

Pearl Meyer

On Point

TIMELY, ACCURATE, INSIGHTFUL

Looking Ahead to Executive Pay Practices in 2016

Executive Summary

Key Highlights Among Public Firms



Table of Contents

▪ Introduction	3
▪ Projections for Executive Pay in 2016	4
▪ Relative Total Shareholder Return in Equity Incentive Plans	8
▪ Performance Measure Selection and Setting Performance Standards	13
▪ Peer Group Selection	18
▪ Extraordinary Events, Exclusions, and Discretion	21
▪ Compensation Discussion & Analysis (CD&A) and Communication Effectiveness	27
▪ About the Survey	31



Introduction

Our survey series, ***Pearl Meyer On Point: Looking Ahead to Executive Pay Practices*** is designed to provide organizations with an annual perspective on how their peers are responding to the latest changes in the environment for decision-making around executive pay and governance.

Survey results indicate some trends in performance metrics, particularly the use of relative Total Shareholder Return (rTSR) in long-term incentives. In this area, there are some potential contradictions in the rising use of the measure, yet low perceived effectiveness of its use and indications that it is being implemented as an answer to outside pressure.

We hope you find this information useful as you make compensation-related decisions for the coming year. If you have any questions or are interested in discussing these findings, please contact:

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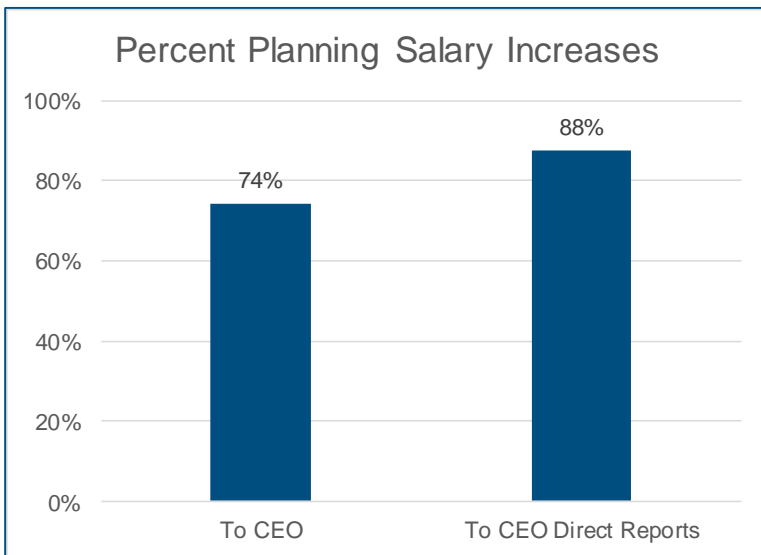


Projections for Executive Pay in 2016

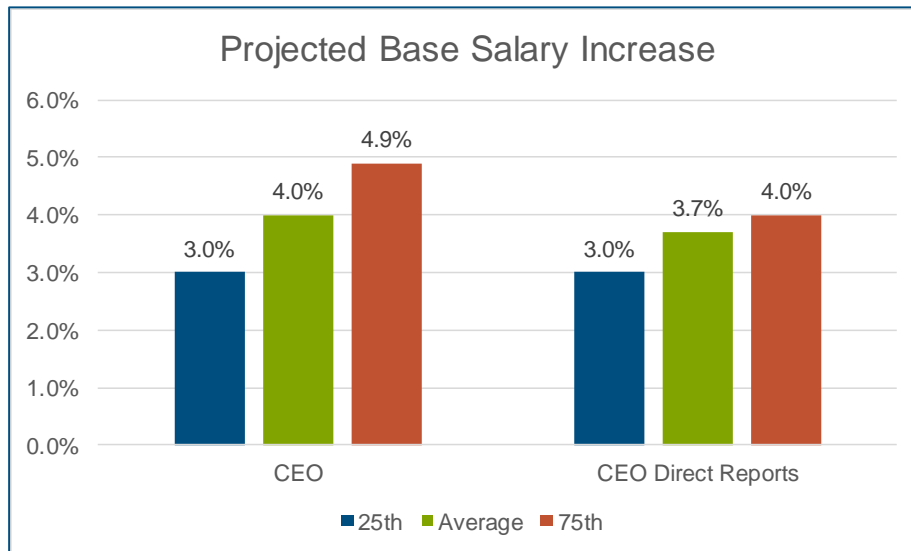
Projections for Executive Pay in 2016

- A significant majority of firms are planning to provide base salary increases to their executive teams. However, the size of those increases continues to be very modest (average of 4% to CEO, 3.7% to CEO direct reports).
- The majority of firms are projecting short- and long-term awards to be about the same or somewhat higher than the prior year.
- Almost all firms are planning to incorporate one or more modifications to their long-term incentive plan in the upcoming year. The most common planned change, by far, is to change the performance metrics used in performance-based awards, followed by changing the mix of vehicles.

Base Salary Projections

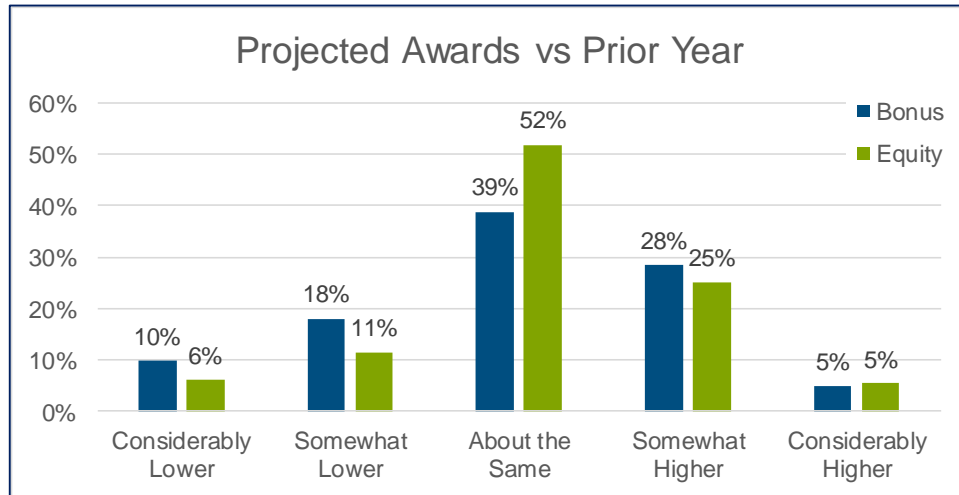


A significant majority of firms are planning to provide base salary increases to their executives...



