NACD Arizona Chapter Meeting

Executive Compensation and Benefit Trends under Dodd-Frank

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Context: Recent Influencers on Executive Compensation

2002-5

- Sarbanes Oxley Act (2002)
- IRC Section 409A (2004)
- FAS 123R (2004-5)

2006-9

- SEC/proxy rule changes (2006)
- Rising influence of shareholder advisory firms, i.e. ISS, Glass Lewis (2006-?)
- Financial crisis spurs focus on exec. comp. (2008-9)

2010-present

- Dodd-Frank Act
- Say on Pay

Impacts on Executive Compensation

Shift in equity—from stock options to time-vested restricted stock to performance-based equity

- Driven first by accounting rule changes then by shareholder advisors

Increase in formulaic incentives; decrease in discretion

- Hastened by disclosure rule changes and shareholder advisors

LTI plans – increase in relative TSR plans

- Driven by shareholder advisors; trend toward a one-size-fits-all approach?

Governance impacts

- Heightened standards of independence and authority for the Compensation Committee
- More transparency regarding executive compensation and Committee decision-making
  - Increased visibility and scrutiny of executive compensation
- Greater focus on communicating with shareholders regarding executive compensation
  - Proxy CD&A as a marketing/communication tool with respect to compensation and link to company performance
  - Shareholder/institutional investor outreach as part of the Committee's purview

Dodd-Frank Act Update

The SEC has issued final rules and effective dates for only three of seven Dodd-Frank Act (DFA) compensation provisions

Provision	Effective	Current Known Status or Scheduled Action
Compensation Committee & Adviser Independence; Committee's Oversight Authority	In effect	SEC issued Final Rules June, 2012 Exchanges issued proposed rules Sept. 25, 2012 SEC finalized the NYSE & NASDAQ listing standards related to compensation committees and their advisors January 16, 2013 Advisor independence & charter: Effective July 1, 2013 Committee independence: Effective earlier of (1) first annual meeting after 01/15/14, or (2) 10/31/14
Disclosure of Compensation Consultant Conflict of Interest	In effect	SEC issued Final Rules June, 2012 Effective for 2013 proxy season
Disclosure of COB/CEO Roles	In effect	Effective for 2011 proxy season

Dodd-Frank Act Update (cont'd)

SEC Proposed Pay Ratio Rules

- On September 18, 2013, the SEC voted 3-2 in favor of a new proposed rule to be finalized following a comment period
  - The rule is likely to be first effective for the 2016 proxy statement
- The proposed rules would require companies to disclose:
  - The median annual total compensation of all employees of the issuer, excluding the CEO
  - The annual total compensation of the issuer's CEO
  - The ratio of those two amounts, e.g., "1 to 200"
- The SEC has proposed some flexibility in determining the median employee
  - Companies may either use the entire employee population or a statistical sampling
  - Additionally, companies may use compensation data as determined by the Summary Compensation Table (SCT) or by any other consistently used measure (e.g., payroll or tax records) to identify this employee
- Total compensation used to calculate the ratio is to be determined under the SCT rules, although companies may use reasonable estimates when calculating for the median employee

Dodd-Frank Act Update (cont'd)

Remaining DFA-mandated provisions, rules and effective dates are still pending

Provision	Effective	Current Known Status or Scheduled Action
Internal Equity (CEO Pay Ratio) Disclosure	None stated	Proposed Rules issued September 2013 Comment period closed December 2013 Final rules likely not effective until 2015 proxies (early 2016)
Clawback Policy	None stated	Final and Proposed Rules "pending" per SEC Likely not effective until 2014-15
Pay-for-Performance Disclosure	None stated	Final and Proposed Rules "pending" per SEC Likely not effective until 2014-15
Disclosure of Hedging Policies	None stated	Final and Proposed Rules "pending" per SEC Likely not effective until 2014-15

Shareholder Advisor Perspectives

ISS and Glass Lewis – Guiding Principles for "Say on Pay" (SOP) Vote Recommendations

- Regardless of the test, ISS and Glass Lewis ("the Advisors") intend to "move the market" on compensation issues in the direction that their clients desire
- Both prioritize an assessment of pay (as they define it) relative to performance achieved and against a peer group (that they have defined)
  - Developing appropriate Peers takes on increased importance in light of new approaches

TSR, especially relative to their defined peer group, drives the recommendations of the Advisors

- Any performance lag relative to the Advisors' peers will increase the probability of an "Against" vote recommendation

Shareholder Advisor Perspectives (cont'd)

ISS and Glass Lewis peer group development

- The Advisors take different approaches to peer group selection and pay for performance analysis

