

SLM CORP  
Form 11-K  
June 29, 2005  
[Table of Contents](#)

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 11-K**

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**x ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the year ended: December 31, 2004

**“ TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-13251

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**Sallie Mae DMO 401(k) Savings Plan**

(formerly General Revenue Corporation 401(k) and Profit Sharing Plan)

(Full title of the Plan)

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**SLM CORPORATION**

(Name of the issuer of the securities held pursuant to the Plan)

**11600 Sallie Mae Drive**

**Reston, Virginia 20193**

(address of principal executive office of the issuer)

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**Table of Contents**

**Sallie Mae DMO 401(k) Savings Plan**

(formerly known as the General Revenue Corporation 401(k) and Profit Sharing Plan)

**Table of Contents**

**December 31, 2004 and 2003**

	<b>Page</b>
<b><u>Report of Independent Registered Public Accounting Firm</u></b>	<b>1</b>
<b>Financial Statements</b>	
<u>Statements of net assets available for benefits <b>December 31, 2004 and 2003</b></u>	<b>2</b>
<u>Statement of changes in net assets available for benefits <b>Year ended December 31, 2004</b></u>	<b>3</b>
<u>Notes to financial statements</u>	<b>4</b>
<b><u>Supplemental Schedule* Schedule of Assets (Held at End of Year)</u></b>	<b>11</b>
<b><u>Signatures</u></b>	<b>12</b>
<b><u>Consent</u></b>	<b>Exhibit 23</b>

\* Other schedules required by 29 CFR 2520.103-10 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA have been omitted because they were not applicable.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Participants and Plan Administrator of the

Sallie Mae DMO 401(k) Savings Plan:

In our opinion, the accompanying statements of net assets available for benefits and the related statement of changes in net assets available for benefits present fairly, in all material respects, the net assets available for benefits of the Sallie Mae DMO 401(k) Savings Plan, formerly known as the General Revenue Corporation 401(k) and Profit Sharing Plan (the Plan) at December 31, 2004 and 2003, and the changes in net assets available for benefits for the year ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule of Assets (Held at End of Year) is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan's management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ PricewaterhouseCoopers LLP

McLean, VA

June 28, 2005

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**Table of Contents**

**Sallie Mae DMO 401(k) Savings Plan**

**Statements of Net Assets Available for Benefits**

**As of December 31, 2004 and 2003**

	<b>2004</b>	<b>2003</b>
<b>Assets</b>		
Interest in Sallie Mae 401(k) Savings Plan Master Trust	\$ 12,926,350	\$ 4,076,083
Employer Contributions Receivable	11,206	203,070
	<hr/>	<hr/>
Net assets available for benefits	\$ 12,937,556	\$ 4,279,153
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The accompanying notes are an integral part of these financial statements.

**Table of Contents****Sallie Mae DMO 401(k) Savings Plan****Statement of Changes in Net Assets Available for Benefits****Year Ended December 31, 2004**

	<b>2004</b>
Additions:	
Additions to net assets attributed to:	
Interest in Sallie Mae 401(k) Savings Plan	
Master Trust investment income	\$ 1,202,708
Contributions	
Participant	1,137,238
Employer	498,627
Rollovers	40,726
	1,676,591
Transfer in (Note 1)	6,731,419
Total additions	9,610,718
Deductions:	
Deduction from net assets attributed to benefits paid to participants	952,315
Net increase	8,658,403
Net assets available for benefits	
Beginning of year	4,279,153
End of year	\$ 12,937,556

The accompanying notes are an integral part of these financial statements.

## **Table of Contents**

### **Sallie Mae DMO 401(k) Savings Plan**

### **Notes to Financial Statements**

### **December 31, 2004 and 2003**

## **1. Plan Description**

### **General**

The Sallie Mae DMO 401(k) Savings Plan, formerly known as the General Revenue Corporation 401(k) and Profit Sharing Plan (the Plan), was first adopted on July 1, 1984 for the benefit of eligible employees electing to participate in the Plan (the Participants). The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The following description of the Plan provides only general information. Participants should refer to the Plan document for a more complete description of the Plan's provisions.

In conjunction with SLM Corporation's realignment on July 1, 2004 for its Debt Management Operations, the Plan covers substantially all employees of the Company or the Employer, which includes General Revenue Corporation, Student Assistance Corporation (wholly owned subsidiaries of SLM Corporation) and Portfolio Management a division of Sallie Mae Inc. Effective January 1, 2004, employees are eligible for participation in the Plan after they have completed 3 months of service. Beginning January 1, 2004, the General Revenue Corporation 401(k) and Profit Sharing Plan was amended to eliminate the age requirement. Effective July 1, 2004, the General Revenue Corporation 401(k) and Profit Sharing Plan was renamed the Sallie Mae DMO 401(k) Savings Plan.

### **Contributions and Vesting**

Effective July 1, 2004, participants may contribute between 1 percent and 25 percent of their eligible compensation for the contribution period up to the Internal Revenue Service maximum of \$13,000 in 2004. Prior to July 1, 2004 the maximum contribution rate was 15 percent. The Plan allows participants who have attained age 50 to make additional contributions up to the IRS maximum of \$3,000 for 2004.

The Plan's match formula for July 1, 2004 through December 31, 2004 was 100% on the first 3% and 50% on the next 2% of Participant compensation contributed as an elective deferral. For January 1, 2004 through June 30, 2004 the formula was 50% up to the first 6% of Participant compensation. In 2003, after 1,000 hours of service and employment as of the last day of the Plan year, the Employer was able to make a discretionary contribution at the end of the Plan year of 50% of the first 6% of Participant compensation contributed as an elective deferral. Additionally, active employees as of December 31 may receive an employer match true up contribution for any difference in the total of the bi-weekly employer match and the employer match based on the participant's contributions for the year.

During 2004, there were \$33,064 forfeitures used to reduce Employer contributions. Unused forfeitures at December 31, 2004 and 2003 were \$10,344 and \$16,857, respectively, which will be used to offset future Employer contributions.





**Table of Contents****Sallie Mae DMO 401(k) Savings Plan****Notes to Financial Statements****December 31, 2004 and 2003**

Participants vest fully upon death, total disability, attainment of age 65 or upon termination of the Plan by the Employer. Participants vest in Employer contributions and earnings thereon in accordance with the following schedule:

	<b>Vesting Percentage January 1 to</b>	<b>Vesting Percentage Effective</b>
	<b>June 30, 2004</b>	<b>July 1, 2004</b>
Less than 1 year of service	0%	0%
1 year but less than 2 years of service	0%	100%
2 years but less than 3 years of service	50%	100%
3 or more years of service	100%	100%

Prior to January 1, 2004, participants vested in employer contributions and earnings therein based on the following schedule:

	<b>Vesting Percentage</b>
Less than 2 years of service	0%
2 but less than 3 years of service	20%
3 but less than 4 years of service	40%
4 but less than 5 years of service	60%
5 but less than 6 years of service	80%
6 or more years of service	100%

**Other Contributions**

The Plan also allows for a profit sharing contribution, whereby the Company will determine the amount of net profits, if any, to contribute to the Plan. There were no profit sharing contributions made during 2004.

**Participant loans**

Participants may borrow from their fund accounts starting at a minimum of \$1,000 up to a maximum of \$50,000 or 50% of their account balance, whichever is less. Participants may have two loans outstanding at any time. The term of the loan shall be a maximum of five years, except in the case of a loan that is used for the Participant's principal residence, which must be repaid over thirty years. The loans are secured by

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the balance in the Participant's account and bear interest at the prime rate at the time of loan origination. Principal and interest is paid through bi-weekly payroll deduction. Active loans have interest rates ranging from 4% to 10% and with maturity dates ranging from 2005 to 2023.

