

ON POINT

TIMELY, ACCURATE, INSIGHTFUL

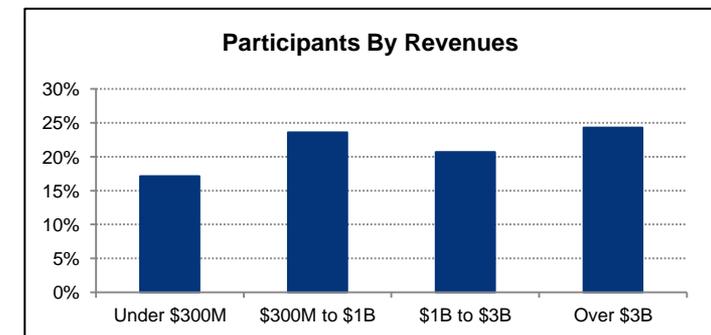
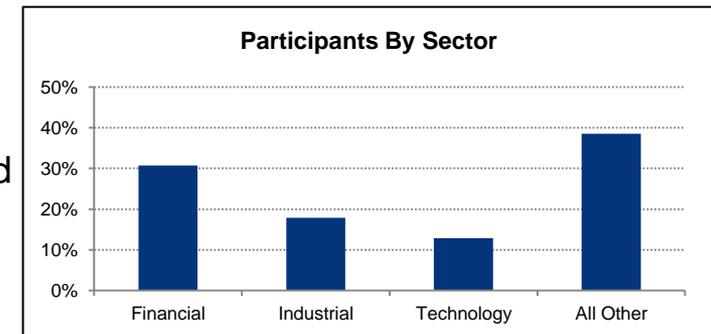
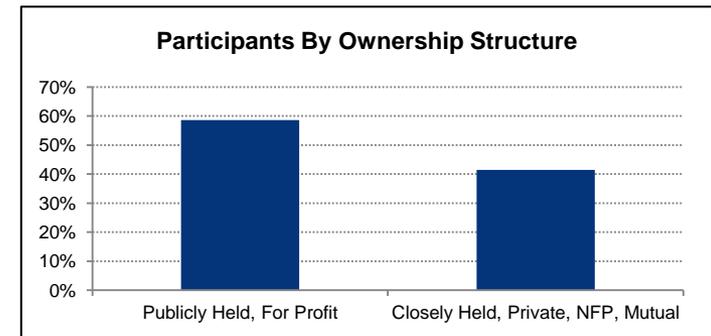
PM&P On Point: **Annual Incentive Plans for Top Corporate Officers** Executive Summary

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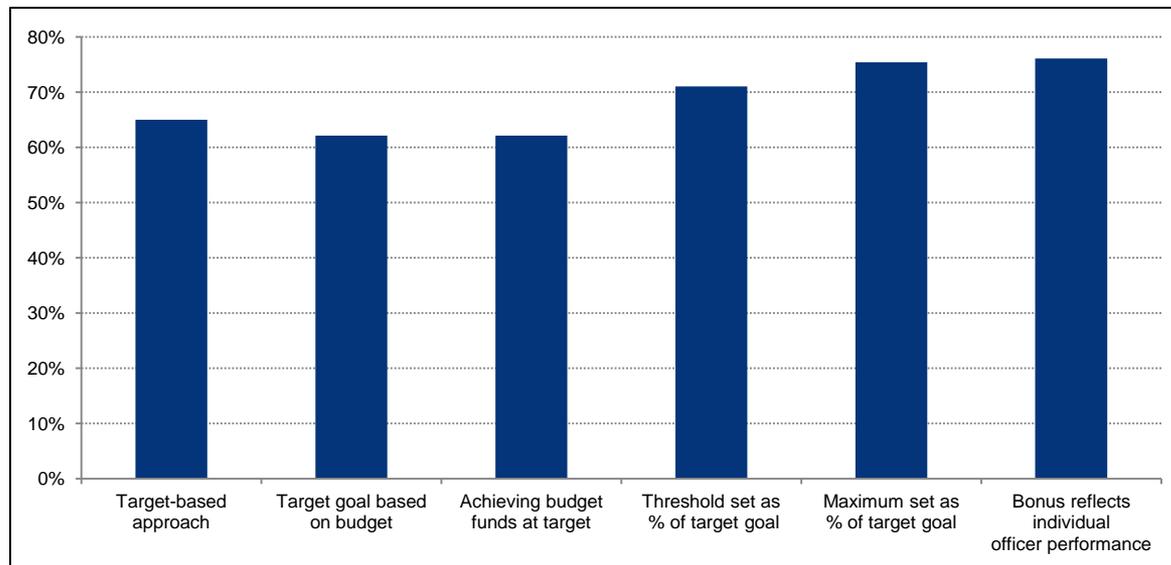
Introduction