Parameter	ISS	Glass Lewis
Selection criteria (universe)	GICS groups; in order: • Company's 8-digit GICS • Peers' 8-digit GICS • Company's 6-digit GICS • Peers' 6-digit GICS • Company's 4-digit GICS	"Market-based peers" (per Equilar methodology): • Self-disclosed peers • Peers of self-disclosed peers • Strength of connections
Peer company size parameters	Revenues: **0.4 – 2.5x** Market cap buckets (0.25x low to 4x high): • $0 – 200M • $200M - 1B • $1B - 10B • $10B+	Not disclosed; peer group structured such that Company is near the median
# of peers	14-24	15-30
Basis for relative pay / performance comparison	3-year TSR	3-year TSR, change in cash flow, EPS growth, ROE, ROA

Shareholder Advisor Perspectives (cont'd)

While methodologies differ, the Advisors are looking at:

- Pay opportunity relative to peer pay as related to relative company performance
- The overall magnitude of pay
- The direction of pay relative to the direction of company performance

Both Advisors reserve the right to recommend an Against vote for a variety of additional reasons

Shareholders seem in many cases to be treating SOP as a referendum on Company performance (TSR)

- As a result, passing in one year is no guarantee of passing in the next
- There may be a limit to what companies can do to avoid a negative SOP outcome if stock price performance is substandard

Above-average TSR, or passing the Advisors' pay for performance tests does not guarantee a For recommendation

Shareholder Advisor Impact on SOP

ISS Recommendations continue to have a significant impact on vote results

Impact of ISS Vote Recommendations*

- ISS vote recommendations (% For vs. % Against) have been relatively consistent: "Against" recommendation issued for ~11% of 2013 SOP votes
- The average SOP approval rate when ISS issues a "For" vote recommendation is 93%; when ISS issues an "Against" rec., SOP approval is only 68%

SOP Vote Result Distribution*

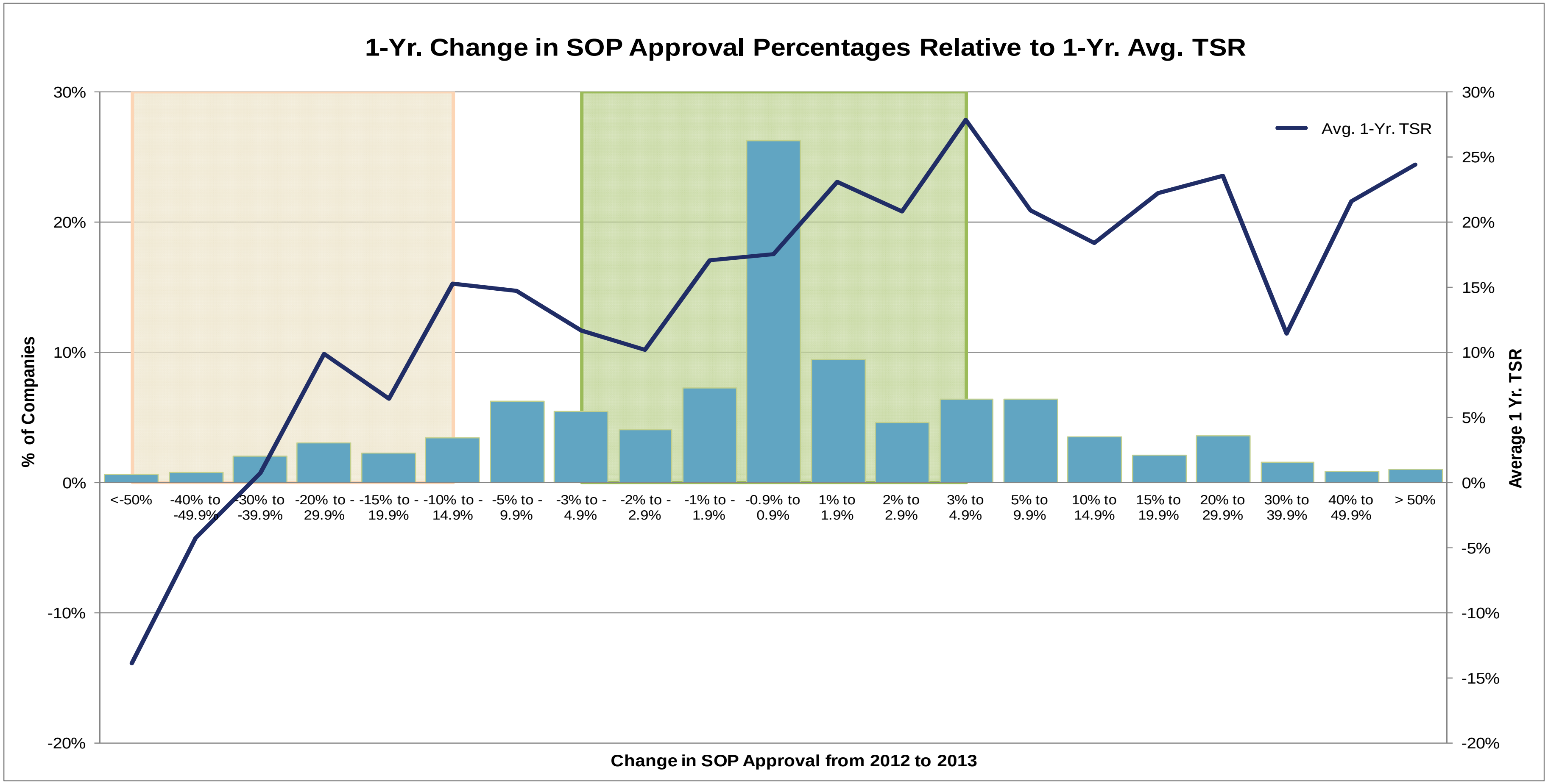
- The % of companies that failed SOP in 2013 is similar to 2012; well below the # of ISS "Against" recommendations; more companies are in the "danger zone" of passing with <70% approval
- A similar % of Top 200 companies fail SOP, and have lower approval levels with an ISS "Against" rec.