### **Investment elections**

Fidelity Management Trust Company ( Fidelity ) is the Plan trustee and recordkeeper. Contributions are invested, based on Participants instructions, in any of the various investment options selected by the Sallie Mae 401(k) Savings Plan and Investment Committees. The Plan offers various mutual funds, an employer stock fund, a money market fund and a self-directed brokerage option. Under the self-directed brokerage option, Participants may direct investments in any security or other investments offered by Fidelity, regardless of whether they are included as investment options offered by the Plan. In order to participate in the self-directed brokerage option, Participants must have a minimum Plan balance of \$10,000 and at least \$500 must remain in the other available funds.

## **Table of Contents**

### **Sallie Mae DMO 401(k) Savings Plan**

### **Notes to Financial Statements**

### **December 31, 2004 and 2003**

#### **Participant accounts**

Each Participant's account is credited with the Participant's and Company's contributions and their portion of the Plan's earnings (losses). Allocations are based on Participant earnings or account balances, as defined. The benefit to which a Participant is entitled is the benefit that can be provided from the Participant's vested account.

#### **Payment of benefits**

Participants may withdraw funds from their account upon retirement, disability, separation from employment, or upon reaching age 59 1/2. Distributions shall be made by a lump sum payment, reduced by the outstanding balance of any loan not repaid by the Participant. The Participant may have distributions paid in cash, SLM Corporation common stock or a combination thereof. Fractional shares of the common stock will be paid in cash.

#### **Administrative expenses**

Participants pay fees for loans and withdrawals, and terminated Participants pay annual maintenance fees. Additionally, Participants may pay for commissions associated with common stock purchases and sales and short term transaction fees in certain funds when Participants trade in and out of the fund within 90 days. The Participant costs are charged directly to the Participant's account and are reflected in the statement of changes in net assets available for benefits as an addition to net assets attributed to Interest in Sallie Mae 401(k) Savings Plan Master Trust income. The Employer bears the remaining cost of Plan administration.

#### **Transfers**

In conjunction with SLM Corporation's realignment on July 1, 2004 for its Debt Management Operations, plan assets in the Sallie Mae 401 (k) Savings Plan for employees of Education Debt Services, Inc., a division of Sallie Mae Inc., were transferred to the Sallie Mae DMO 401(k) Savings Plan on January 30, 2004. The net assets transferred amounted to \$2,185,265. Plan assets in the amount of \$3,845,851 for Student Assistance Corporation and Portfolio Management division Participants were transferred in July from the Sallie Mae 401(k) Savings Plan to the Sallie Mae DMO 401(k) Savings Plan. A transfer from the Pioneer Credit Recovery, Inc. 401(k) Plan amounted to \$19,681. Remaining transfers of \$680,622 relate to employee transfers between companies.

## **2. Summary of Significant Accounting Policies**

**Basis of accounting**

The Plan maintains its accounting records on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

**Investment valuation and income recognition**

Investments held by the Sallie Mae 401(k) Savings Plan Master Trust (the Master Trust ) consist of mutual funds, an employer stock fund, a money market fund and a self-directed brokerage option. Money market funds are carried at cost, which approximates fair value.

## **Table of Contents**

### **Sallie Mae DMO 401(k) Savings Plan**

### **Notes to Financial Statements**

#### **December 31, 2004 and 2003**

Common stock, securities and brokerage account investments traded on national securities exchanges are carried at market value based on the closing price on the last business day of the year. The fair value of mutual funds is determined based on the net asset value for shares held by the Master Trust at year-end. Investments traded in the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and asked prices. Participants in the Sallie Mae Stock Fund hold units in the fund and not shares, the value of which was \$39.15 per unit at December 31, 2003 vs. SLM Corporation common stock which was valued at \$53.39 per share on December 31, 2004. Loans to Participants are valued at cost, which approximates fair value.

The Master Trust information in Note 4 presents the net appreciation (depreciation) in the fair value of its investments, which consists of realized gains or losses and unrealized appreciation (depreciation) on those investments. Dividend income is recorded on the ex-dividend date. Interest earned on investments is recorded on the accrual basis. Purchases and sales of securities are recorded on the trade date.

#### **Use of estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein, and disclosure of contingent assets and liabilities. Such estimates include those regarding fair value. Actual results could differ from those estimates.

#### **Risks and uncertainties**

The Plan, through the Master Trust, provides for various investment options. Such investments are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the fair values of the investment securities and risks will occur in the near term and that such changes could materially affect Participants' account balances and the amounts reported in the statement of net assets available for benefits.

#### **Benefit payments**

Benefits are recorded when paid.

### **3. Investments**

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The individual investments representing 5 percent or more of the fair value of net assets available for benefits is the interest in the Master Trust which was \$12,926,350 and \$4,076,083 at December 31, 2004 and 2003, respectively.

**Table of Contents****Sallie Mae DMO 401(k) Savings Plan****Notes to Financial Statements****December 31, 2004 and 2003****4. Investment in Master Trust**

At December 31, 2004 and 2003, the Plan's investment assets were held in a trust account with Fidelity and consist of a specific interest in the Master Trust. The Master Trust also includes the investment assets of the Sallie Mae 401(k) Savings Plan and the Pioneer Credit Recovery, Inc. 401(k) Plan, both defined contribution retirement plans.

The Master Trust was composed of the following investments, at fair value at December 31, 2004 and 2003:

	<b>2004</b>	<b>2003</b>
Mutual Funds	\$ 226,188,976	\$ 182,545,084
Sallie Mae Stock Fund	65,451,833	48,959,428
Money Market Funds	29,803,674	28,319,447
Common/Preferred Stock	3,534,654	4,571,061
Corporate/Government Bonds	942,951	469,875
Participant Loans	7,973,284	6,230,530
<b>Total Master Trust Assets</b>	<b>\$ 333,895,372</b>	<b>\$ 271,095,425</b>

The net investment income of the Master Trust for the year ended December 31, 2004 is summarized as follows:

	<b>2004</b>
Dividends	5,541,166
Interest	326,691
Net appreciation (depreciation) in fair value of investments related to:	
Mutual Funds	17,991,814
Sallie Mae Stock Fund	18,708,930
Common Stock/Preferred Stock	52,836
Corporate Bonds/Government Bonds	(32,814)
	<b>42,588,623</b>

The Plan's specific interest in the net assets of the Master Trust was approximately 4% and 2% at December 31, 2004 and 2003, respectively. Master Trust income is allocated based on each plan's specific interest in the Master Trust.

**5. Plan Termination**

Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of Plan termination, Participants will become immediately 100% vested in their accounts.



**Table of Contents**

**Sallie Mae DMO 401(k) Savings Plan**

**Notes to Financial Statements**

**December 31, 2004 and 2003**

**6. Related Party Transactions**

At December 31, 2004 and in 2003, certain Plan investments are shares of mutual funds or amounts of the Sallie Mae Stock Fund managed by Fidelity. Fidelity is the trustee as defined by the Plan and therefore these transactions qualify as party-in-interest. Fees paid by the Plan for administrative services were \$4,292 for the year ended December 31, 2004.

Among the Plan in the Master Trust are investments in the Sallie Mae Stock Fund which is comprised principally of SLM Corporation stock. At December 31, 2004 and 2003, the amounts were 34,756 and 4,264 units, respectively, valued at \$1,360,688 and \$118,407, respectively. During 2004, 60,168 units in the amount of \$1,813,648 were purchased and 29,676 units in the amount of \$911,247 were sold related to the Sallie Mae Stock Fund. Such transactions qualify as party-in-interest transactions, as SLM Corporation is the Plan's sponsor.