- This survey was designed to provide insight to how companies design annual incentive plans for top corporate officers. These plans often represent the most tangible indication of how executive compensation is linked to organization performance.
- The survey was conducted online between May 23, 2013 and June 19, 2013.
- There were 140 survey participants, of whom 60% responded as employees at their reported organization and 40% as outside Directors of their company.
- Participants represent a wide variety of industry sectors and size. Approximately 59% of respondents represent publicly-traded companies.
- The complete results are available for purchase at www.pearlmeier.com.
- Please contact Jim Heim to discuss any aspects of these findings at jim.heim@pearlmeier.com or 508-630-1502.



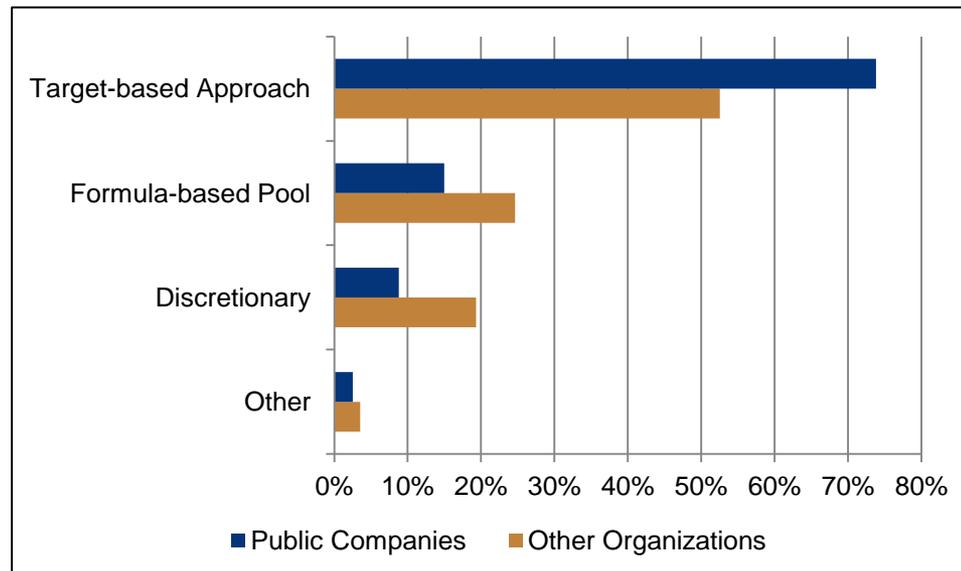
Overall

- Survey responses generally confirm that “conventional wisdom” regarding common design areas is the most prevalent. However, responses also show that many organizations deviate from the norm in some area.
- Common design features regarding top executive officer bonus plans include:
 - Bonus opportunity expressed as a target (usually percentage of salary)
 - Target financial goals based on the Board-approved budget
 - Achieving the budget corresponding to earning or funding a target bonus (subject to weighting of goals)
 - Threshold and maximum goals set as a percentage of the target goal that is usually consistent year-over-year
 - Final bonus determinations reflecting individual officer performance considerations