Say-on-Pay Results and Impact of ISS	2011	2012	2013 (through 12/31/2013)	2013 Top 200
# of companies disclosing SOP results	3,293	2,683	3,375	181
Shareholder Support:				
Overall average shareholder support	90%	89%	90%	88%
% of companies receiving less than 50% shareholder support	1.50%	2.40%	2.10%	2.21%
ISS Vote Recommendations:				
% of companies ISS recommended "For"	89%	88%	88%	88%
% of companies ISS recommended "Against"	11%	12%	11%	12%
Impact of ISS Vote Recommendations:				
Average shareholder support with **positive** ISS recommendation	93%	93%	93%	92%
Average shareholder support with **negative** ISS recommendation	69%	65%	68%	59%
Average shareholder support for companies issuing rebuttal after negative ISS recommendation		61%	63%	69%
Average support for companies that ISS recommended "For" in prior year and "Against" in current year (2012 and 2013)		63%	65%	62%

Shareholder Advisor Impact on SOP (cont'd)

Year-over-year changes in SOP approval levels

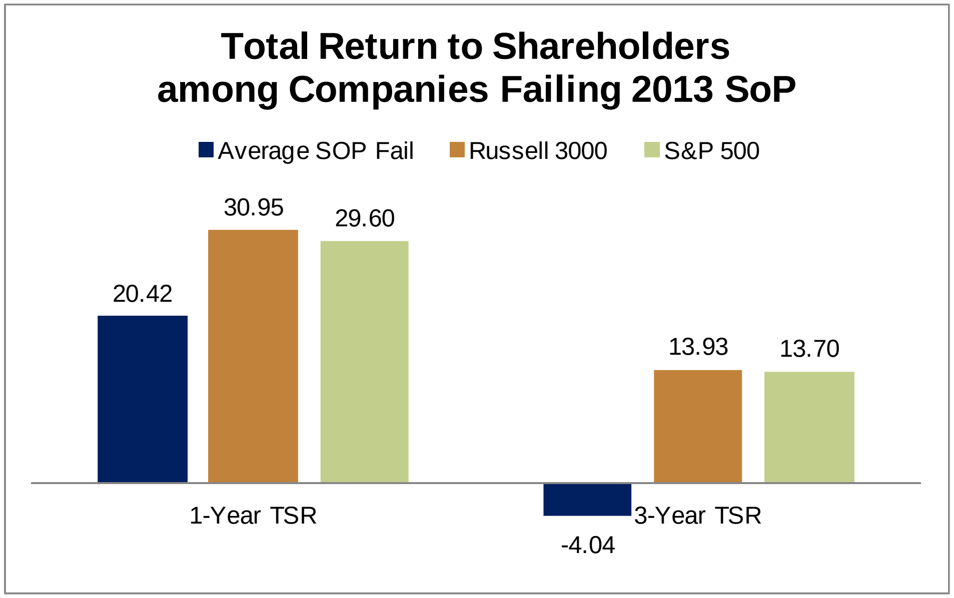
- 62% of companies had less than +/- 5% change in their SOP approval in 2013; while 12% of companies had a -10% change (or greater)
  - Those with the most negative Y-O-Y changes had the lowest average 1-year TSRs



Shareholder Advisor Impact on SOP (cont'd)

Both ISS and shareholders appear to be strongly influenced by the performance of the company

- 1-year TSR among companies failing 2013 SoP was 20% on average, trailing the Russell 3000 and S&P 500 by roughly 10%
- 3-year TSR was **-4%** on average, compared with roughly 14% for the Russell 3000 and S&P 500