**7. Income Tax Status**

The Company adopted the McDermott Will & Emery Prototype Non-standardized Safe Harbor Profit Sharing Plan with CODA (Prototype Plan), which obtained a favorable determination letter from the Internal Revenue Service on September 24, 2001. The Sponsor has not applied for a stand-alone plan determination letter. Although the Plan has been amended since adopting the Prototype Plan, the Plan administrator believes that the Plan and related trust are operating in accordance with the Internal Revenue Code (IRC) and are qualified under Section 401(a) of the IRC and the Plan is therefore not subject to tax under present income tax law.

**8. Subsequent Events**

Effective January 1, 2005, eligible employees of Pioneer Credit Recovery, Inc. became participants in the Plan. The Pioneer Credit Recovery, Inc. 401(k) Plan will be merged with and into the Plan during 2005. As of December 31, 2004 the value of these assets was \$4,526,433.

Employees of Arrow Financial Services, Inc. became participants in the Plan as of January 1, 2005. The Arrow Financial Services, LLC Retirement Savings Plan will merge with and into the Plan during 2005. As of December 31, 2004 the value of these assets was \$3,895,846.

**Table of Contents**

**SUPPLEMENTAL SCHEDULE**

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10

**Table of Contents**

<b>Identity of issuer, borrower of similar entity</b>	<b>Description of Investment</b>	<b>Cost**</b>	<b>Current value</b>
<b>Participant Loans:</b>			
Plan participants *	Loans allowable under the plan instrument, collateralized by Participant account balances, due in varying installments from 2005 through 2023, with interest rates ranging from 4% to 10%		\$ 534,487
* Denotes party-in-interest ** Not applicable			

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**Table of Contents**

**SIGNATURE**

*The Plan.* Pursuant to the requirements of the Securities and Exchange Act of 1934 the Plan Administrator has duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

**Sallie Mae DMO 401(k) Savings Plan**  
(Full title of the Plan)

Date: June 28, 2005

By: /s/ C.E. Andrews

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C.E. Andrews  
Executive Vice President, Accounting  
and Risk Management

12

argin-bottom:0px; text-indent:4%">In fulfilling its oversight responsibility of appointing and reviewing the services performed by the Company's independent auditors, the Audit Committee carefully reviews the policies and procedures for the engagement of the independent auditor, including the scope of the audit, audit fees, auditor independence matters and the extent to which the independent auditor may be retained to perform non-audit related services. The Audit Committee considered the independent auditors' provision of non-audit services in 2012 and determined that the provision of those services is compatible with and does not impair the auditors' independence.

The Audit Committee discussed with the Company's auditors the scope and plans for the independent audit. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles. The Audit Committee has reviewed and discussed with management and the auditors the Company's audited financial statements, including the auditor's judgments about the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements. The Audit Committee also discussed with the auditors the matters required by Statement on Auditing Standard No. 114 The Auditor's Communication With Those Charged With Governance, as amended.

10

The Audit Committee has received the written disclosures and the letter from the Company's independent accountants required by PCAOB Ethics and Independence Rule 3526 ( PCAOB Rule 3526 ), Communications with Audit Committees Concerning Independence and the Audit Committee discussed with the auditors their independence from the Company and its management.

Based on the Audit Committee's discussion with management and the auditors and the Audit Committee's review of the representations of management and the report of the auditors to the Audit Committee, the Audit Committee recommended to the Board that the audited consolidated financial statements be included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which was filed with the Securities and Exchange Commission.

James F. Reilly

David I. Beatson

Dr. Neil W. Jacobs

*Members of the Audit Committee*

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## EXECUTIVE COMPENSATION

### Overview of Compensation Program

The Compensation Committee of the Board is responsible for establishing and implementing our compensation philosophy. The Compensation Committee believes that the total compensation paid to our executive officers should be and is fair, reasonable and competitive. In this section of the Proxy Statement, the individuals who served during our fiscal year ended December 31, 2012 as our Chief Executive Officer and the other executive officers included in the Summary Compensation Table on page 16, are referred to as the Named Executive Officers.

### Compensation Philosophy and Objectives

The Compensation Committee believes that executive officer compensation be structured to provide competitive base salaries and benefits to attract and retain superior employees and to provide short- and long-term incentive compensation to incentivize executive officers to attain, and to reward executive officers for attaining, established financial goals that are consistent with increasing stockholder value. The Compensation Committee may use cash bonuses and retention based equity awards as key components in the short- and long-term incentive compensation arrangements for executive officers, including the Named Executive Officers.

The Compensation Committee's goal is to maintain compensation programs that are competitive within our industry and geographic market. Each year, the Compensation Committee reviews the executive compensation program with respect to the external competitiveness of the program, the linkage between executive compensation and the creation of stockholder value, and determines what changes, if any, are appropriate.

In determining the form and amount of compensation payable to Named Executive Officers, the Compensation Committee is guided by the following objectives and principles:

Compensation levels should be sufficiently competitive to attract and retain key executives. We aim to ensure that our executive compensation program attracts, motivates and retains high performance talent and rewards them for our achieving and maintaining a competitive position in our industry and geographic market. Total compensation (i.e. maximum achievable compensation) should increase with position and responsibility.

Compensation should relate directly to performance and incentive compensation should be a portion of total compensation. We aim to foster a pay-for-performance culture, with the bonus portion of total compensation being at risk. Accordingly, absent unusual circumstances, any bonus payable as part of total compensation should be tied to and vary with our financial, operational and strategic performance, as well as individual performance. Bonuses should not be granted if these goals and results are not achieved.

Long-term incentive compensation should align executives' interests with our stockholders. Awards of equity-based compensation encourage executives to focus on our long-term growth and prospects, and incentivize executives to manage the company from the perspective of stockholders with a meaningful stake in us, as well as to focus on long-term career orientation.

Our executive compensation program is designed to reward the achievement of goals regarding growth, productivity and profitability, including such goals as:

To assist the Company in achieving and surpassing its internal targets and budgets, including quarterly financial and operating targets.

To recruit, motivate and exhibit leadership that aligns employees' interests with that of our stockholders.

To develop business models and systems that seek out strategic opportunities, which benefit us and our stockholders.

To implement a culture of compliance and commitment to operate our business with the highest standards of professional conduct and compliance.

### **Compensation Committee Practices and Procedures**

The Compensation Committee determines and reviews the value and forms of compensation for the Named Executive Officers and other officers based on the Compensation Committee members' general knowledge and experience, as well as, if appropriate, commercially available compensation surveys prepared by third party firms or otherwise generally available. The Compensation Committee is authorized to retain compensation consultants to assist the Committee in its efforts.

The Compensation Committee is delegated all authority of the Board as may be required or advisable to fulfill the purposes of the Compensation Committee. The Compensation Committee meets as often as it deems necessary or appropriate.

### **Role of Executive Officers in Compensation Decisions**

The Compensation Committee makes all compensation decisions for all executive officers (which includes the Named Executive Officers). The Compensation Committee actively considers, and has the ultimate authority of approving, recommendations made by the Chief Executive Officer regarding all equity awards to our employees. Our Chief Executive Officer determines the non-equity compensation of management level employees who are not executive officers or officers.

