are similar to American University on at least 5 of 8 criteria (see next page)

<sup>(3)</sup>Private universities with the Carnegie Classification of "Doctoral/Research – Extensive" excluding certain schools that report no income payable to the President, e.g. Loyola, Marquette, etc.

<sup>(4)</sup>Subset of "Doctoral/Research Universities – Extensive" with scope factors similar to American University

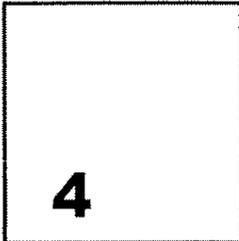
## Mercer Survey

### Table of Criteria

Criteria	Rationale
1. University	<ul style="list-style-type: none"> <li>• Includes the complexity of both undergraduate and graduate programs.</li> </ul>
2. Metropolitan Location	<ul style="list-style-type: none"> <li>• Operational challenges of high costs for labor, services, facilities, security, etc.</li> <li>• Student living costs higher affecting competitiveness for students.</li> <li>• Commuter/resident issues significant.</li> <li>• Expansion and growth challenged due to land access and cost.</li> </ul>
3. Top 10% of Schools in US (group of 357)	<ul style="list-style-type: none"> <li>• Broader than top 50. Many of these schools are striving to raise their national standing.</li> </ul>
4. Private	<ul style="list-style-type: none"> <li>• Funding issues different than for state schools</li> </ul>
5. Alternative for students	<ul style="list-style-type: none"> <li>• Students vote for what is “comparable” with their applications</li> </ul>
6. Size (4,000 to 10,000 students)	<ul style="list-style-type: none"> <li>• Proxy for comparability in scope and complexity</li> </ul>
7. Selectivity (current and aspirational peers)	<ul style="list-style-type: none"> <li>• Proxy for schools of comparable educational quality or somewhat above, but not the very top level.</li> </ul>
8. International and other diversity	<ul style="list-style-type: none"> <li>• Reflects the challenge of a far-flung student body and educational delivery system.</li> </ul>

#### Resources:

1. The Best 357 Colleges, 2005 Edition, The Princeton Review
2. Complete Book of Colleges, 2005 Edition, The Princeton Review
3. Ultimate College Guide, 2005 Edition, U.S. News and World Report



### **Total Annual Cash (Salary and Annual Incentives)**

Annual incentive compensation plans are a growing trend for university Presidents, but still a minority practice (slightly less than half of the peer group universities report having such a plan). Therefore, it is necessary to assess the competitiveness of total annual cash compensation, regardless of whether it is split between salary and incentive pay.

#### **Comparator Data**

Dr. Ladner's 2004 total cash compensation was \$633,000, which is in the 90th – 95th percentile of the average of three comparator groups, as shown below:

#### **2004 Total Annual Cash Compensation**

	50th %ile	75th %ile	90th %ile	Highest
Towers Perrin Survey	\$432,348	\$515,000	not available	not available
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
All Private Doctoral/Research	\$538,125	\$580,000	\$619,000	\$655,000
Subset Doctoral Research	\$562,400	\$606,300	\$624,500	\$655,000

*Note: Although the comparator group of all private doctoral research universities includes institutions that have a larger student population, much larger endowment, or greater prestige than American University, annual cash compensation is aligned with the practices of smaller, less elite institutions. Simply put, there is an unspoken "cap" on compensation for University Presidents due to donor/faculty issues and IRS scrutiny. Instead, these schools provide a platform for a President to realize substantial outside earnings through corporate directorships, investment in start-ups, speakers fees, etc.*