Shareholders seem in many cases to be treating SOP as a referendum on Company performance (TSR)

Taking Your Case to Shareholders

Shareholder outreach planning process

Process	Activities	Timeframe
Assess vote results	Assess communication materials (proxy, supplemental); areas to improve Review Advisor commentary; errors/misinterpretations Assess need for program changes and/or response	Immediately following shareholder vote (May - June)
Conduct shareholder outreach	Understand voting and rationale Gather comments/input	June - July
Consider program changes and/or potential responses	Analyses and modeling Response outline	July - October
Pre-test changes and/or response; approve final changes	Meetings/calls with shareholders; shareholder advisors (ISS, GL) Committee approval of changes	October - December
Preliminary ISS CEO pay-for-performance modeling	Preliminary modeling to estimate results of ISS p4p quantitative tests Inform decision-making with respect to compensation; prepare for proxy communications	December - January
Proxy planning/drafting	Craft proxy highlighting changes and/or responses Executive summary; realizable pay and other analyses to effectively tell story	January – March/April

CEO Compensation Trends

PM&P annually conducts an analysis of CEO pay among "Top 200" companies

- Revenues > $10 billion
- Leaders in terms of executive compensation and governance trends

Since 2009 we have conducted a similar analysis of CEO pay among Mid-Sized companies—revenues of $1-3 billion

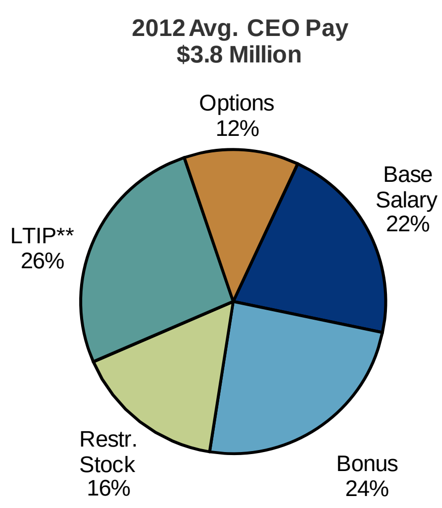
- 2012 study included 291 companies with median revenues of $1.47 billion

The following pages summarize CEO pay trends among these mid-sized companies

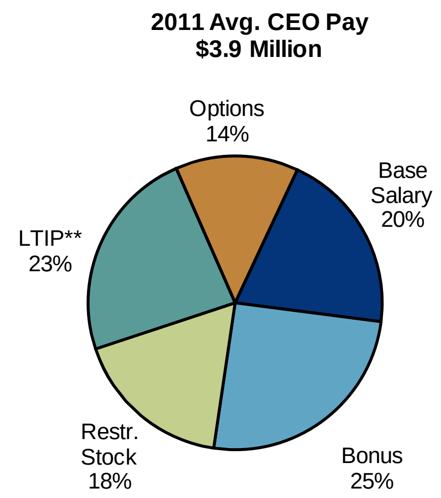
2012 vs. 2011 – CEO Pay Mix

Review of year-over-year CEO pay mix suggests:

- Continued emphasis on long-term pay (>50% of total)
- LTI programs are placing greater emphasis on performance vehicles over retention vehicles



Pay Mix: 46% Annual / 54% Long-Term
LTI Mix: 30% RS / 48% LTIP / 22% Options



Pay Mix: 45% Annual / 55% Long-Term
LTI Mix: 32% RS / 43% LTIP / 25% Options

Notes:

* Based on 291 companies, by revenue, within the Russell 2000. Represents 2012 and 2011 compensation data for the 202 of 291 companies that had the same CEO in both years. Median 2012 revenues: $1.47 billion; median market capitalization: $1.09 billion.

** Includes performance share/unit/cash plans and performance-based restricted stock ("PBRS")

2012 vs. 2011 – Changes in CEO Pay

Median 2012 CEO total compensation was 3.2% *__lower__* than 2011, driven by lower bonuses and overall equity values

	Same CEO Y-O-Y - 202 Companies							
	Median			Average			Prevalence	
	2012	2011	% Change	2012	2011	% Change	2012	2011
Base Salary	$802	$788	+1.8%	$811	$786	+3.3%	100%	100%
Annual Incentive Payout	678	733	-7.5%	921	988	-6.8%	88%	90%
Total Cash	**$1,494**	**$1,502**	**-0.5%**	**$1,723**	**$1,764**	**-2.4%**	**100%**	**100%**
Tgt. LTIP & PBRS	651	470	+38.6%	999	919	+8.7%	67%	61%
Restricted Stock (Time-Based)	290	327	-11.4%	610	687	-11.2%	57%	64%
Stock Options	0	0	+0.0%	462	528	-12.5%	46%	49%
Total LTI	**$1,748**	**$1,865**	**-6.3%**	**$2,052**	**$2,115**	**-3.0%**	89%	**90%**
Total Direct Compensation	**$3,409**	**$3,521**	**-3.2%**	**$3,765**	**$3,869**	**-2.7%**	**100%**	**100%**