The Chief Executive Officer annually reviews the performance of each executive officer (other than the Chief Executive Officer whose performance is reviewed by the Compensation Committee). Based on these annual reviews, the Chief Executive Officer makes recommendations to the Compensation Committee with respect to annual base salary adjustments and short- and long-term incentive compensation awards for such executive officers. The Compensation Committee then reviews these recommendations and exercises its discretion in whether to accept such recommendations or to modify such recommendations as it deems appropriate. The Compensation Committee annually reviews the performance of the Chief Executive Officer and determines the total compensation, including base salary, cash bonus and long-term equity compensation, for the Chief Executive Officer. The Chief Executive Officer does not participate in such determination.

### **Setting Executive Compensation**

Based on the foregoing compensation philosophy, the Compensation Committee has structured our annual, short- and long-term compensation to motivate executives to achieve the financial performance objectives we set and to incentivize the executives to achieve and exceed, and to reward the executives for achieving and exceeding, such objectives. During fiscal year 2012, the Compensation Committee retained the services of The Hay Group to provide the Committee with competitive market compensation data for senior management, a comparison of the Company's senior management compensation levels compared to market data and other data and services to assist the Committee in its consideration of the establishment, structure and amount of executive compensation. During fiscal year 2012, The Hay Group did not provide any other services to the Company.

### **2012 Executive Officer Compensation Components**

For the year ended December 31, 2012, the principal components of compensation for Named Executive Officers were:

base salary;

performance-based incentive compensation;

retirement and other benefits; and

perquisites and other personal benefits.

### ***Base Salary***

We provide our Named Executive Officers and other employees with a base salary to compensate them for services rendered during the year. Base salary ranges for Named Executive Officers are determined for each executive officer based on various factors considered by the Compensation Committee, including his or her position and level of responsibility and his or her actual performance during the preceding year. Base salaries for each year are typically evaluated annually in the first quarter of such year. Merit-based increases to base salaries for executive officers are based on the Compensation Committee's assessment of various factors, including the individual's performance during the preceding year and base salary history.

### ***Performance-Based Incentive Compensation***

Our 2005 Employee Stock and Incentive Plan provides the Compensation Committee with the flexibility to design cash and stock-based incentive compensation programs to promote performance and the achievement of our goals and objectives by executive officers and other key employees by allowing them to participate in our long-term growth and profitability. The Compensation Committee believes that providing performance-based incentive compensation is necessary to attract and retain superior executive talent and to align the financial interests of executive officers with those of our stockholders. A portion of each executive officer's potential aggregate compensation is in the form of incentive compensation. There are two types of performance-based incentive compensation used by the Compensation Committee. The first type is short-term incentive compensation in the form of a performance based cash award. The second type is long-term incentive compensation in the form of grants of stock options, performance shares, stock appreciation rights, restricted stock or restricted stock units.

For fiscal year 2012, the Compensation Committee authorized the continuation of the 2011 base compensation and the 2011 management bonus plan (the 2011 Bonus Plan) pursuant to our 2005 Employee Stock and Incentive Plan. Under the terms of the 2011 Bonus Plan, performance based cash awards, if any, were awarded to the Chief Executive Officer and other executive officers, officers and senior management based on, and subject to, the quarterly achievement of a specified performance goal. The performance goal for the 2012 fiscal year was for the Company to exceed, on an individual quarterly basis, the corresponding projected quarterly adjusted earnings before interest, taxes, depreciation, amortization, stock based compensation, and certain other charges contained in the Company's 2012 annual budget (or, in case of a budgeted operating loss, to reduce the operating loss below the budgeted operating loss) (Adjusted EBITDA).

The maximum aggregate amount available to be awarded for any quarter was the sum of the following: (i) fifty percent (50%) of the first Two Hundred Thousand Dollars (\$200,000) in amount by which the Adjusted EBITDA for such quarter exceeded the budgeted Adjusted EBITDA for such quarter (the Excess EBITDA) up to a maximum of One Hundred Thousand Dollars (\$100,000), plus (ii) if the amount of Excess EBITDA for such quarter exceeded Two Hundred Thousand Dollars (\$200,000), twenty percent (20%) of the amount of such excess, provided, however, the total bonus amount under clauses (i) and (ii) for each quarter cannot exceed Two Hundred Thousand Dollars (\$200,000).

During fiscal year 2012, an aggregate of \$733,000 of quarterly performance based cash awards were granted under the 2011 Bonus Plan to the Named Executive Officers, executive officers and officers.

Long-term incentive compensation for each executive officer consists of awards of stock options or other equity grants based on the executive officer's level and scope of responsibility. The Compensation Committee is responsible for the granting of all equity-based compensation, including the award dates for each grant, which is determined in its discretion. Stock options typically vest over a three-year period in quarterly installments. An important purpose of the granting of stock options is to retain executive talent and incentivize the executive team to increase stockholder value. There were no issuances of stock options to any Named Executive Officers, executive officers or officers during 2012.

### ***Retirement and Other Benefits***

Executive officers are eligible to participate in our 401(k) plan and other benefit programs as described below. The Compensation Committee reviews the overall cost to us of these various programs generally on an annual basis or when changes are proposed. The Compensation Committee believes that the benefits provided by these programs have been important factors in attracting and retaining the overall executive officer group, including the Named Executive Officers.



Our 401(k) plan allows for discretionary employer matching funds of the employee contribution. During 2012, the employer match portion was 12%. We do not provide any other retirement benefits or tax-qualified deferred compensation plans or programs for our executive officers.

Executive officers also receive benefit of life insurance policies, which provide coverage in varying amounts up to \$3.0 million.

Executive officers are also entitled to participate in the various other group health, term life and similar benefit plans available to all of our employees and on the same terms as such employees.

#### *Perquisites and Other Personal Benefits*

We provide Named Executive Officers with perquisites and other personal benefits that the Compensation Committee believes are reasonable and consistent with our overall compensation program to better enable us to attract and retain superior employees for key positions.

### **Tax and Accounting Implications**

#### *Deductibility of Executive Compensation*

As part of its role, the Compensation Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Code, which provides that we may not deduct compensation of more than \$1 million that is paid to certain individuals, subject to certain exceptions. We believe that compensation paid in 2012 is generally fully deductible for federal income tax purposes. However, the Compensation Committee may approve compensation that will not meet these requirements in order to ensure competitive levels of total compensation for its executive officers.

### **Compensation for Fiscal Year 2013**

For fiscal year 2013, the Compensation Committee retained the services of The Hay Group to update its 2012 report and assist the Committee in its consideration of the establishment, structure and amount of executive compensation. As of the date of its updated 2013 report, The Hay Group did not provide any other services to the Company. For fiscal year 2013, the Compensation Committee believes that, as compared to fiscal year 2012, a larger component of executive compensation should consist of performance based short and long term compensation, including equity based compensation subject to vesting.