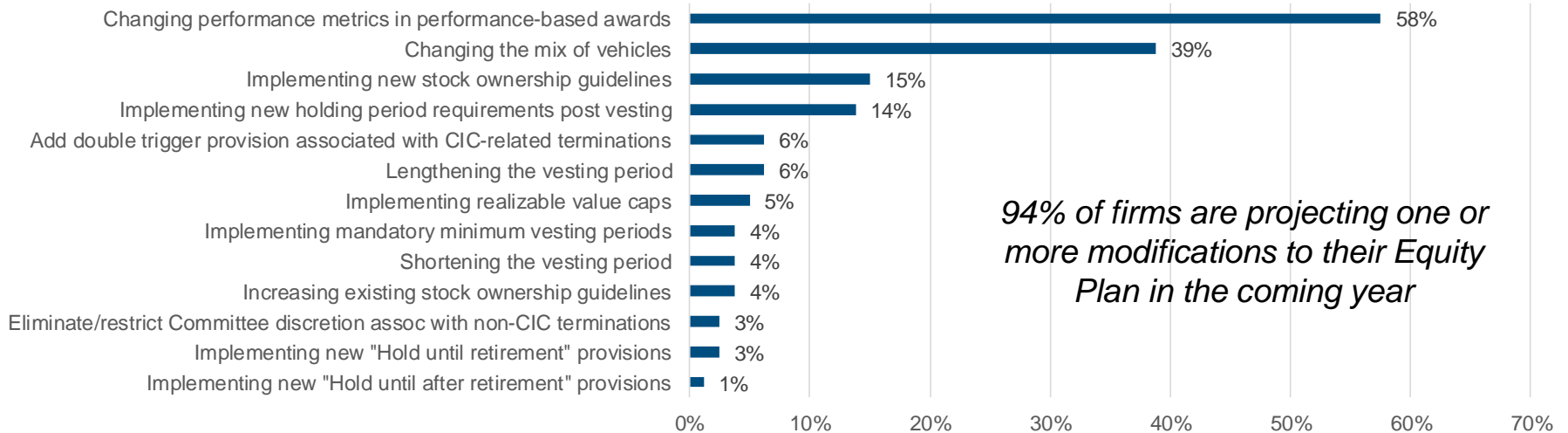
...although those increases continue to be modest

Incentive Plan Projections



Incentive awards – short-term and long-term – are expected to be generally the same to somewhat higher than the prior year

Anticipated Equity Plan Modifications



94% of firms are projecting one or more modifications to their Equity Plan in the coming year



Relative Total Shareholder Return in Equity Incentive Plans



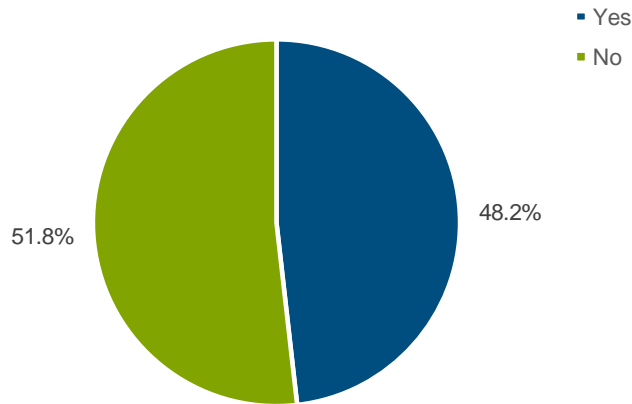
Key Findings

Relative Total Shareholder Return (rTSR) in Equity Incentive Plans

- Just under half of public firms indicate that rTSR is a measure in their long-term incentive program. Of those using rTSR, almost two-thirds of firms use it along with one or more additional measures of performance, while interestingly, more than one-third rely on it as their *sole* measure in long-term incentive plans.
- The popularity of rTSR is increasing with half the surveyed firms indicating that they have used this measure for three or fewer years.
- The most common reason cited for incorporating rTSR is to align investor and management interests, followed by creating balance to existing financial metrics. Outside pressures, however also clearly play a strong role. 75% of respondents cite peer practices as a somewhat or very important reason for the use of rTSR, while 56% say investor concerns play a somewhat or very important role in its use. More than half of respondents indicated that responding to proxy advisory group concerns played a somewhat or very important role in including rTSR in the equity plan.
- While more firms are including rTSR in their long-term incentive plans, very few believe it has a significant positive influence on either firm financial performance or actual Total Shareholder Return. In fact over 40% believe it has had no impact or a negative impact.
- Similarly, very few firms believe that the inclusion of rTSR as a long-term incentive metric plays a very important role in fostering the right executive behaviors and even fewer believe it reflects the overall performance of the executive team.
- Among firms not currently using rTSR, most cited that the measure was not relevant (i.e., the company is not public) or the company prefers financial or other measures. And, less than 10% of these firms indicated that they are considering adding rTSR as a measure in the future.

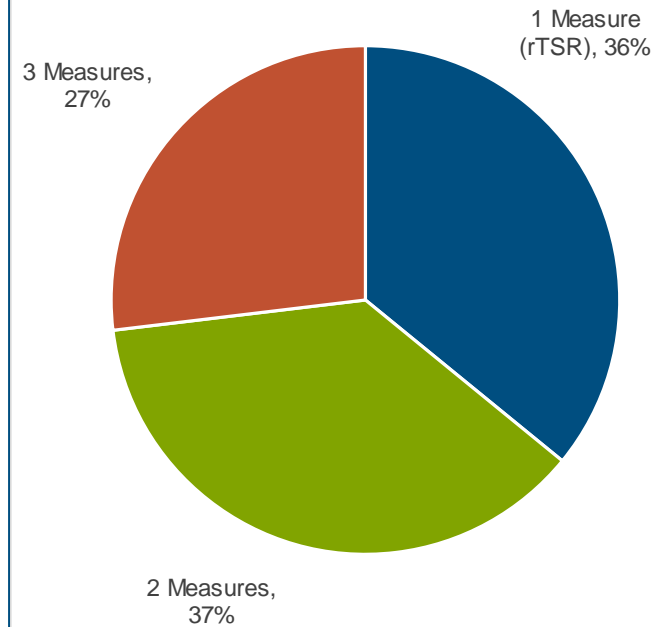
Relative Total Shareholder Return (rTSR)

Firms Including rTSR in LTI Program



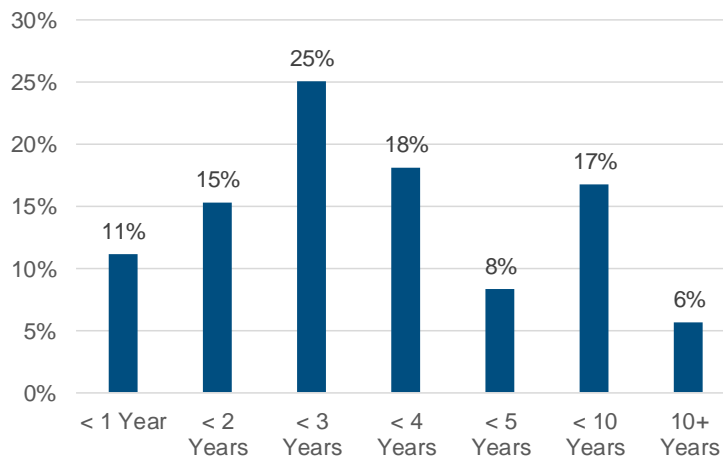
Just under half of public firms surveyed include relative TSR as a measure in their LTI program