– The prevalence of performance-based equity increased from 61% to 67%, and median values increased substantially

– Restricted stock awards decreased in both prevalence and value year-over year

– Stock option value remained fairly steady, but prevalence continues to decrease (46% vs 49%)

3-year Change in CEO Pay Levels

Median total pay has increased 38% over the past 3 years

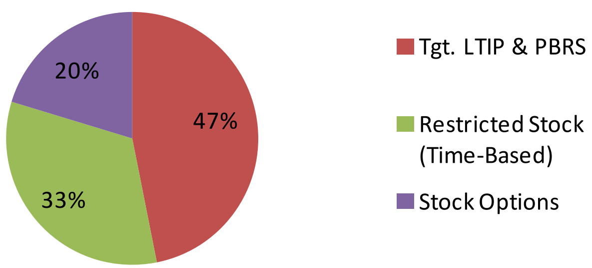
- Most of the increase has been in LTI/equity values, particularly performance-based equity

	Same CEO Y-O-Y - 130 Companies									
	Median					Average				
	2012	2011	2010	2009	3-Yr % Change	2012	2011	2010	2009	3-Yr % Change
Base Salary	$836	$814	$783	$750	+11%	$842	$820	$795	$758	+11%
Annual Incentive Payout	730	748	861	600	+22%	973	1,069	1,123	892	+9%
Total Cash	**1,565**	**1,562**	**1,694**	**1,363**	**15%**	**1,816**	**1,889**	**1,918**	**1,650**	**10%**
Tgt. LTIP & PBRS	721	590	345	0	n/a	1,013	915	706	552	+83%
Restricted Stock (Time-Based)	299	415	244	153	+96%	709	725	588	524	+35%
Stock Options	0	0	0	10	-100%	439	502	489	477	-8%
Total LTI	**1,747**	**1,903**	**1,518**	**1,198**	**46%**	**2,161**	**2,142**	**1,783**	**1,553**	**39%**
Total Direct Compensation	**3,607**	**3,668**	**3,155**	**2,622**	**38%**	**3,976**	**4,031**	**3,701**	**3,202**	**24%**

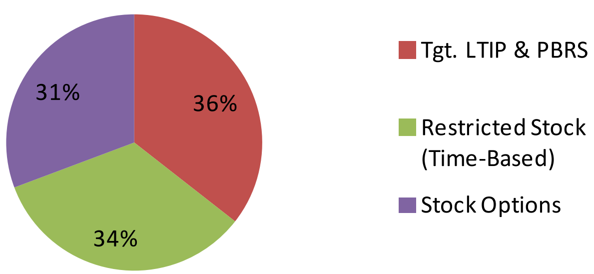
3-year Change in CEO Pay Levels

The prevalence and value of performance-based equity has increased substantially over 3 years

2012 LTI Mix=130 Companies



2009 LTI Mix= 130 Companies



	Prevalence				
	2012	2011	2010	2009	2009 vs. 2012 % Change
Base Salary	100%	100%	100%	100%	0%
Annual Incentive Payout	88%	90%	86%	84%	4%
Total Cash	**100%**	**100%**	**100%**	**100%**	**0%**
Tgt. LTIP & PBRS	68%	62%	58%	49%	19%
Restricted Stock (Time-Based)	57%	64%	58%	52%	5%
Stock Options	43%	46%	49%	50%	-7%
Total LTI	**88%**	**91%**	**88%**	**85%**	**3%**
Total Direct Compensation	**100%**	**100%**	**100%**	**100%**	**0%**

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Current Trends in Executive Benefits

Presented by: Jason Maples, Executive Vice President, Lockton Companies

May 6, 2014

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Three Forms of Compensation

- **Cash Compensation**
  - Base
  - STI
  - LTI
- **Equity**
  - RSUs
  - Options
- **Benefits**
  - Restoration
  - Recruiting & Retention
  - Protection