**SUMMARY COMPENSATION TABLE**

The following table sets forth the compensation paid or accrued by the Company to the Company's Chief Executive Officer and to each of the two most highly compensated executive officers of the Company for services rendered to the Company during the two fiscal years ended December 31, 2012:

Name and Principle Position	Period	Salary (1)	Option Awards (2)	Non-Equity Incentive		All Other Compensation	Total
				Plan Compensation (3)			
Mark C. Layton (7) Chairman, Chief Executive Officer	2012	\$ 612,346	\$ 0	\$ 95,290		\$ 79,181(4)	\$ 786,817
	2011	601,548	314,910	\$ 32,290		69,456	1,018,204
Michael C. Willoughby (7) President Chief Information Officer	2012	\$ 451,731	\$ 0	\$ 95,290		\$ 28,496(5)	\$ 575,517
	2011	431,874	178,926	\$ 32,290		27,841	670,931
Thomas J. Madden Executive Vice President Chief Financial Officer	2012	\$ 401,538	\$ 0	\$ 95,290		\$ 38,788(6)	\$ 535,616
	2011	386,244	232,604	\$ 32,290		32,542	683,680

- (1) Salary represents base salary earnings
- (2) Options granted have a ten year term and generally vest quarterly over three years of continuous service after the date of grant. The amounts reported in this column represent the aggregate grant date fair value for stock options granted in each respective year, as calculated under Accounting Standards Codification Topic 718. The assumptions made in calculating the grant date fair value amounts for these stock options are summarized in Note 5 to the Company's consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2012. The amounts in this column do not necessarily correspond to the actual economic value that may be realized by the Named Executive Officers from the options.
- (3) Represents performance based cash awards earned in 2011 and 2012 under the Company's 2011 Bonus Plan.
- (4) Represents amounts paid in respect of life insurance premiums, automobile allowance and expenses for personal use of automobile (\$35,186 and \$34,849 in 2012 and 2011, respectively), club dues and memberships, Company paid healthcare premiums and income tax preparation fees.
- (5) Represents amounts paid in respect of life insurance premiums, automobile allowance and expenses for the personal use of automobile and Company paid healthcare premiums.
- (6) Represents amounts paid in respect of life insurance premiums, automobile allowances and expenses for the personal use of automobile, club dues and memberships and company paid healthcare premiums.
- (7) Effective March 2013, Mr. Layton no longer serves as Chairman and Chief Executive Officer of the Company and Mr. Willoughby serves as Chief Executive Officer.

## OUTSTANDING EQUITY AWARDS AT 2012 FISCAL YEAR END

Name	Grant Date	Option Awards			
		Number of Securities	Underlying Unexercised Options (# Exercisable)	Number of Securities Underlying Unexercised Options (1) (# Unexercisable)	Option Exercise Price (\$)
Mark C. Layton (2)	4/11/2003	13,192			\$ 1.83
	3/29/2004	9,149			\$ 7.57
	4/5/2005	7,660			\$ 12.08
	5/16/2007	4,468			\$ 4.42
	5/20/2008	8,723			\$ 4.14
	5/27/2009	28,250			\$ 1.46
	4/19/2010	37,500		7,500	\$ 4.00
	3/30/2011	51,333		36,667	\$ 5.00
Michael C. Willoughby (2)	4/11/2003	13,192			\$ 1.83
	3/29/2004	9,149			\$ 7.57
	4/5/2005	7,660			\$ 12.08
	5/16/2007	8,511			\$ 4.42
	5/20/2008	8,723			\$ 4.14
	5/27/2009	28,250			\$ 1.46
	4/19/2010	45,833		9,167	\$ 4.00
	3/30/2011	29,167		20,833	\$ 5.00
Thomas J. Madden	4/11/2003	13,192			\$ 1.83
	3/29/2004	9,149			\$ 7.57
	4/5/2005	7,660			\$ 12.08
	5/16/2007	4,255			\$ 4.42
	5/20/2008	8,723			\$ 4.14
	5/27/2009	28,250			\$ 1.46
	4/19/2010	37,500		7,500	\$ 4.00
	3/30/2011	37,917		27,083	\$ 5.00

- (1) The Options Awards listed above are generally subject to a quarterly vesting schedule over a three-year period commencing on the date of grant.
- (2) Effective March 2013, Mr. Layton no longer serves as Chairman and Chief Executive Officer of the Company and Mr. Willoughby serves as Chief Executive Officer.

## EMPLOYMENT, CHANGE OF CONTROL AND TERMINATION ARRANGEMENTS FOR EXECUTIVES

The Company and the named executive officers have entered into Change in Control and Severance Agreements. Under these agreements, and in consideration of certain commitments of the officer to continue employment, upon the occurrence of a change in control, all unvested options held by the officer immediately vest and become exercisable. During the two year period following a change in control (whenever occurring), if the employment of the officer is terminated (other than for cause, death, disability or retirement), or if there is a material adverse change in the officer's responsibilities, compensation or benefits to which the officer does not consent, then, in each case, the officer is entitled to receive from the Company (1) all salary and bonus amounts accrued through the date of termination, (2) a severance payment equal to twice the officer's salary and bonus amount (which is defined as the greater of (i) the highest annual incentive bonus earned by the executive during the last three completed fiscal years or (ii) the executive's then target bonus, if any) and (3) continuation for two years of all employee benefits (unless otherwise provided by a subsequent employer). If applicable, the officer is also entitled to receive an additional payment to compensate the officer for any additional excise tax liability arising by reason of the receipt of such severance or bonus payment. The agreement terminates upon the voluntary resignation or termination of employment by the officer.



The Company and the named executive officers have also entered into Executive Severance Agreements. Under these agreements, and in consideration for, among other things, the agreement by the executive to be bound by a restrictive covenant, in the event of the termination of the employment of the executive other than for cause (including a material adverse change in the officer's responsibilities), the executive is entitled to a severance payment, based on the executive's years of service, up to a maximum of twice the executive's salary and the bonus, if any, that the executive would have received for such fiscal year (based upon the executive's targeted bonus amount and the Company's actual results for such fiscal year), payable in monthly installments over a period not to exceed two years (based on the executive's years of service). In addition, in the event of termination without cause, the executive is entitled to a continuation of benefits and to the accelerated vesting of all options then held by the executive. The severance payment and benefits are reduced by any compensation or benefits received by the executive from any subsequent employer.

Effective as of December 31, 2008, the Company and the named executive officers entered into an amendment to the existing Executive Severance Agreements and Change in Control Severance Agreements between the Company and such persons. The primary purpose of such amendment was to modify such agreements so that they conform to Section 409A of the Internal Revenue Code. In addition, the amendment to the Executive Severance Agreement modified the calculation of the severance amount thereunder so that it is based on the highest annual rate of base salary during the 12-month period immediately prior to the qualifying termination.

In connection with the termination of Mr. Layton's employment and effective as of March 2013, the Company and Mr. Layton amended certain of the terms of the Executive Severance Agreement between the Company and Mr. Layton. The amendment modified certain provisions regarding severance payments payable to Mr. Layton, including the payment of certain additional amounts upon the occurrence of a change in control, and included an additional covenant restricting Mr. Layton from being employed by certain named competitors of the Company. A copy of the amendment was filed as an exhibit to the Company's Form 8-K filed with the SEC on March 29, 2013 and reference is made thereto for a complete description of the terms thereof.

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2012. For additional information about our equity compensation plans, see note 5 to our financial statements in Item 8 of our 2012 Annual Report on Form 10-K:

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options and warrants</b>	<b>Weighted-average exercise price of outstanding options and warrants</b>	<b>Number of securities remaining available for future issuance</b>
Equity compensation plans approved by security holders	2,100,184	\$ 4.55	1,407,231

**2012 DIRECTOR COMPENSATION**

The following table sets forth the compensation earned by non-employee Directors for their service on the Board of Directors and its committees, as applicable, during the year ended December 31, 2012:

	<b>Fees Earned or Paid in Cash</b>	<b>Option Awards (1)</b>	<b>Total</b>
David I. Beatson	\$ 53,500	\$ 17,792(2)	\$ 71,292
James F. Reilly	114,750	17,792(3)	132,542
Dr. Neil W. Jacobs	53,500	17,792(4)	71,292
Timothy M. Murray	47,500	17,792(5)	65,292

(1) Represents aggregate grant date fair value computed in accordance with ASC Topic 718.

(2) Mr. Beatson had 51,277 options outstanding as of December 31, 2012.