Number of Measures



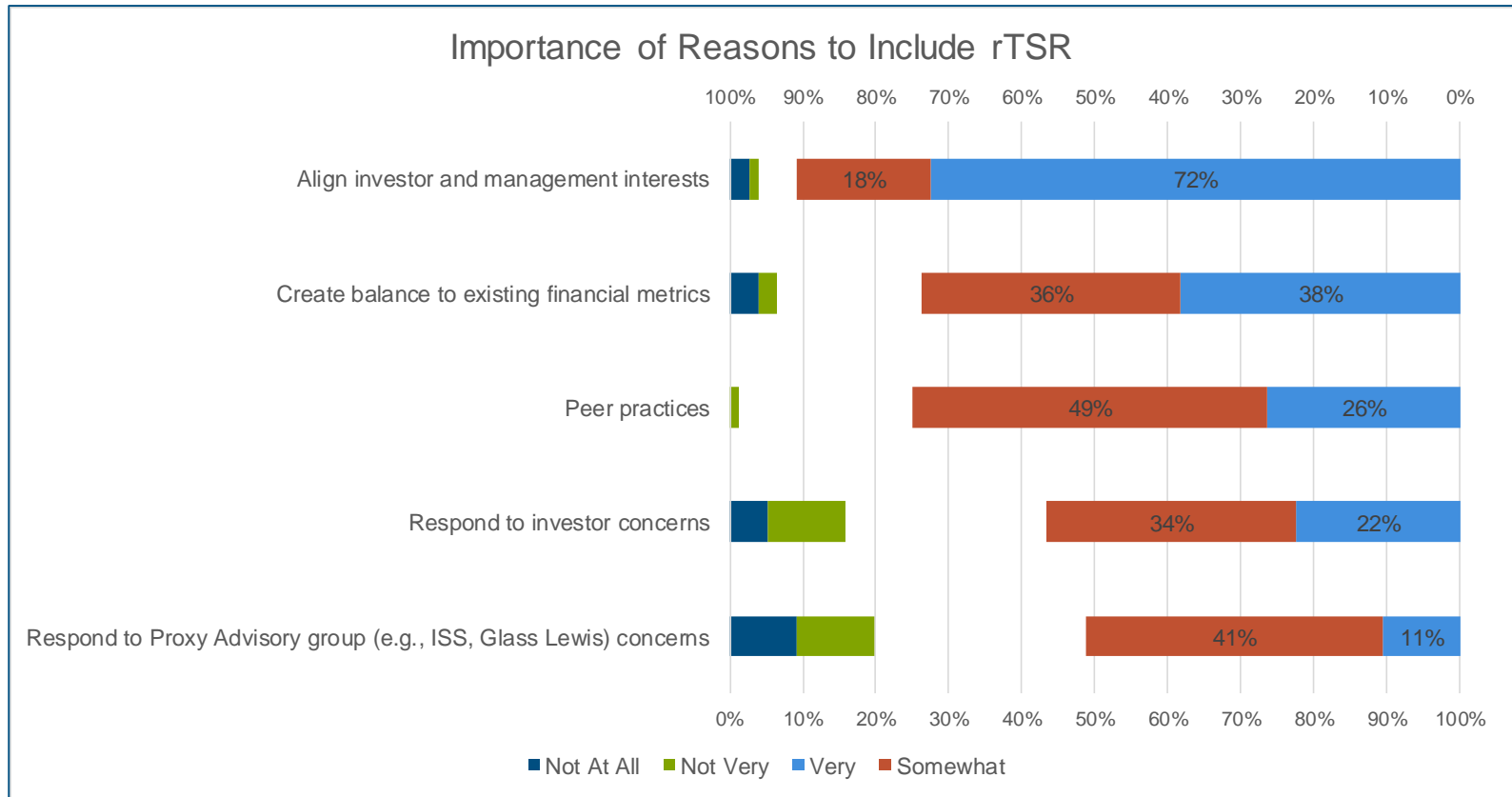
Just under two-thirds use rTSR as a supplement to other measures

Measure Has Been In Place For . . .

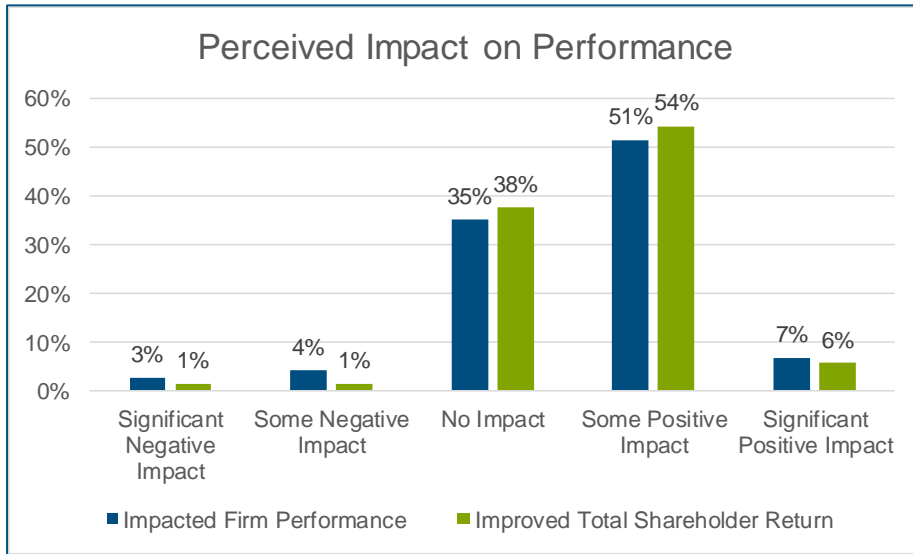


The use of rTSR is increasing in recent years; half of the firms have included rTSR for three or fewer years

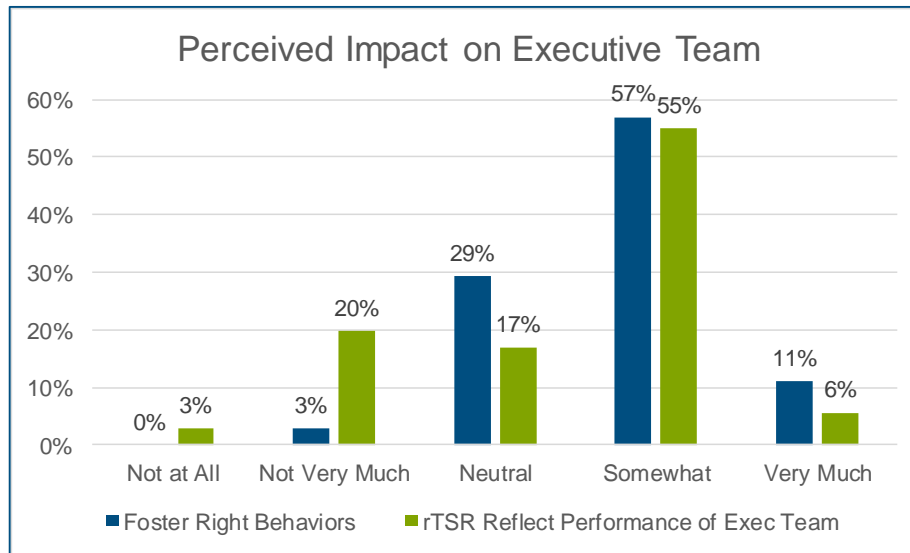
Relative TSR



Relative TSR



Most firms believe that the inclusion of rTSR has had little to no positive impact on firm performance and Total Shareholder Return



Most firms believe that the inclusion of rTSR has had little to no positive impact on fostering the right executive behaviors; even fewer firms believe that rTSR accurately reflects the performance of the executive team



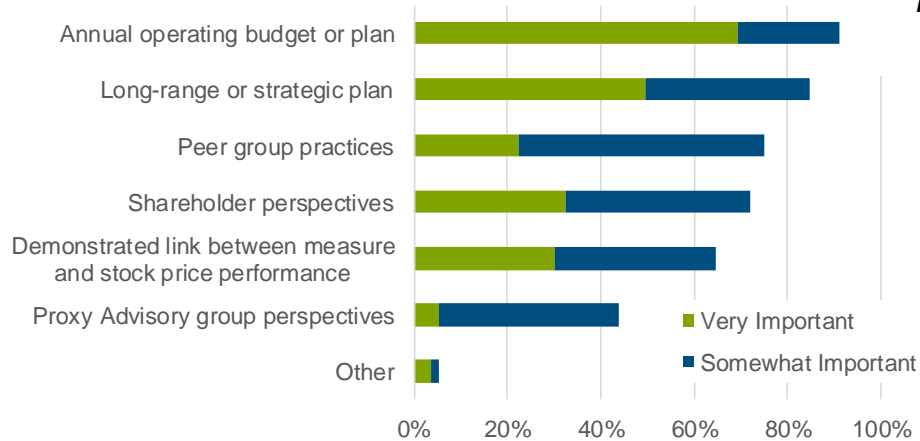
Performance Measure Selection and Setting Performance Standards