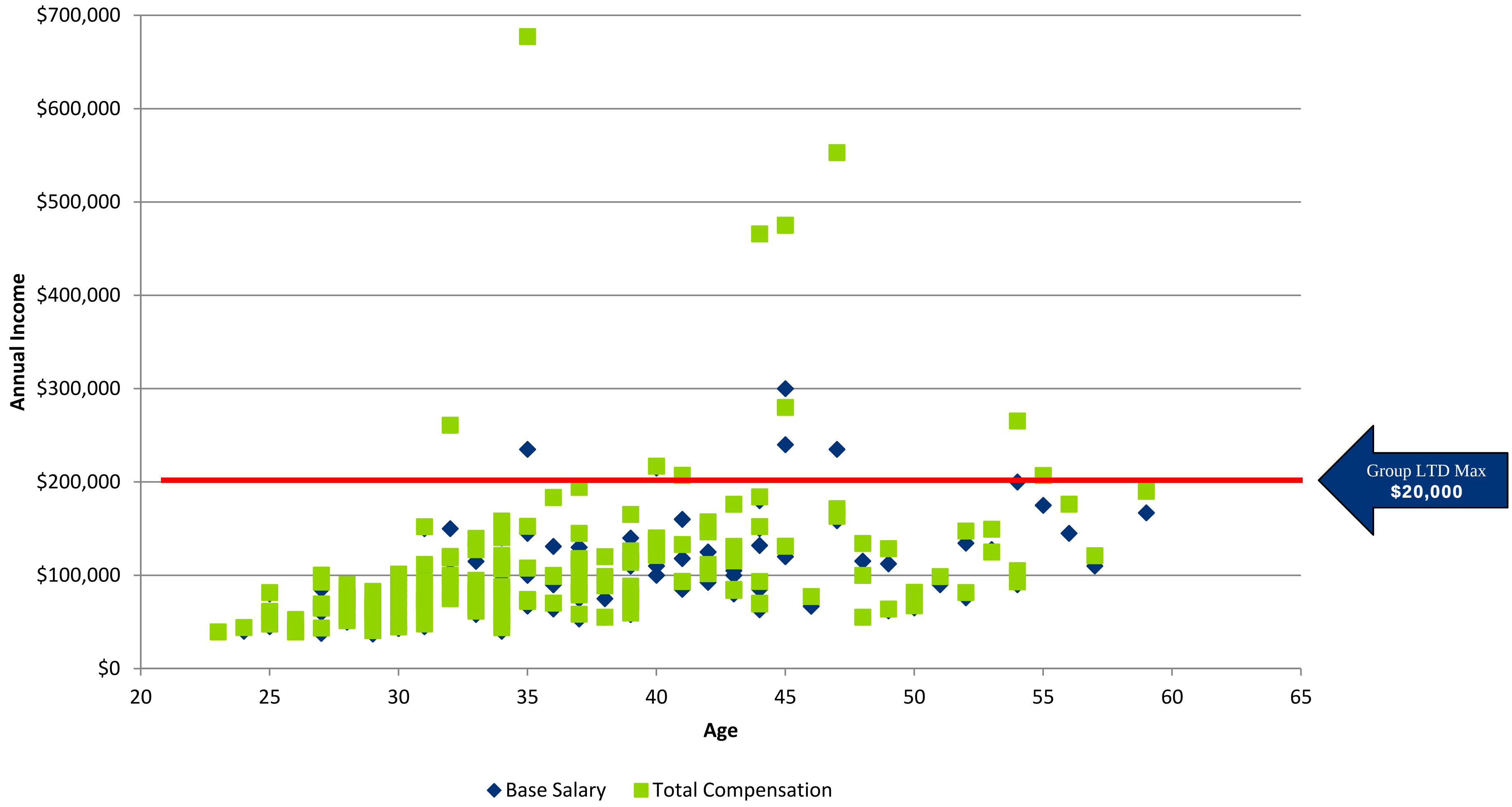
Why Executive Benefits Exist

- **To Restore Benefits that are lost due to ERISA Laws and Benefit Plan Limits**
  - ERISA limitations on qualified plan benefits and contributions
  - Monthly Income Benefit caps on Group Long Term Disability (LTD) Plans
  - Death benefit caps on Group Life Insurance (LI) Plans
  - Group LI & LTD Programs typically insure salary only