(3) Mr. Reilly had 51,277 options outstanding as of December 31, 2012.

(4) Dr. Jacobs had 44,894 options outstanding as of December 31, 2012.

(5) Mr. Murray had 51,277 options outstanding as of December 31, 2012. Mr. Murray resigned from the Board in May 2013.

In June 1999 the Company adopted a Non-Employee Director Stock Option and Retainer Plan (the "Non-Employee Director Plan"). As amended in June 2011, the Non-Employee Director Plan also provides for the issuance to each non-employee director of options to purchase 10,000 shares of common stock as of the date of each annual meeting of stockholders. During calendar year 2012, each non-employee director received an option to purchase 10,000 shares of common stock with an exercise price of \$2.54 per share. The Non-Employee Director Plan also permits the payment of non-employee director retainer fees in shares of Common Stock in lieu of cash.

All options to be issued to non-employee directors under the Non-Employee Director Plan are non-qualified options for federal income tax purposes and have an exercise price equal to the fair market value of a share of common stock as of the date of the annual meeting upon which such option is granted. All options have a ten-year term and are subject to a one-year vesting schedule.

Generally, unless the Non-Employee Director Plan administrator otherwise provides, options are non-transferable other than by will or the laws of descent and distribution. At the time of any merger, consolidation, reorganization, recapitalization, stock dividend, stock split, or other change in the corporate structure or capitalization affecting the Company's common stock, the Non-Employee Director Plan administrator will make appropriate adjustments to the exercise price, number and kind of shares to be issued under the Non-Employee Director Plan and any outstanding options. The Board of Directors has the authority to amend, modify, suspend or terminate the Non-Employee Director Plan at any time.

During 2012 non-employee directors received an annual retainer fee of \$22,000, payable quarterly, a director meeting fee of \$2,500 for each board meeting attended, a committee meeting fee of \$1,500 for each quarterly Audit Committee meeting attended and a committee meeting fee of \$750 or \$1,250 (depending upon the meeting length) for each special committee meeting. The lead director received an additional \$5,000 for each board meeting attended, \$15,000 for serving as chairman of the special committee and \$25,000 for additional services performed for the special committee.

Directors who are also employees of the Company or any of its subsidiaries receive no remuneration for serving as directors or Committee members.

## Security Ownership of Certain Beneficial Owners and Management

The following table sets forth as of May 23, 2013, certain information regarding the beneficial ownership of the Company's Common Stock by (i) each person who is known to the Company to beneficially own more than 5% of the Common Stock, (ii) each of the Directors and named executive officers of the Company individually and (iii) the Directors and executive officers of the Company as a group. The information contained in this table reflects beneficial ownership as defined in Rule 13d-3 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and, as such, also includes shares acquirable within 60 days. Unless otherwise indicated, the stockholders identified in this table have sole voting and investment power with respect to the shares owned of record by them.

Name and Address of Beneficial Owner	Number of Shares	Percent (1)
transcosmos inc. (2) 21-25-18 Shibuya, Shibuya-ku Tokyo 150-8530 Japan	3,214,369	19.9%
Austin W. Marx and David M. Greenhouse (3) 527 Madison Avenue, Suite 2600 New York, NY 10022	2,441,165	15.2%
Privet Fund LP (4) 3280 Peachtree Rd NE Atlanta, GA 30305	1,343,428	8.4%
Thomas J. Madden (5)	191,916	1.2%
Michael C. Willoughby (5)	172,654	1.1%
Cindy Almond (5)	125,575*	
James F. Reilly (5)	69,661*	
David I. Beatson (5)	57,277*	
Dr. Neil W. Jacobs (5)	49,215*	
Benjamin Rosenzweig	*	
Shinichi Nagakura	*	
All directors and executive officers as a group (8 persons) (6)	666,298	4.1%

\* Represents less than 1%

(1) This table is based on 16,079,885 shares of Common Stock outstanding on May 23, 2013.

(2) Based on Form 8-K filed on May 15, 2013.

(3) Based on a January 14, 2013 Form SC 13 D/A joint filing by Austin W. Marx ( "Marx" ) and David M. Greenhouse ( "Greenhouse" ). Marx and Greenhouse share sole voting and investment power over 505,700 common shares owned by Special Situations Cayman Fund, L.P., 1,535,465 common shares owned by Special Situations Fund III QP, L.P., and 400,000 common shares owned by Special Situations Private Equity Fund, L.P.

(4) Based on a May 20, 2013 Form SC 13 D/A filing by Privet Fund LP.

(5) Includes the following outstanding options to purchase the specified number of shares of Common Stock, which are fully vested and exercisable: Thomas J. Madden 151,787; Michael C. Willoughby 154,793; Cindy Almond 112,809; David I. Beatson 51,277; James F. Reilly 51,277; and Dr. Neil W. Jacobs 44,894.

(6) Includes outstanding options to purchase 566,837 shares of Common Stock, which are fully vested and exercisable.

**ITEM 3**

**AMENDMENT TO THE COMPANY'S BYLAWS TO PROVIDE A MAJORITY VOTE STANDARD IN  
UNCONTESTED ELECTIONS OF DIRECTORS**

In order to give shareholders a meaningful role in the director election process, the Board of Directors has unanimously approved the adoption of a new Section 2.8.1 of the Bylaws to provide for a majority vote standard in uncontested elections of directors. A copy of Section 2.8.1 of the Bylaws, as it would be implemented upon stockholder approval of this proposal, is attached as **Appendix B** to this Proxy Statement. If approved by stockholders, the majority vote provision will be in effect for the 2014 Annual Meeting of Stockholders.

Under a majority vote standard, in an uncontested election of directors, each nominee must be elected by a majority of the votes cast (i.e., the votes cast for such nominee's election must exceed the votes cast against such nominee's election). Broker non-votes, if any, and abstentions are not treated as votes cast. In the event an incumbent director receives less than a majority of the votes cast in an uncontested election, such director must tender his or her resignation, whereupon the Nominating Committee and the Board will evaluate such resignation in light of the best interests of the Company and its stockholders and determine whether to accept or reject the resignation, or whether other action should be taken, and, in so doing, may consider any factors they deem relevant in making such determination. If the Board does not accept the resignation, the director who offered to resign will continue to serve on the Board until the next annual meeting of stockholders and until the director's successor is elected and qualified or until the director's death, resignation or removal. If the Board accepts the resignation, the Nominating Committee may recommend to the Board whether to fill the resulting vacancy or to reduce the size of the Board. In any event, the Board will publicly disclose its decision regarding the resignation within 90 days after the results of the election are certified.

**Recommendation and Vote Required**

**The Board unanimously recommends that the stockholders vote FOR this Proposal.**

The proposal to amend the Company's Bylaws to provide for a majority vote standard in uncontested elections of directors requires the affirmative vote of at least 75% of the outstanding shares of the Company's common stock. Abstentions and broker non-votes are treated as votes against the proposal.

**ITEM 4**

**ADVISORY VOTE ON THE COMPENSATION OF  
THE COMPANY'S NAMED EXECUTIVE OFFICERS**

The Company seeks your advisory vote approving the compensation of our named executive officers as disclosed in this Proxy Statement. We believe that our executive compensation programs are structured in the best manner possible to support our business objectives and are designed to provide competitive total compensation that is tied to the achievement of Company performance objectives and to attract, motivate and retain individuals who will build long-term value for our stockholders. See "Executive Compensation" above. Key characteristics of our executive compensation programs include the following:

*Pay for Performance.* Our compensation programs seek to tie pay to performance and a meaningful portion of our executives' compensation is incentive based and contingent upon Company financial performance.