Performance Measure Selection and Setting Performance Standards

- Not surprisingly, the annual operating budget and the long-range or strategic plan are top considerations when selecting performance measures and setting annual standards or goals.
- Interestingly, the majority of both Boards and management indicated that proxy advisory group perspectives have little to no impact on the selection of performance measures.
- When setting performance standards (or goals), Boards and management generally consider the same factors, although Boards give less consideration to percent value sharing (i.e., percent of earnings paid out to the management team).
- Over half the organizations surveyed indicate that the degree of Board involvement in these processes has increased over the past several years. At the same time, most organizations indicate that the level of involvement is just about right. Almost a quarter of respondents indicate that Boards spend 10 or more hours per year focusing on this topic.

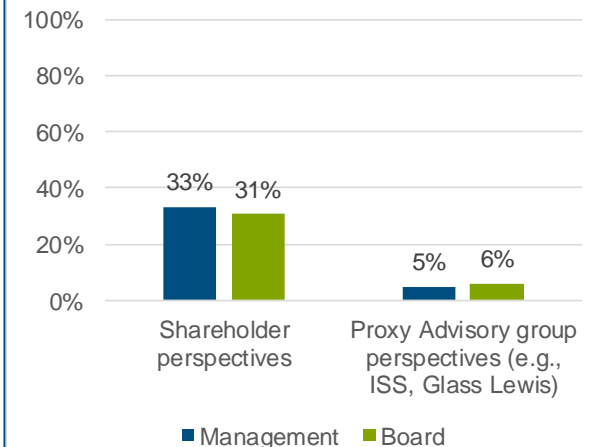
Performance Measure Selection

Factors Influencing Measure Selection



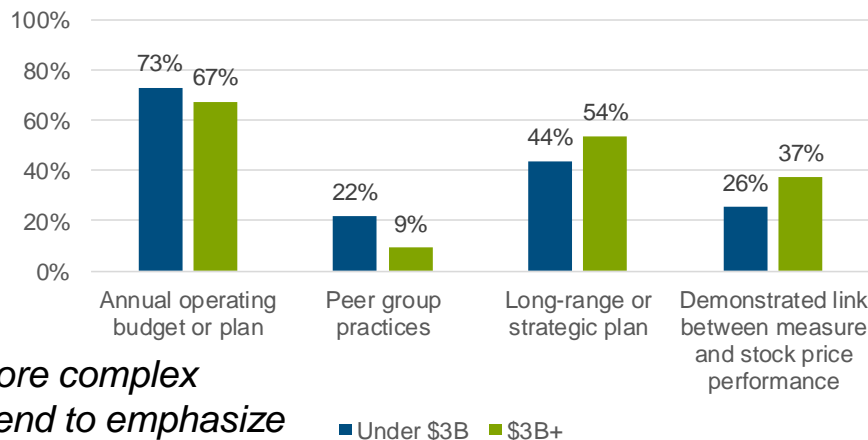
Annual operating budget remains most common factor influencing measurement selection

Percent Rating Very Important



Board and management views are similar with respect to external influences on measure selection

Percent Rating Very Important



Larger, more complex organizations tend to emphasize slightly different factors

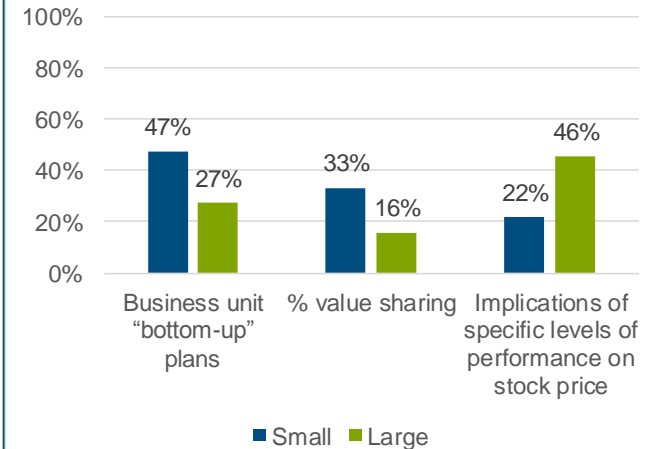
Setting Performance Standards or Goals

Factors Influencing Goal Setting

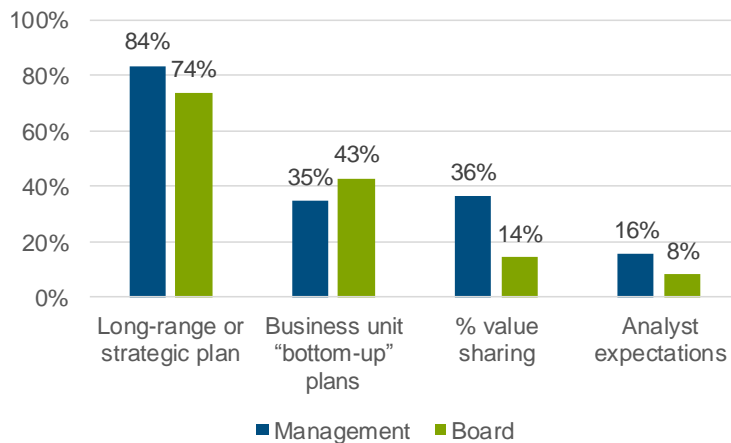


Many factors are concurrently considered, however the degree to which they are "always" considered varies

Percent Rating Very Important



Percent Rating Very Important

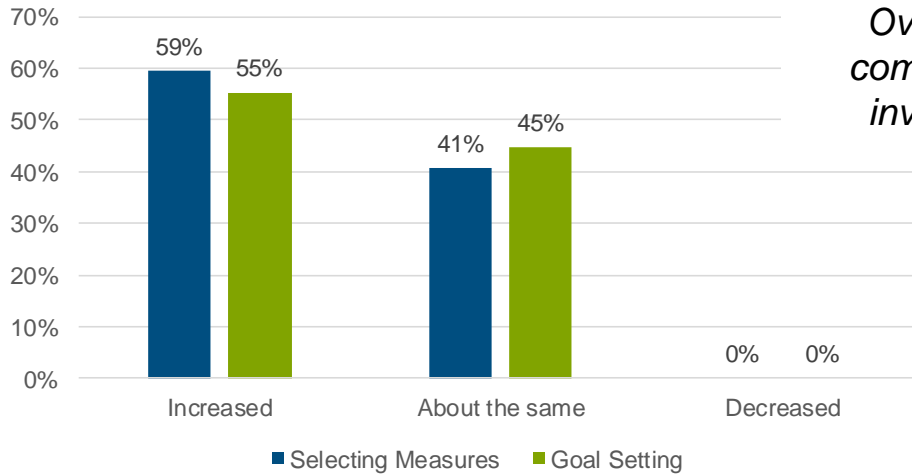


Boards and management value most items similarly; The area with the largest gap is the degree to which value sharing with executives should influence setting performance standards

Larger, more complex organizations tend to emphasize slightly different factors; Larger companies are more keen on ensuring that their goals result in share price appreciation

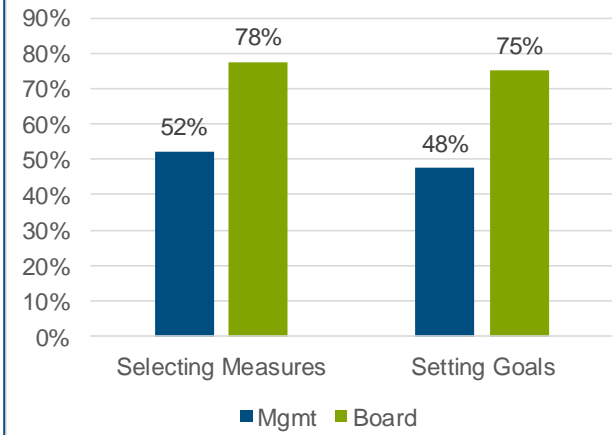
Board Involvement in Measure Selection and Goal Setting

Level of Board Involvement Has...