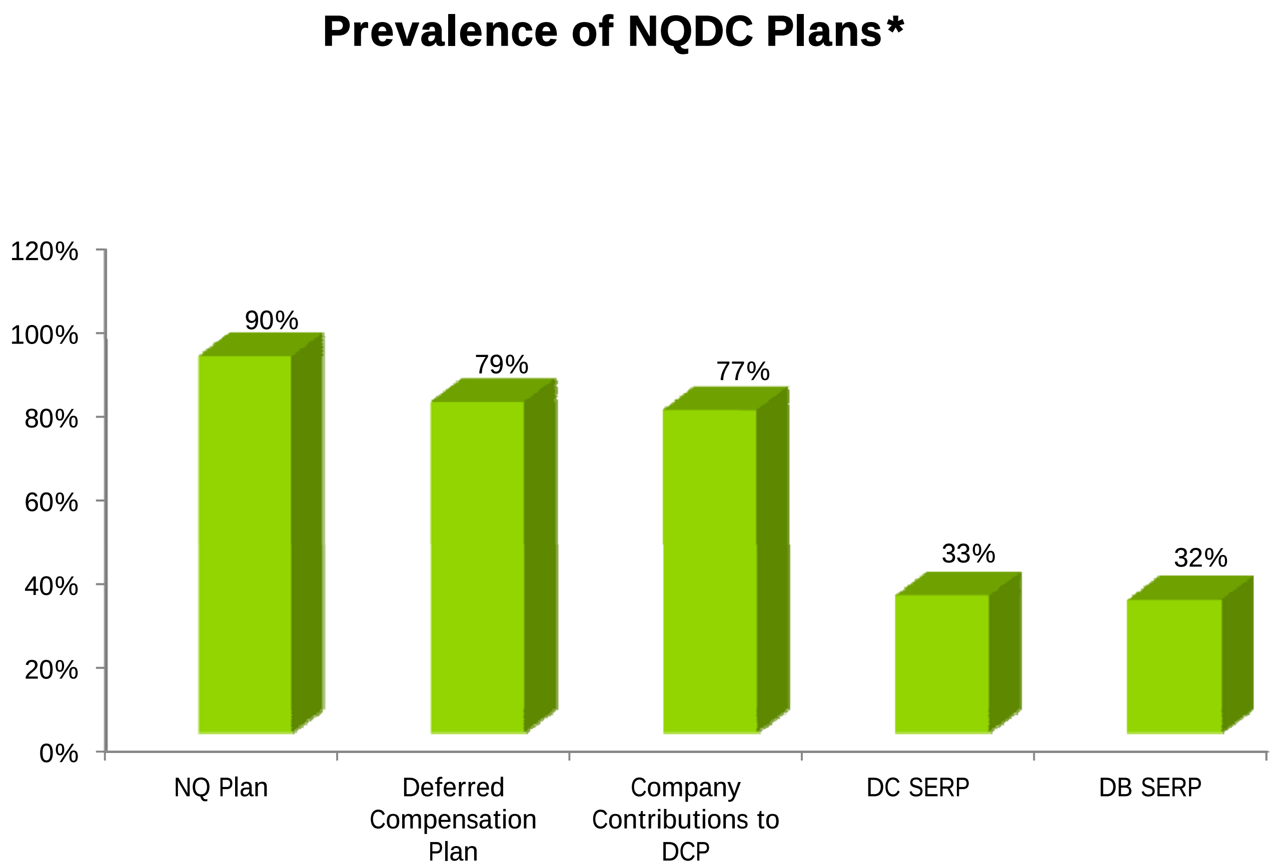
- **Recruit, Reward, Motivate and Retain**
  - Can executives see themselves accomplishing their financial goals at your organization?
  - Many companies want creative alternatives to cash and/or equity incentive programs

- **Human Capital Risk Mitigation**
  - Desire to mitigate financial impact in the event that a key executive dies or becomes disabled

Sample Benefit Restoration Analysis for Long Term Disability
(Current Group Long Term Disability plan replaces 60% to $10K)