## Conclusions

- Dr. Ladner's total annual cash compensation is within the 90th – 95th percentile of competitive practices for several comparator groups. Therefore, the conclusion is reliable.
- This market place positioning is defensible in light of the following facts and circumstances:
  - a large portion of annual cash varies based on the achievement of performance objectives,
  - annual incentive plan payments have varied as a percent of salary since the plan was implemented, as shown below:
    - 27% in 2000
    - 35% in 2001
    - 41% in 2002
    - 40% in 2003
    - 43% in 2004
  - under Dr. Ladner's leadership, the University has made significant progress in:
    - financial stability (S&P "A" credit rating)
    - growth in endowment contributions (\$250+ million)
    - investment return for the endowment (top 5%)
    - growth in annual operating revenue (up 70%)
    - growth in annual giving (average annual giving increased by 50%)
    - improved ranking in numerous academic programs
    - new accreditations
    - enhanced facilities and green space
    - a more selective student body
    - international presence
    - athletics
- The University's maximum annual incentive award is more aggressive than that of most universities. However, the plan is a good management tool, and it can be used to ensure that Dr. Ladner's pay is appropriately correlated with his job performance.
  - Mercer recommends that annual goals be quantified and specified as minimum, threshold, or maximum performance whenever possible. Qualitative goals should also be carefully defined. All performance goals should be carefully analyzed at the beginning of each plan year and when final award payments are determined.

When making a recommendation for future salary increases, the Board should be mindful of the leveraging effect – annual incentive awards, retirement plan contributions, and deferred compensation are all affected by salary increases.

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### **Supplemental Retirement Plan**

Dr. Ladner participates in the University-wide defined contribution retirement plan. IRS limits University contributions to the first \$210,000 of salary. A supplemental retirement plan was established so that Dr. Ladner and other University executives can receive their full retirement plan contribution without regard to the IRS compensation limit.

### **Comparator Data**

While only 59% of universities report having such a plan, in our experience, a large majority of universities in these comparator groups will provide such a benefit either as a separate plan or as part of another deferred compensation or split-dollar life insurance plan.

### **Conclusion**

The University's pension plan formula is standard for the industry. Therefore, Dr. Ladner's supplemental retirement plan benefit is comparable to that of a majority of university Presidents.

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### **Split-Dollar Life Insurance**

American University entered into a split-dollar life insurance agreement with Dr. Ladner in 1997. The purpose of the plan was two-fold:

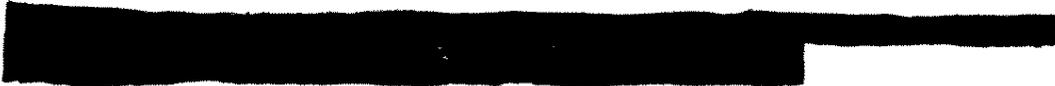
- provide a supplemental retirement benefit through the policy's cash value accumulation (owned by Dr. and Mrs. Ladner), and
- provide a supplemental pre-retirement death benefit, and the possibility of post-retirement life insurance in lieu of a retirement benefit.

A premium amount was determined based on a desired amount of projected cash value accumulation. However, the policy's investment performance has been lower than projected:

- \$906,606 has been paid as premiums,
- \$845,384 represents the current cash value, and
- two additional annual premiums of \$109,000 are scheduled to be paid.

The current death benefit is \$3,595,384. In the event of Dr. Ladner's death benefit prior to retirement, American University will receive a portion of the life insurance proceeds equal to premiums paid, and Dr. Ladner's beneficiary will receive the balance.

### **Comparator Data**



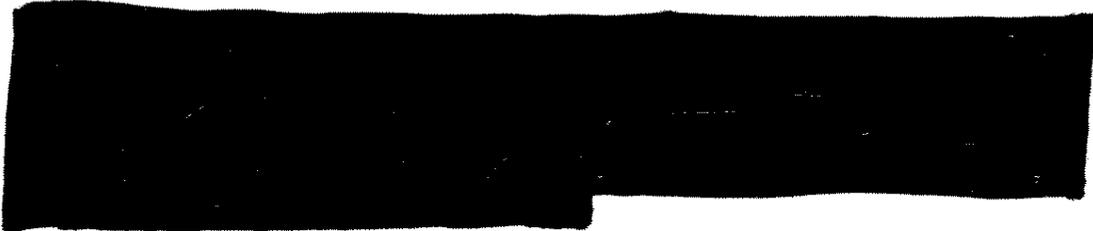
- Tax law changes have resulted in very few split-dollar plans being implemented since that time. (Dr. Ladner's policy retains favorable tax treatment.)
- Some policies have been reduced or surrendered due to low investment returns.