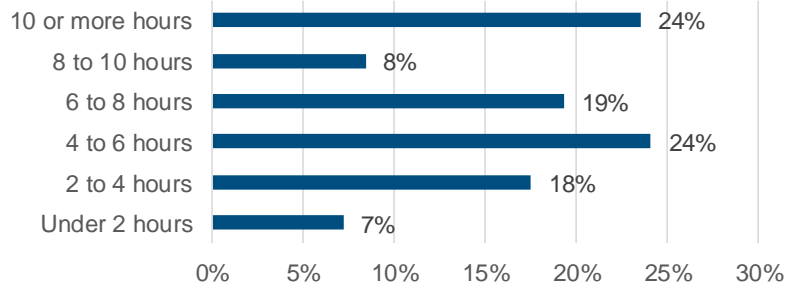
Over recent years, in many companies the level of Board involvement has increased

Percent Saying Involvement Increased



The majority of Board members feel their involvement has increased

Board Time Spent Per Year on Measure Selection & Goal Setting





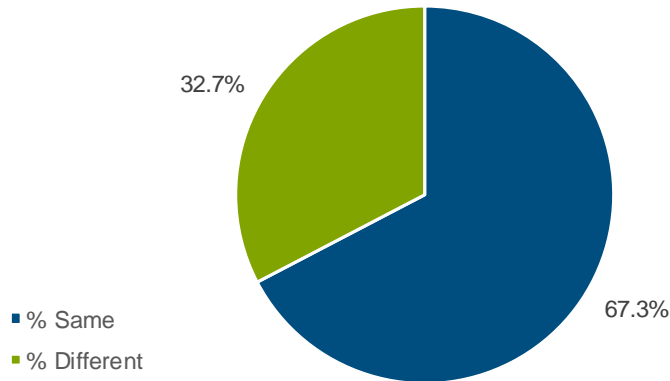
Peer Group Selection

Peer Group Selection

- Among organizations that employ both a benchmarking and a performance peer group, the majority use the same group of firms for both types of comparisons.
- Industry affiliation is the most important factor when selecting either a benchmarking or a performance peer group, followed by firm size.
- Talent competitors, geography, and business model play a somewhat larger role when selecting a benchmarking peer group than when selecting a performance peer group.

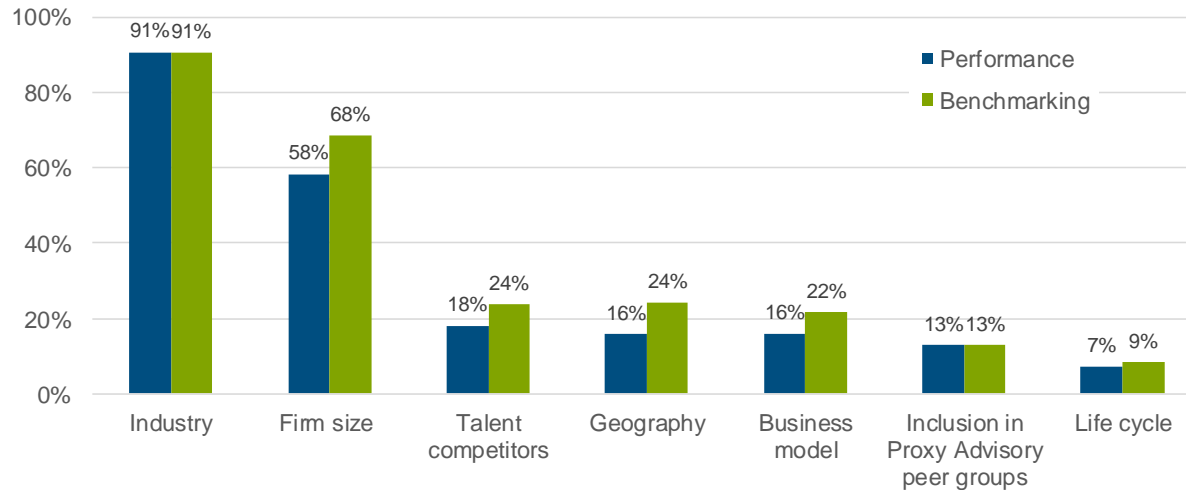
Peer Group

Performance vs Compensation Peer Group



Of companies with a performance peer group, the majority use the same peer group for compensation benchmarking and assessing relative performance

Factors Considered - Firms with Two Peer Groups
(Percent Rating Very Important)



Industry affiliation is the most important factor in selecting benchmarking or performance peers

Size, talent competitors, geography, and business model play a somewhat larger role when selecting benchmarking peer group versus when selecting performance peers