*Pay Competitively.* We are committed to providing an executive compensation program designed to attract, motivate, reward, and retain executive officers with the skills necessary to successfully lead and manage our business.

*Pay Responsibly.* Our compensation program is designed to align the interests of our executive officers with our stockholders and to discourage excessive risk-taking.

We are asking stockholders to approve, on an advisory basis, the compensation of our named executive officers for 2012 as disclosed in the Summary Compensation Table and related compensation tables, notes, and narrative discussion following the compensation tables in this proxy statement. This vote is not intended to address any





specific item of compensation, but rather the overall compensation program for our named executive officers described in this proxy statement. The vote on this proposal is advisory and non-binding; however, the Compensation Committee and the Board will review the results of the vote and consider them when making future determinations regarding our executive compensation programs.

#### **Recommendation and Vote Required**

**The Board unanimously recommends that the stockholders vote FOR this Proposal.**

The non-binding proposal to approve the compensation of the Company's named executive officers requires the affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting. Abstentions are treated as votes against the proposal, while broker non-votes have no effect.

### **ITEM 5**

#### **ADVISORY VOTE TO DETERMINE THE FREQUENCY OF FUTURE ADVISORY VOTES ON**

##### **EXECUTIVE COMPENSATION**

We are seeking an advisory (non-binding) vote from our stockholders to determine the frequency of future advisory votes on the compensation of our named executive officers.

The Board believes that annual (i.e., 1 year) advisory votes will allow the Board to obtain information on stockholders' views of the compensation of our named executive officers on a regular basis, and will provide our Board and Compensation Committee with annual input from stockholders on our compensation program.

Accordingly, we are giving stockholders an opportunity to cast an advisory vote to determine the frequency of future advisory votes on executive compensation. When voting on this proposal, stockholders may indicate whether they would prefer an advisory vote every one, two or three years (or you may abstain).

#### **Recommendation and Vote Required**

**The Board unanimously recommends that the stockholders vote FOR 1 YEAR on this Proposal.**

The non-binding proposal to determine how often to seek the non-binding stockholder approval of the compensation of the Company's named executive officers will be determined based upon which option (1 year, 2 years or 3 years) receives the affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting. If no option receives such affirmative vote, the Company will consider the option that receives the most votes to be the option approved by stockholders. Abstentions and broker non-votes will have no effect upon this proposal.

### **ITEM 6**

#### **RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS**

The Company has appointed Grant Thornton LLP as the Company's independent auditors for the fiscal year ending December 31, 2013. Ratification of the appointment of Grant Thornton LLP as the Company's independent auditors will require the affirmative vote of a majority of the shares of Common Stock represented in person or by proxy and entitled to vote at the Annual Meeting. In the event stockholders do not ratify the appointment of Grant Thornton LLP as the Company's independent auditors, such appointment may be reconsidered by the Audit Committee and the Board of Directors. Representatives of Grant Thornton LLP will be present at the Annual Meeting to respond to appropriate questions and to make such statements as they may desire.

The Board of Directors of the Company recommends a vote FOR ratification of Grant Thornton LLP as the Company's independent auditors for the fiscal year ending December 31, 2013.

**Fees billed to the Company by Grant Thornton LLP for the years 2011 and 2012**

The following table sets forth (i) the aggregate fees billed by Grant Thornton LLP relating to the audit of the 2011 and 2012 consolidated financial statements and (ii) the fees for other professional services billed by Grant Thornton LLP in connection with services rendered during the previous two fiscal years.

Fee Type	2011	2012
Audit fees (a)	\$ 372,200	\$ 407,300
Audit-related fees (b)	60,500	71,550

- (a) Includes fees for professional services rendered in connection with the audit of the annual financial statements, reviews of the quarterly financial statements, fees paid for the audit of the Company's subsidiary, Supplies Distributors, to satisfy requirements of its senior debt agreements and internal control review.
- (b) Consists of aggregate fees billed for assurance services provided in connection with reports on certain internal controls under Statement of Auditing Standards No. 70 and Statement on Standards for Attestation Engagements (SSAE) No. 16.

All of the fees listed in the chart above were pre-approved by the Audit Committee, which concluded that the provisions of such services by Grant Thornton LLP was compatible with the maintenance of that firm's independence in the conduct of its audit functions.

**Policy on Audit Committee Pre Approval of Audit and Permissible Non Audit Services of Independent Registered Public Accountants**

The Audit Committee pre-approves all audit and permissible non-audit services provided by the Company's independent auditors. These services may include audit services, audit related services, tax and other services. Pre-approval is generally provided for up to one year, and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditors and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditors in accordance with this pre-approval and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case by case basis. During 2011 and 2012, all audit, non-audit and tax services provided by Grant Thornton LLP were pre-approved by the Audit Committee in accordance with this policy.

**GENERAL INFORMATION****Voting Procedures**

All matters specified in this Proxy Statement that are to be voted on at the Annual Meeting will be by written ballot. One or more inspectors of election will be appointed, among other things, to determine the number of shares outstanding and the voting power of each, the shares represented at the Annual Meeting, the existence of a quorum and the authenticity, validity and effect of proxies, to receive votes or ballots, to hear and determine all challenges and questions in any way arising in connection with the right to vote, to count and tabulate all votes and to determine the result.

**Admission to Annual Meeting**

Attendance at the Annual Meeting is limited to stockholders. Admission to the meeting will be on a first-come, first-served basis. Registration will begin at 9:30 a.m. and each stockholder may be asked to present valid picture identification such as a driver's license or passport. Cameras, recording devices and other electronic devices will not be permitted at the meeting.

### **Stockholder Proposals for the 2014 Annual Meeting**

A stockholder desiring to submit an otherwise eligible proposal for inclusion in the Company's proxy statement for the 2014 annual meeting of stockholders of the Company must deliver the proposal so that it is received by the Company no later than 120 days prior to the anniversary of the date of the 2013 Annual Meeting. The Company requests that all such proposals be addressed to the Company's Secretary at the Company's principal executive offices, 505 Millennium Drive, Allen, Texas 75013, and mailed by certified mail, return-receipt requested.

### **Compliance with Certain Reporting Obligations**

Section 16(a) of the Exchange Act requires the Company's executive officers, directors and controlling stockholders to file initial reports of ownership and reports of changes of ownership of the Company's Common Stock with the Securities and Exchange Commission and the Company. To the Company's knowledge, all reports required to be so filed were filed in accordance with the provisions of said Section 16(a).

### **Financial and Other Information**

The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 is being sent to stockholders of record as of the Record Date together with this Proxy Statement.

### **OTHER MATTERS**

The Board of Directors knows of no matters other than those described in this Proxy Statement that are likely to come before the Annual Meeting. If any other matters properly come before the Annual Meeting, or any adjournment thereof, the persons named in the accompanying form of proxy intend to vote the proxies in accordance with their best judgment.

By Order of the Board of Directors,

/s/ Cindy Almond

Cindy Almond

*Secretary*

Allen, Texas

June \_\_, 2013

**Article TENTH of the Certificate of Incorporation and Section 3.2 of the Bylaws**

1. Except as otherwise provided in the Certificate of Incorporation or the General Corporation Law of the State of Delaware, the business and affairs of the Corporation shall be managed by or under the direction of a Board of Directors consisting of such number of members as may be fixed, subject to the rights of the holders of any series of Preferred Stock then outstanding, from time to time, by the affirmative vote of the majority of the members of the Board of Directors of the Corporation, but not less than the minimum number authorized by the State of Delaware.