**Split-Dollar Policies  
Projected Cash Value at Retirement**

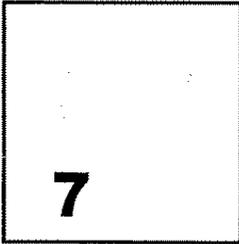
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\*estimate based on current cash value and 2 more premium payments.



**Conclusion**

Dr. Ladner's split-dollar plan is highly competitive. Because the actual (vs. projected) cash value at retirement will vary by the investment returns realized by each individual, it is not possible to precisely define the market position of Dr. Ladner's policy. Based on available survey data, however, it is reasonable to conclude that his policy value equals or exceeds the 90th percentile of the value provided to other university Presidents who have this benefit.

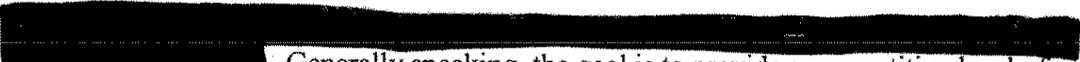


### **Deferred Compensation Plan**

In 1998, a deferred compensation plan was adopted for Dr. Ladner that provides:

- an annual contribution to a trust equal to 25% of salary, with such amount subject to review,
- an initial retention contribution of \$400,000,
- deposit of contributions into an investment account, and
- payment of the account balance commencing at death, disability, or retirement.

### **Comparator Data**



Generally speaking, the goal is to provide a competitive level of retirement income from the following sources:

- current employer
- vested benefits from prior employers
- social security

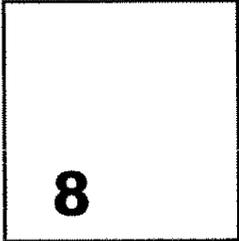
Contribution rates are shown below:

**Deferred Compensation Plan  
Annual Contribution as a Percent of Salary**

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### **Conclusion**

Dr. Ladner's Deferred Compensation Plan contribution is equal to the 90th percentile contribution for universities that have such a plan.



## Conclusions

- Dr. Ladner's annual cash compensation is highly competitive, and it appears reasonable based on facts and circumstances.
  - The annual incentive plan supports the University's strategy, and payouts have varied based on a review of Dr. Ladner's performance
  - The average annual increase in Dr. Ladner's cash compensation over the past 5 years (40.6%) is comparable to the average for the comparator groups used in this survey (45% - including new hires).
  - Dr. Ladner stepped into a difficult situation and has moved the University forward significantly during his term as President
- The University is contributing to three retirement plans for Dr. Ladner.
- Total annual retirement plan/deferred compensation contributions for Dr. Ladner equal 65% of salary:

University-Wide Plan	10%
Deferred Compensation Plan	25%
Split-Dollar Plan	<u>30%*</u>
	65%**

\*Average since inception

\*\*Excludes an initial Deferred Compensation Plan contribution of \$400,000



■ [REDACTED]  
 [REDACTED]

Source	"Average" % of Final Salary
Qualified retirement plans (current and former employers)	[REDACTED]
Social Security	[REDACTED]
Nonqualified retirement/deferred compensation/split-dollar plans	[REDACTED]
TOTAL	[REDACTED]

By comparison, Dr. Ladner is projected to receive an estimated life annuity benefit of 47% of final salary each year from the Deferred Compensation Plan and Split-Dollar Plan,

[REDACTED]

■ [REDACTED]  
 ■ [REDACTED]  
 ■ [REDACTED]

- Each element of Dr. Ladner's remuneration is at the high end of competitive practices. Consequently, his remuneration, in its entirety, exceeds the IRS guideline of "an amount that would ordinarily be paid for like services by like enterprises under like circumstances", as supported by appropriate data. In order to meet this standard, Mercer recommends that Dr. Ladner's annual compensation not exceed \$800,000 for 2005. It appears that this can be most easily accomplished by reducing the Deferred Compensation Plan contribution. However, other approaches (such as reducing the annual incentive award) may be feasible.

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