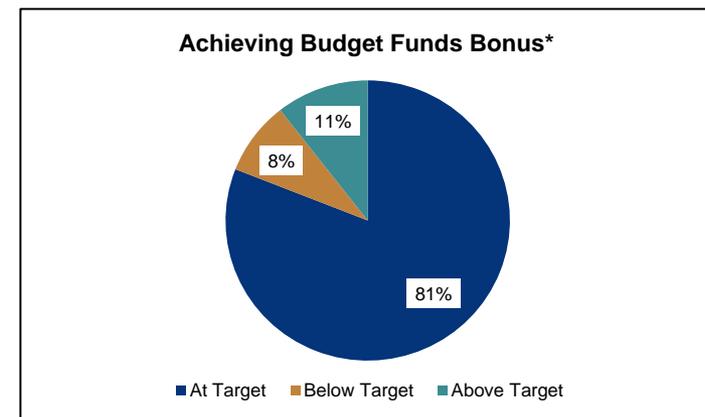
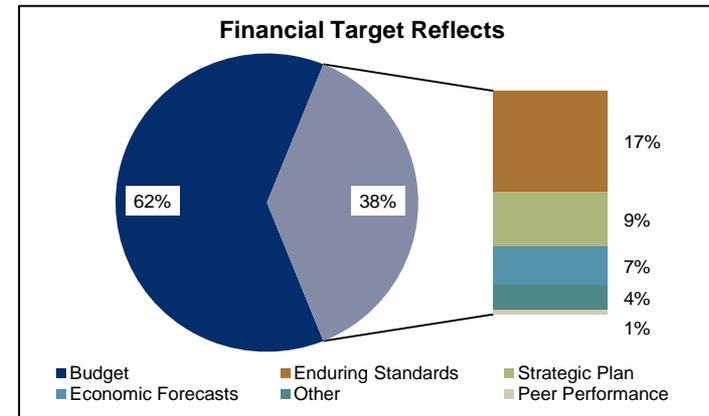
Design

- The most common approach is target-based, in which participants are assigned a target bonus opportunity and actual bonuses vary from target based on goal achievement.
 - The next most prevalent approach is a formula-based pool, in which the bonus pool is equal to X% of operating income over some specified level.
 - Private companies, not-for-profits and mutuals are more likely than public companies to have alternative designs.



Target Financial Performance Goals

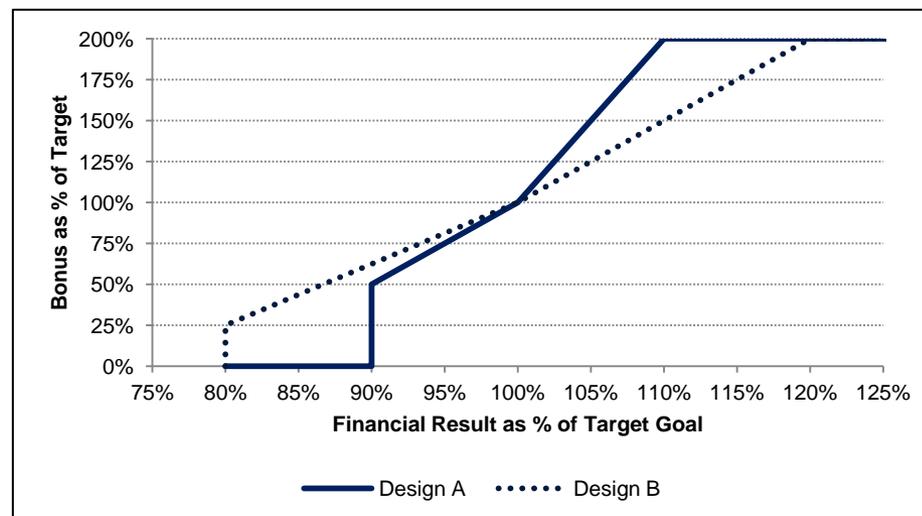
- The most common practices are to base financial goals on the budget or to fund bonuses at target if the target goal is achieved.
- Some organizations use an enduring standard, such as 10% growth or 15% return on capital.
- Few companies use economic forecasts or industry peers to set goals.
- Regardless of how the bonus plan works, the most common definition of “a good year” is when financial results meet or exceed the internal budget or plan.