Extraordinary Events, Exclusions, and Discretion

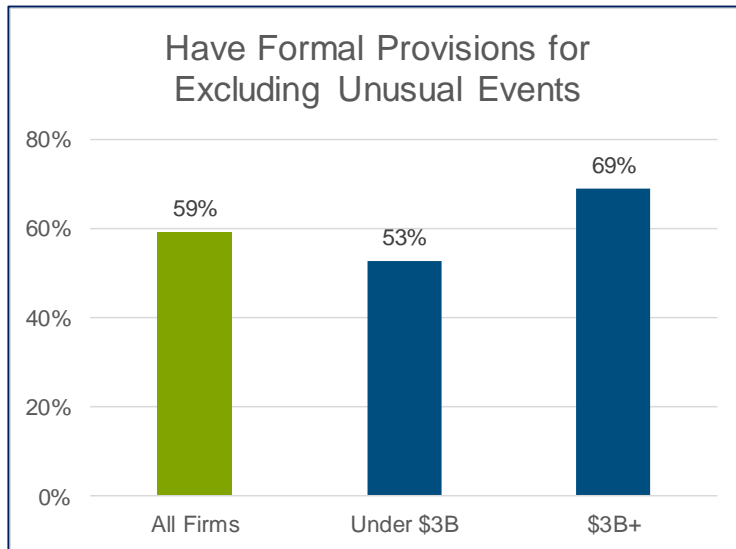


Key Findings

Extraordinary Events, Exclusions, and Discretion

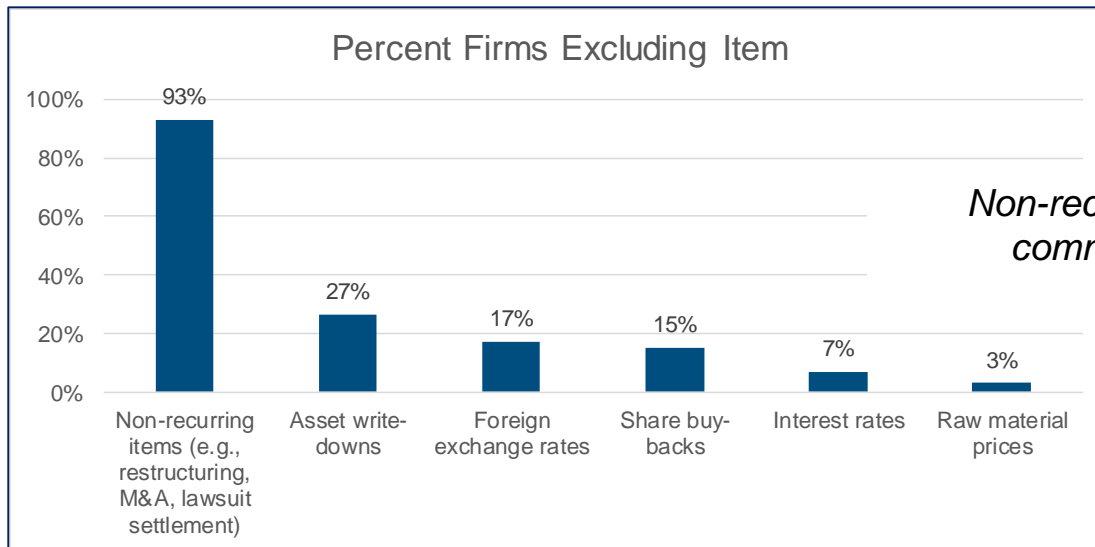
- Just over half of respondents indicate that their incentive plans *formally* provide provisions for dealing with extraordinary events.
- Most organizations formally exclude or make adjustments for non-recurring items such as restructuring, M&A, and/or lawsuit settlements.
- Less than one-fifth of organizations formally address foreign exchange rates. However, among firms with international operations, almost two-thirds of organizations have some methodology for addressing foreign exchange rate changes (either formally or informally).
- The majority of respondents believe some level of Board discretion is appropriate when determining final incentive plan awards. Board members are somewhat more conservative in the degree of discretion they feel is appropriate (as compared to management). Both groups feel that the level of discretion that should be applied when determining final awards for long-term incentive plans should be *less than* that afforded for annual incentive plans.
- Factors most commonly identified to be considered include restructuring or discontinued operations, and significant economy-wide or industry-wide downturn.
- Factors most commonly identified to NOT be considered include unanticipated gain or loss of a key customer or account, unanticipated changes in key raw materials prices, and unusual events associated with risky foreign operating environments. A number of respondents also wrote in that individual performance should not be considered when applying discretion.

Exceptions and Exclusions



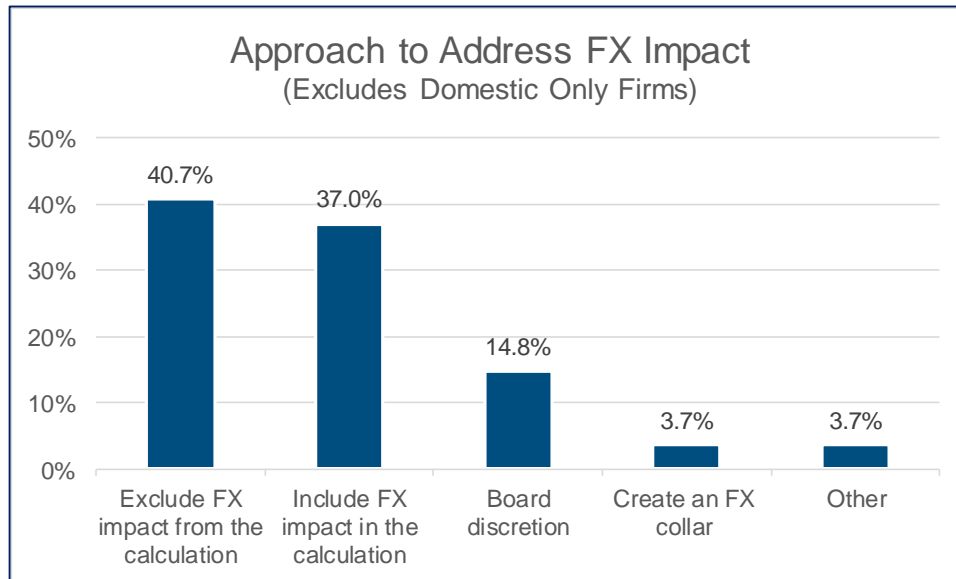
Many organizations incorporate formal provisions in their incentive plans for excluding unusual events

Larger firms are somewhat more likely to incorporate these provisions



Non-recurring items most commonly excluded

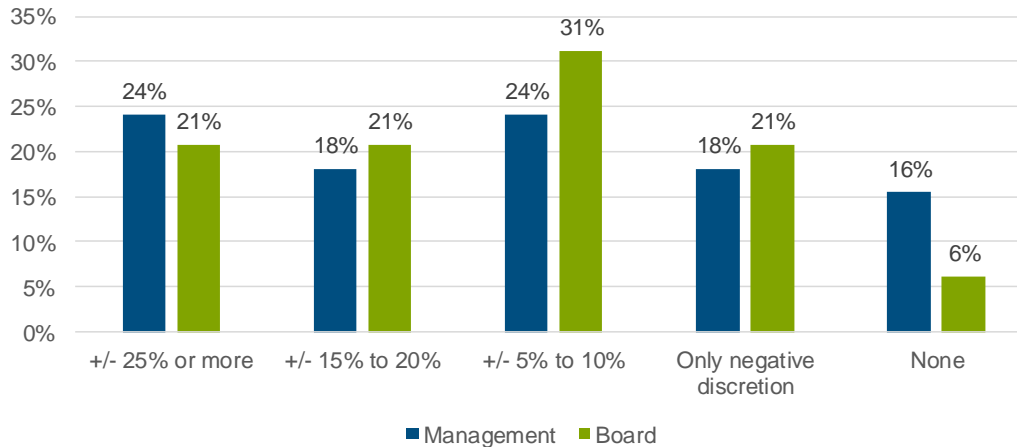
Foreign Exchange Rates



Of companies with international operations, almost two-thirds incorporate some methodology to address FX impacts

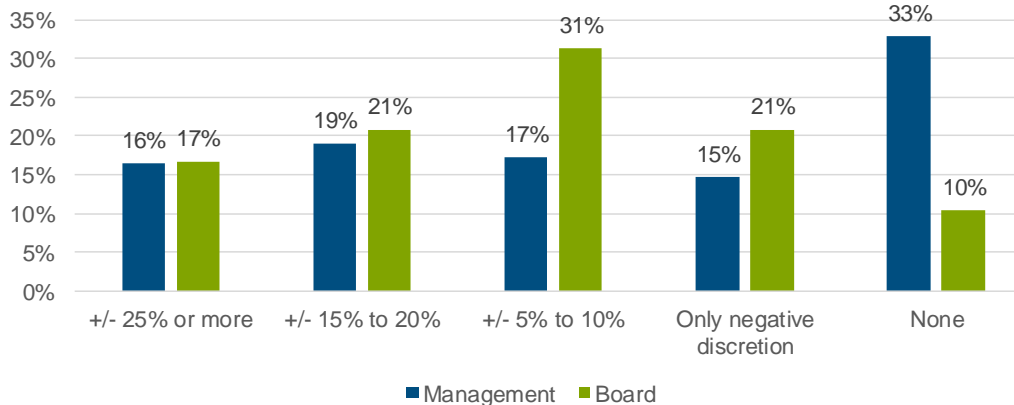
Board Discretion

Appropriate Level of Discretion in Determining Final Annual Incentive Plan Awards