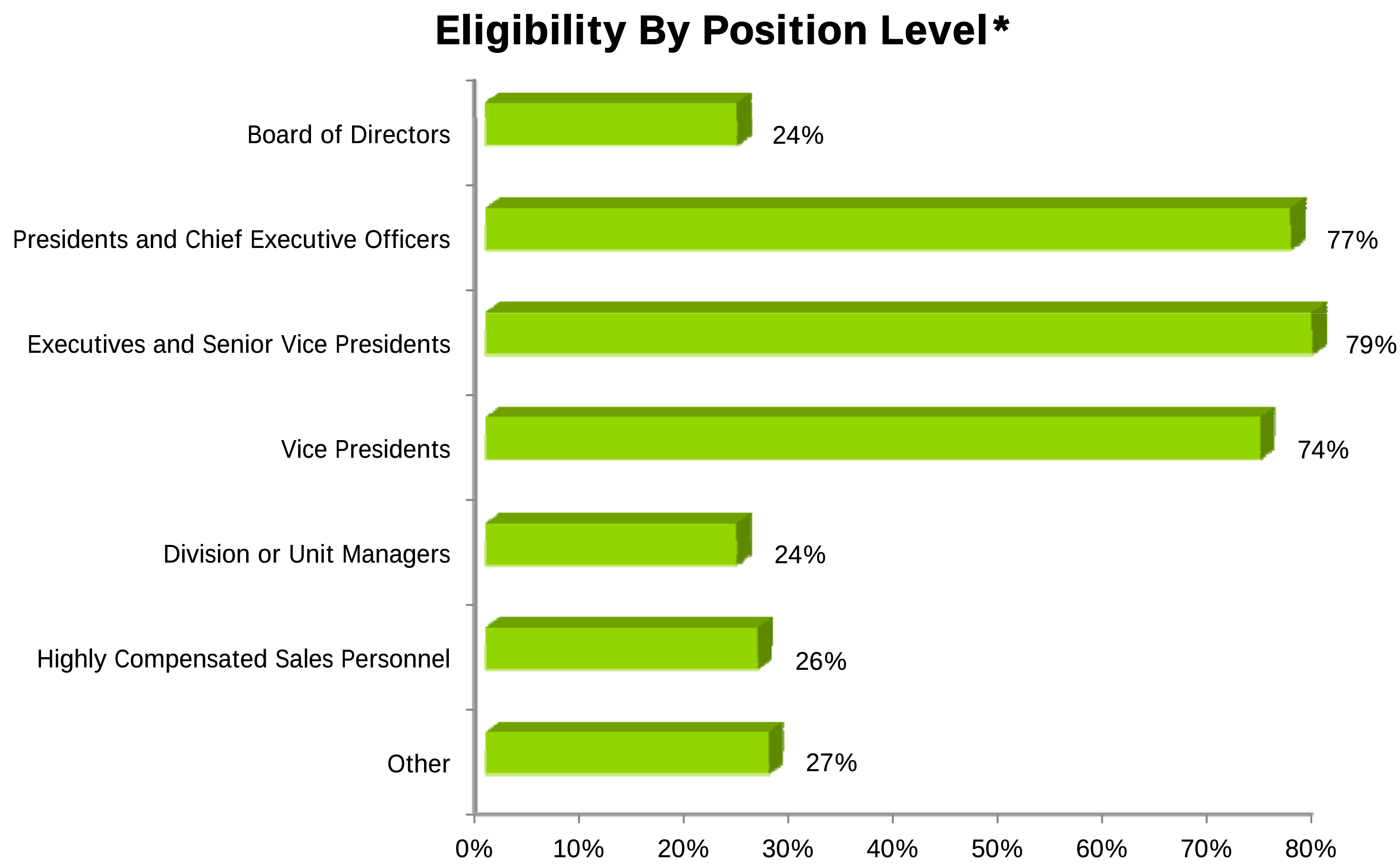
Non-Qualified Deferred Compensation Plan Prevalence



As the chart shows, 90% of Fortune 1000 companies offer some sort of nonqualified plan.

**Executive Benefits: A Survey of Current Trends -The Newport Group* (2011/2012 Edition)

Non-Qualified Deferred Compensation Plan Eligibility



**Executive Benefits: A Survey of Current Trends - The Newport Group* (2011/2012 Edition)

NQDC Plan Design Components

Component I:

- **Basic Participant Elective Deferrals**
  - Executives defer from base salary, bonus or incentive compensation
  - Money comes from executives, ***no required employer contribution***

Component II:

- **Optional Employer Restoration or Regular Match Contribution**
  - Employer money that would have gone into the 401k plan except for government limits
  - No additional employer cost if money would have gone into the qualified plan other than the restored cost of match

Component III:

- **Employer Discretionary Contributions**
  - Discretionary contributions **at any time**, **for anybody**, **in any reasonable amount**, **with any vesting schedule**
  - Can be used as incentive for performance, another profit sharing, retention bonus, recruiting bonus, etc.

Tax Changes

Federal Tax Rate Changes Effective 2013

	Previous	Current
Marginal Tax Rates Increased at Upper Incomes ($450k+)	35.0%	39.6%
Top Marginal Long Term Capital Gains ($450k+)	15.0%	20.0%
Top Marginal Qualified Dividends ($450k+)	15.0%	20.0%
Estate and Gift Tax**	35.0%	40.0%
Medicare Excise Tax (On investment income if AGI over $250k)	None	3.8%
Medicare Tax for compensation over $200k	1.45%	2.35%
Itemized Deduction	Allowed	Phase Out

*Married Filing Jointly Tax Rates
**Exemption kept at $5M and indexed for inflation

Trends in Executive Benefits

- **Restoration is not a dirty word**
  - Guaranteed issue supplemental life and disability plans for executives to close the gaps
  - 401(k) matching contributions above the covered compensation limits ($260k) directed to 409A plans
- **Increased use of Non-Qualified Deferred Compensation Plans (Elective Deferral plans) due to Tax Reform**
- **Increase in 409A plans for equity grants so that the participant can control the timing and taxation of income – especially for those subject to Stock Ownership Guidelines**
- **Increase in use of 409A plans for Directors**

Other Perquisites

<u>Other Executive Perks (prevalence)</u>

- Car Allowance (37%)
- Country Club Dues (10%)
- Executive Physicals (31%)
- Financial Counseling (45%)
- Personal or Home Security (15%)
- Sport Tickets (9%)
- Spouse Travel (16%)

* Source: S&P 500 2012 Proxy Data