*of companies that set financial goals using the budget

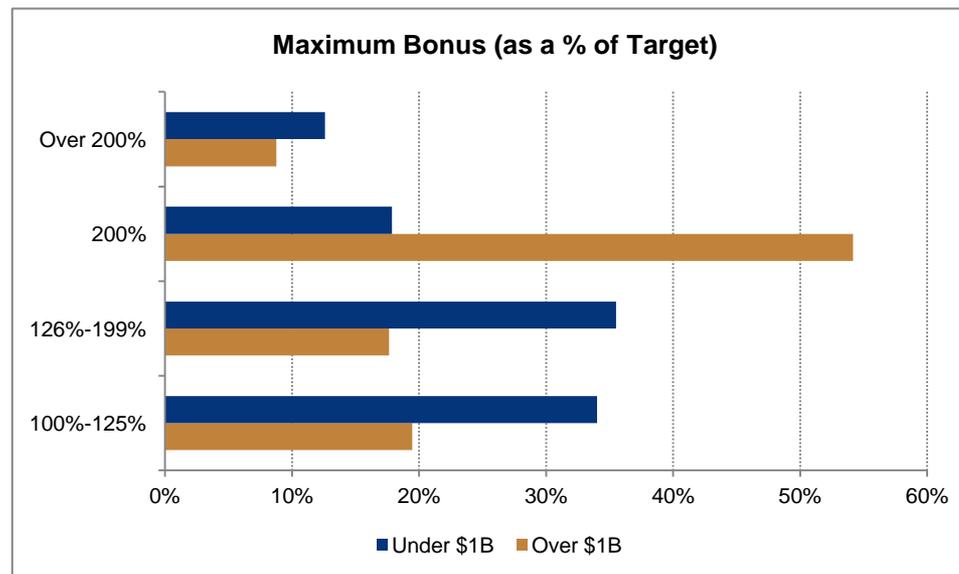
Threshold/Maximum Goals

- By far, the most common approach is to set the threshold and maximum goals as a consistent percentage of the target goal from year-to-year.
- It's rare that financial results precisely equal the target goal. Bonus outcomes are largely determined by how these threshold and maximum goals are established and calibrated to bonus payouts (as a percentage of target).
- The chart below illustrates the importance of this issue.
 - Design A sets the threshold at 90% of the target goal and funds at 50% of the target award; the maximum goal is 110% of the target goal and funds at 200% of the target award.
 - Design B sets the threshold at 80% of the target goal but funds only at 25% of the target award; the maximum goal is set at 120% of the target goal with funding at 200% of the target award.
 - Because of its “wider” ranges, Design B is less likely to result in payouts of either zero or maximum. Also, the relationship between results achieved and bonus funding is far less leveraged in Design B as compared to Design A.