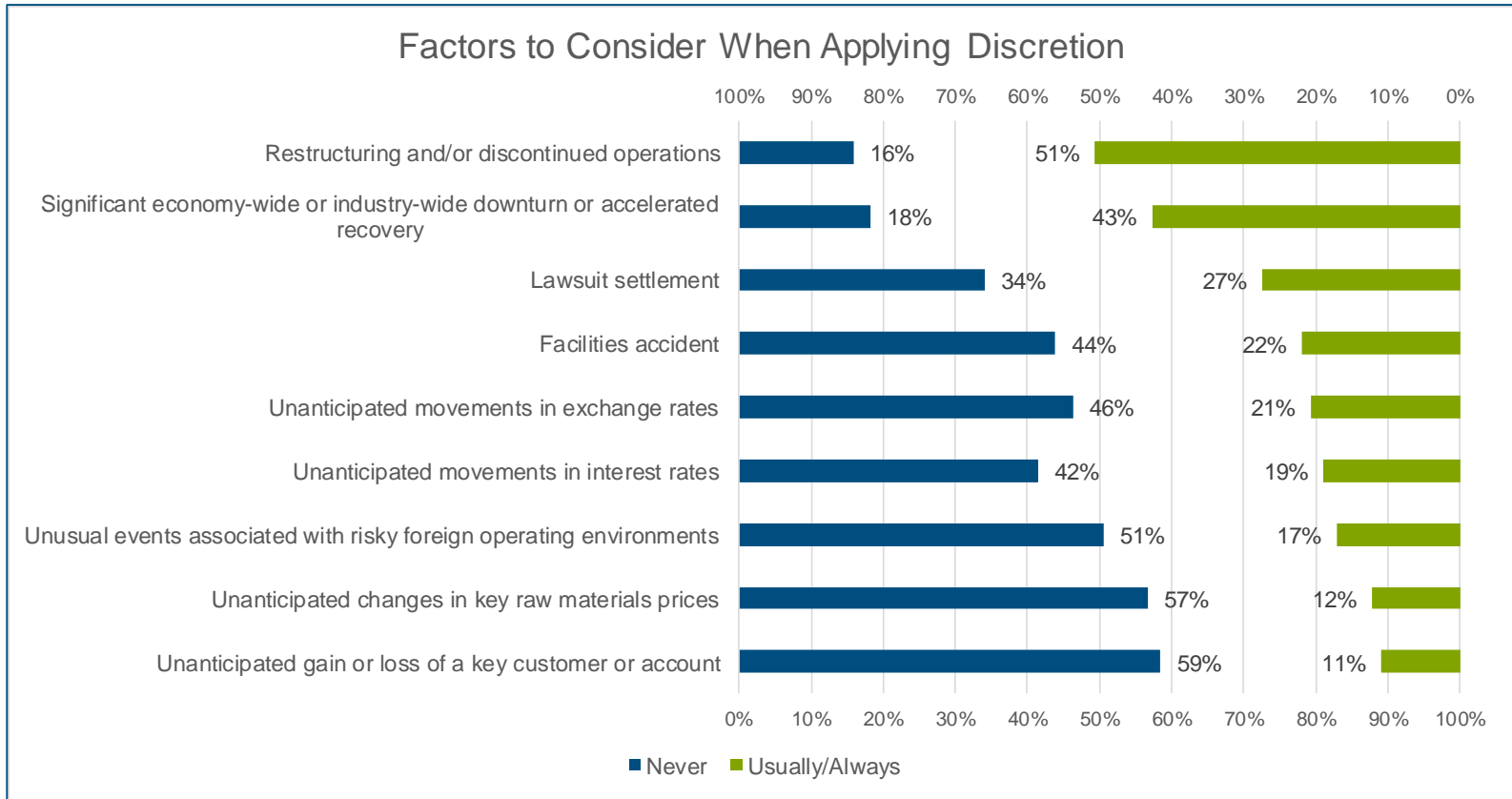
While Board members believe some level of discretion is appropriate, they recommend a somewhat lower degree of discretion (fewer believe 25% or more discretion is appropriate; more believe a 5% to 10% level of discretion is appropriate)

Appropriate Level of Discretion in Determining Final Long-Term Awards (Cash LTIP, Perf Share Plan)




Management views on the appropriate level of discretion to apply in long-term incentive plans is substantially more conservative (compared to annual incentive plans)

Board Discretion



Restructuring and significant economy-wide downturns were identified as the most common factors to consider when applying discretion