2. Subject to the rights of the holders of any series of Preferred Stock then outstanding:

(a) Until the election of directors at the 2015 Annual Meeting of Stockholders, the Board of Directors shall be divided into three classes of directors, as nearly equal in number as possible. Subject to the provisions set forth below and Sections 3 and 4 of this [Article TENTH] [Section 3.2], each class of directors shall be elected for a three-year term and the terms of each class shall be staggered so that only one class of directors will be elected at each annual meeting of stockholders.

(b) Each director elected at the 2013 Annual Meeting of Stockholders shall be elected for a one-year term and shall hold such office until the term for which they were elected or appointed expires and their successor is duly elected and qualified, or until their earlier death, resignation or removal from office.

(c) Each director serving as a director immediately following the 2013 Annual Meeting of Stockholders, or elected or appointed thereafter, shall hold office until the term for which they were elected or appointed expires and their successor is duly elected and qualified, or until their earlier death, resignation or removal from office.

(d) Each director elected at the 2014 Annual Meeting of Stockholders shall be elected for a one-year term and shall hold such office until the term for which they were elected or appointed expires and their successor is duly elected and qualified, or until their earlier death, resignation or removal from office.

(e) From and after the election of directors at the 2015 Annual Meeting of Stockholders, the Board of Directors shall cease to be classified and all directors shall be elected for one-year terms expiring at the next annual meeting of stockholders.

3. Subject to the rights of the holders of any series of Preferred Stock then outstanding:

(a) Until the 2015 Annual Meeting of Stockholders, any director, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of at least a majority of the voting power of all of the shares of the Corporation entitled to vote for the election of directors. For purposes of this [Article TENTH][Section 3.2], cause for removal shall be construed to exist only if the director whose removal is proposed has been convicted of a felony by a court of competent jurisdiction or has been adjudged by a court of competent jurisdiction to be liable for negligence or misconduct in the performance of his duty to the Corporation in a matter of substantial importance to the Corporation.

(b) From and after the 2015 Annual Meeting of Stockholders, any director, or the entire Board of Directors, may be removed from office at any time, with or without cause, only by the affirmative vote of the holders of at least a majority of the voting power of all of the shares of the Corporation entitled to vote for the election of directors.

4. Subject to the rights of the holders of any series of Preferred Stock then outstanding:

(a) Newly created directorships resulting from any increase in the authorized number of directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause shall be filled by a majority vote of the directors then in office.

(b) Until the election of directors at the 2015 Annual Meeting of Stockholders, each director chosen to fill a vacancy in the Board of Directors shall receive the classification of the vacant directorship to which he or she has been appointed or, if it is a newly created directorship, shall receive the classification that at least a majority of the directors

then in office designate and shall hold office until the first meeting of stockholders held after his or her appointment for the purpose of electing directors of that classification, and until his or her successor is duly elected and qualified or until his or her earlier death, resignation or removal from office.

(c) From and after the 2015 Annual Meeting of Stockholders, each director chosen to fill a vacancy in the Board of Directors shall hold office until the first meeting of stockholders held after his or her appointment for the purpose of electing directors and until his or her successor is duly elected and qualified or until his or her earlier death, resignation or removal from office.

**EXHIBIT B**

**Section 2.8.1 of the Bylaws**

2.8.1 **Majority Vote Provision.** At the 2014 annual meeting of stockholders and at each annual meeting thereafter, the stockholders shall elect directors by a majority of the votes cast unless the number of nominees exceeds the number of directors to be elected, in which case the directors shall be elected by a plurality of the shares represented in person or by proxy at such meeting and entitled to vote on the election of directors. A majority of votes cast means that the number of shares entitled to vote on the election of directors and represented in person or by proxy at such meeting casting their vote for a director must exceed the number of such votes cast against that director. Broker non-votes, if any, and abstentions shall not be treated as votes cast. If a nominee for director, who is not serving as a director of the Corporation at the time of such election, does not receive a majority of the votes cast at a meeting of stockholders for the election of directors, such nominee shall not be elected. If a nominee for director, who is serving as a director of the Corporation at the time of such election, does not receive a majority of the votes cast at a meeting of stockholders for the election of directors, such nominee shall tender his or her resignation to the Board of Directors. The Nominating Committee shall then make a recommendation to the Board of Directors as to whether to accept or reject the resignation. The Board of Directors will consider the Nominating Committee's recommendation and such other factors as it deems appropriate, and publicly disclose (by press release, filing of a Form 8-K with the Securities Exchange Commission or any other means of public disclosure) its decision and the reasons for it within 90 days from the date that the election results are certified. The director who tenders his or resignation will not participate in the Board's decision.

**PFSweb, Inc.**

**Electronic Voting Instructions**

**Available 24 hours a day, 7 days a week!**

Instead of mailing your proxy, you may choose one of the voting methods outlined below to vote your proxy.

VALIDATION DETAILS ARE LOCATED BELOW IN THE TITLE BAR.

**Proxies submitted by the Internet or telephone must be received by 11:59 p.m., Eastern Time, on July 02, 2013.**

**Vote by Internet**

Go to **[www.investorvote.com/PFSW](http://www.investorvote.com/PFSW)**

Or scan the QR code with your smartphone

Follow the steps outlined on the secure website

**Vote by telephone**

Call toll free 1-800-652-VOTE (8683) within the USA, US territories & Canada on a touch tone telephone



Follow the instructions provided by the recorded message

Using a **black ink** pen, mark your votes with an **X** as shown in this example. Please do not write outside the designated areas.

**IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.**

q

**A** **Proposals** The Board of Directors recommends a vote **FOR** all the nominees listed and **FOR** Proposal 2 - 5.

**For Against Abstain** +

1. Amendment to Certificate of Incorporation

.. ..

2. Election of Directors: **For Withhold**

01 - Dr. Neil W. Jacobs

.. ..

02 - Benjamin Rosenzweig

**For Withhold**

.. ..

3. Majority Vote **For Against Abstain**

.. ..

4. Advisory Vote on Executive Compensation

**For Against Abstain**

.. ..

5. Advisory Vote **1 Year 2 Years 3 Years Abstain**

.. ..

on Frequency of Advisory Vote on Executive Compensation

6. Ratification of Auditors

.. ..

**In their discretion, the proxies are authorized to vote upon such other business as may properly be presented at the meeting OR any adjournments or postponements thereof.**

**B Non-Voting Items**

**Change of Address** Please print new address below.

**Comments** Please print your comments below.

**C Authorized Signatures** This section must be completed for your vote to be counted. **Date and Sign Below**  
NOTE: Please sign as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

Date (mm/dd/yyyy)	Signature 1	Signature 2
/	Please keep	Please keep
/	signature within the box.	signature within the box.

**Important notice regarding the Internet availability of proxy materials for the Annual Meeting of Stockholders.** The Proxy Statement and the 2012 Annual Report to Stockholders are available at:

**<http://www.pfsweb.com/investor-relations/proxy-materials>**

**q IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.**

q

**Proxy PFSweb, Inc.**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned hereby appoints Thomas J. Madden and Cindy Almond as proxies, with power to act without the other and with power of substitution, and hereby authorizes them to represent and vote, as designated on the other side, all the shares of stock of PFSweb, Inc. standing in the name of the undersigned with all powers that the undersigned would possess if present at the Annual Meeting of Stockholders of the Company to be held July 3, 2013 or any adjournment thereof.

**This Proxy when properly executed will be voted in the manner directed herein by the undersigned stockholder. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED **FOR EACH PROPOSAL.****

**(Continued and to be marked, dated and signed, on the other side)**