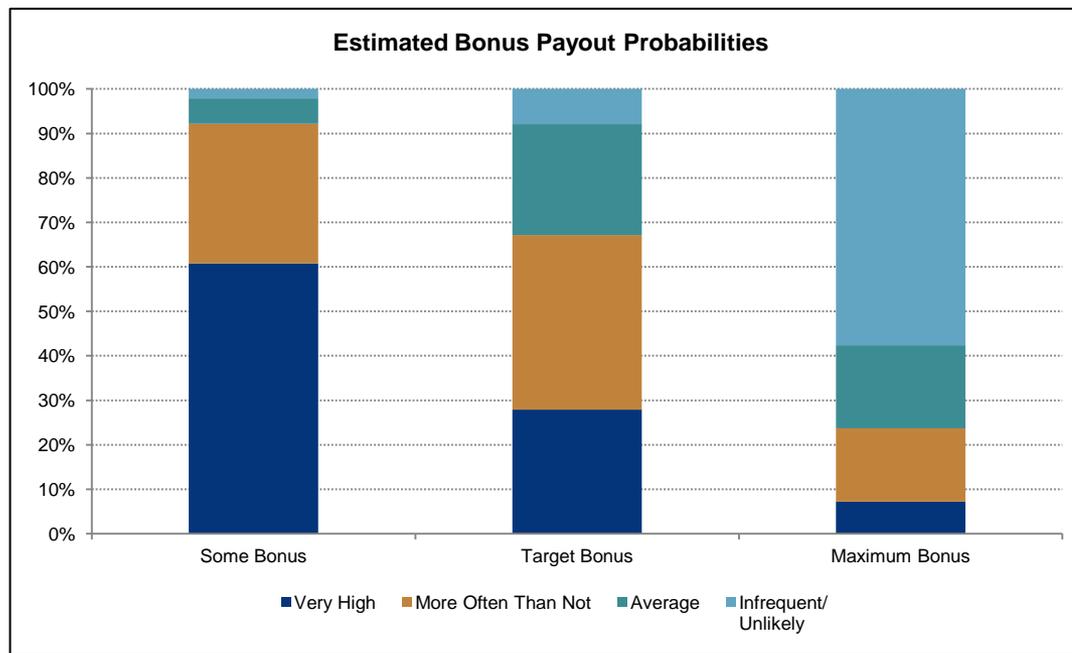
Maximum Bonus Opportunity

- Larger companies (revenues over \$1 billion) typically set the maximum bonus opportunity at 200% of the target for top officers.
- Smaller companies commonly have maximum bonus opportunities of either 125% or 150% of the target award.
- Only one public company respondent reported an unlimited bonus opportunity.
 - 162(m) requires a limit on potential bonuses for officers in order for them to qualify as “performance-based compensation” and remain fully deductible for tax purposes.
 - Public companies are required to disclose information related to compensation program risk, and caps on individual incentive opportunities are considered to be a “risk mitigator.”



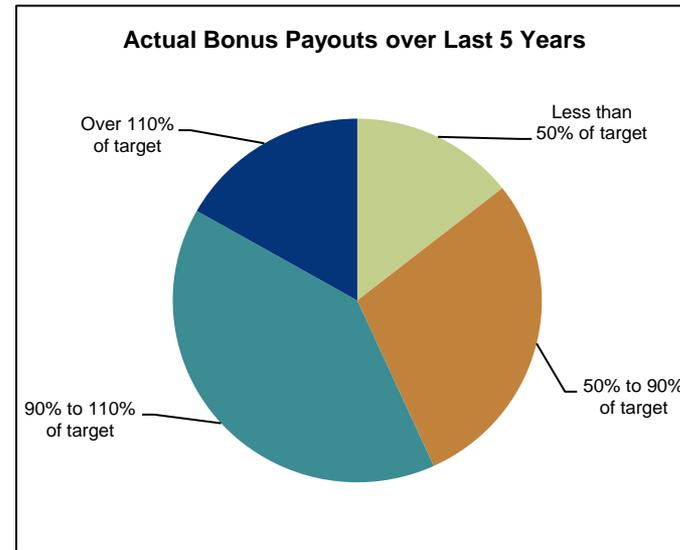
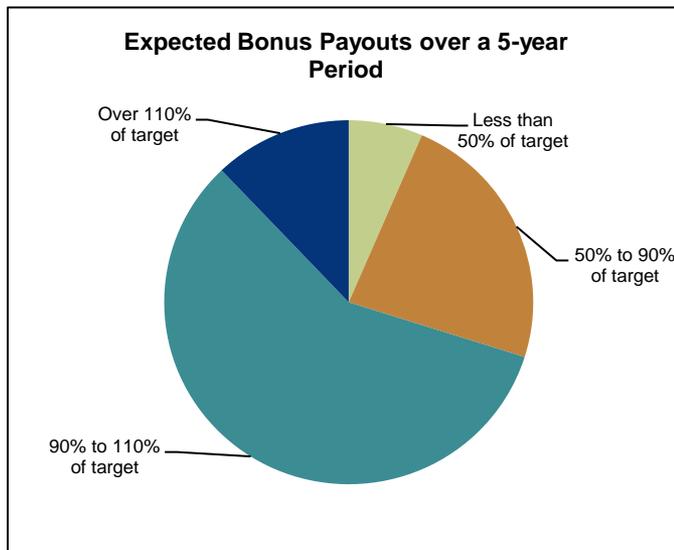
Calibration Philosophy

- Responses indicate that current designs at many companies may facilitate “feast or famine” outcomes.
 - Conventional wisdom is that a bonus plan design should have a reasonable probability of at least a target payout, and relatively low probabilities of either zero or maximum payout.
 - While survey results generally support this expectation, a significant number of companies reported a relatively high chance of either a zero or maximum payout.



Calibration Philosophy (continued)

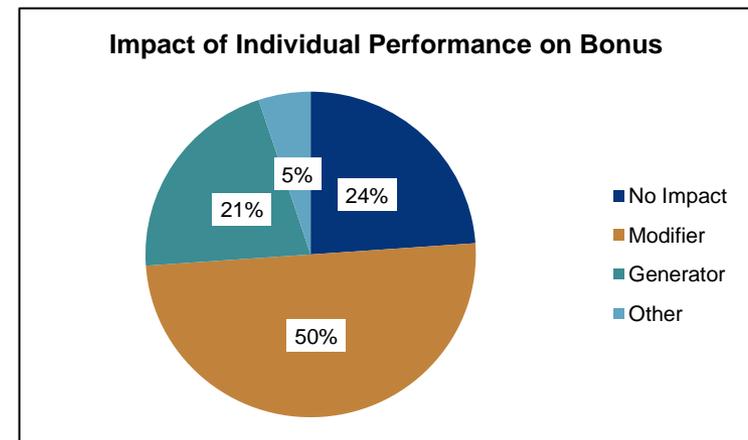
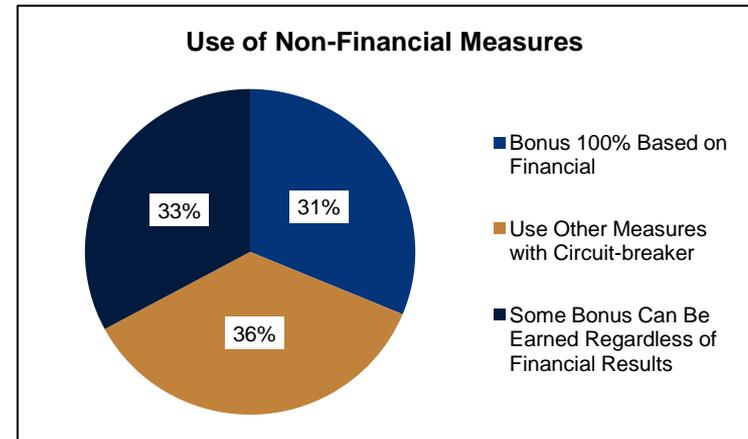
- Participants confirmed that in general, the “expected payout” from bonus plans is the target bonus.
 - Over 90% of participants stated that the probability of a target bonus payout is “average or better.”
 - Nearly 70% of respondents said that the average payout over a five-year period should be 90% of the target bonus or higher.
 - However, only 58% of participants reported that the actual average payout over the last five years has been 90% of target or higher. This may be a reflection of the recent economic recession.



Non-financial Performance

- Only one-third of participants report that top officers can earn bonuses even if overall financial results fall below the minimum/threshold goal.
 - A third report that bonuses can be earned based on non-financial result, but only if the threshold financial goal is achieved. This design feature is often referred to as a “circuit breaker.”
 - The remaining companies base top officer bonuses solely on financial performance results.

- Most companies do consider individual officer performance in determining bonuses, usually modifying on the basis of financial performance results.
 - Only one out of five participants reported that top officers can earn some bonus based on individual performance or contributions, regardless of results in other areas.



About Pearl Meyer & Partners

For 25 years, Pearl Meyer & Partners (www.pearlmeyer.com) has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. The firm provides comprehensive solutions to complex compensation challenges for multinational companies ranging from the Fortune 500 to not-for-profits as well as emerging high-growth companies. These organizations rely on Pearl Meyer & Partners to develop global programs that align rewards with long-term business goals to create long-term value for all stakeholders: shareholders, executives and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, San Francisco and San Jose, as well as an office in London.

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