Compensation Discussion & Analysis (CD&A) and Communication Effectiveness

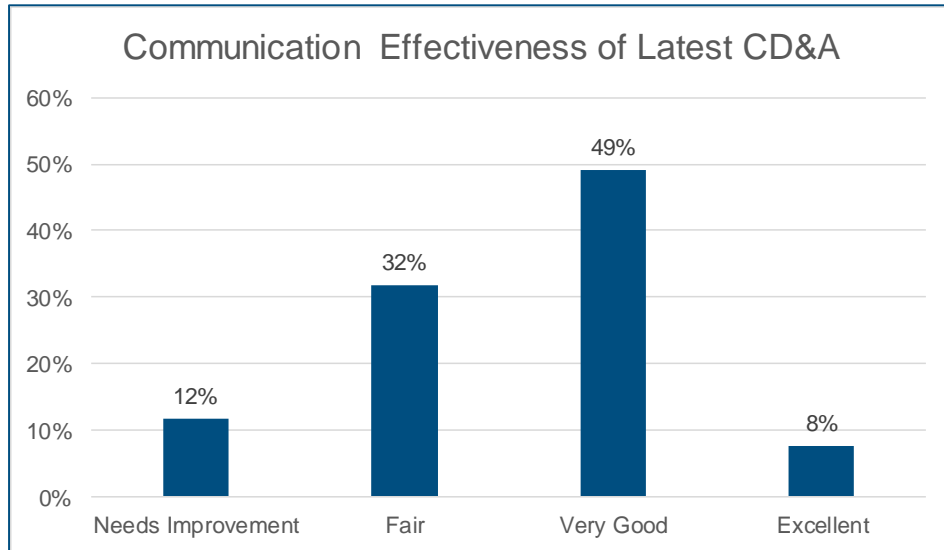


Key Findings

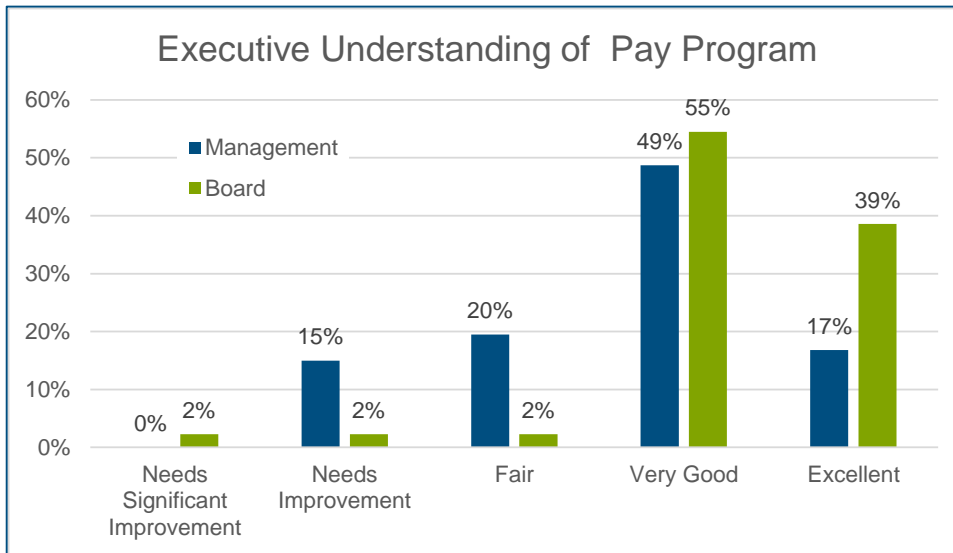
CD&A and Communication Effectiveness

- Across-the-board, organizations are making investments to improve the clarity and effectiveness of their CD&A, with almost all organizations implementing one or more changes to their CD&A in the past year and more than half planning to make some further enhancements to tone and/or style in the upcoming year.
- The most common addition is the inclusion of an executive summary at the beginning of the CD&A. Of those rating their proxy as very good to excellent, more than half also incorporated charts/graphs on change in CEO pay from current to prior year, charts/graphs on ratio of variable versus fixed pay for CEOs and NEOs, and a proxy summary.
- Even with all of these enhancements, fewer than 10% of respondents rate their CD&A as Excellent, while just under half rate their proxy as Fair or Needs Improvement.
- Almost two-thirds of firms rate executive understanding of the pay program as Very Good or Excellent. Almost ninety percent of Board members rate understanding as Very Good or Excellent (compared to sixty percent of executives). That Board members are considerably more positive in their assessments of pay program communication than management indicates a possible need for Boards to be more clear in how they discuss compensation with senior leadership.

Communication Effectiveness



Few companies perceive the effectiveness of their CD&A as Excellent – although just under half believe it is at least Very Good

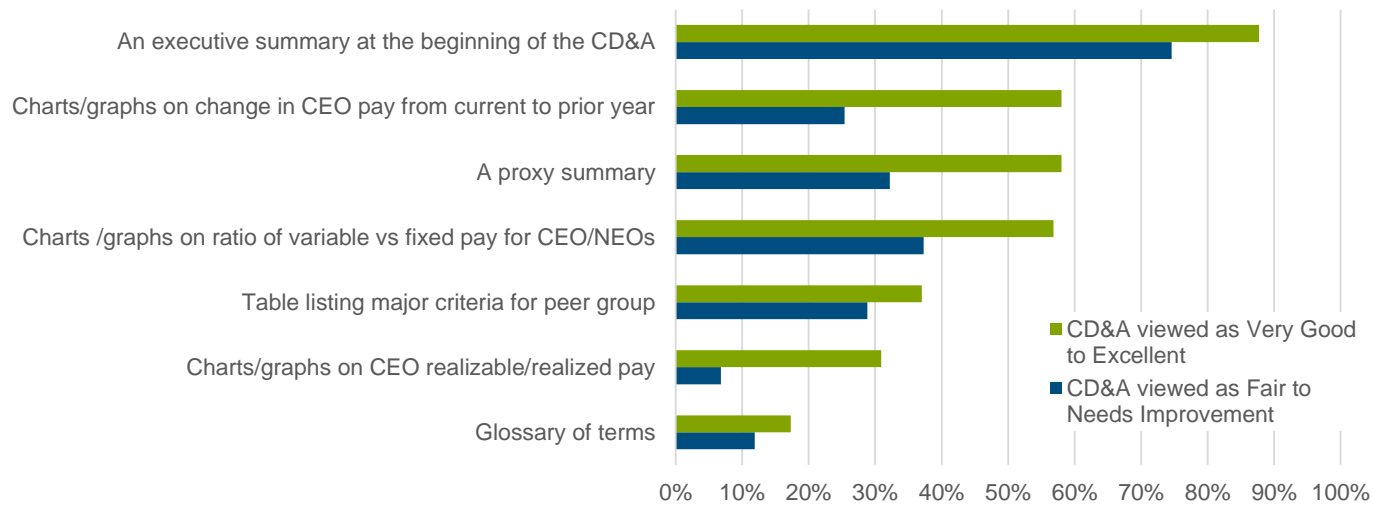


Nearly 75% of firms believe their executives have a very good to excellent understanding of their pay program

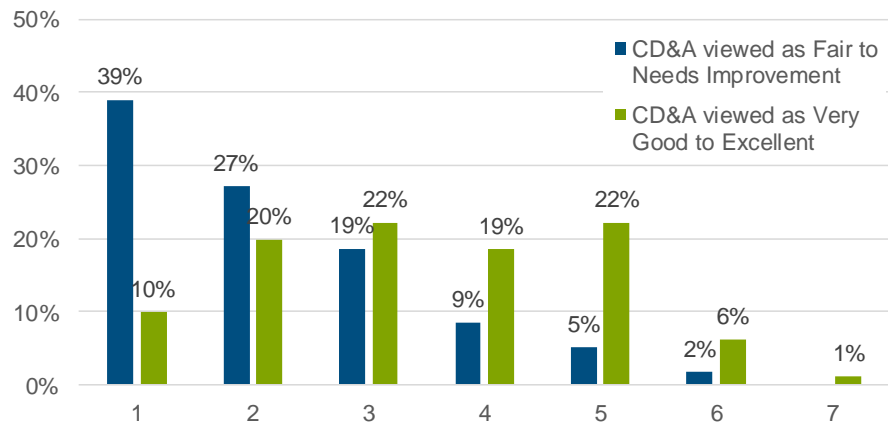
Executives themselves, however, rate their understanding lower than their Board members

Enhancing CD&A

Elements Incorporated Into Latest CD&A



Number of Elements Incorporated



Firms that rate their latest CD&A as Very Good or Excellent have invested in improving their CD&A

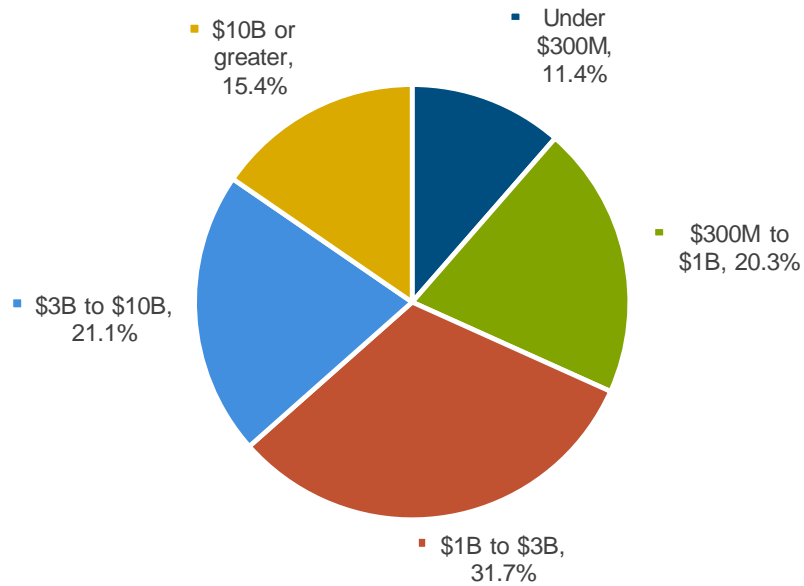
Almost half have incorporated four or more “best practice” elements into their latest CD&A in an effort to improve clarity and understanding



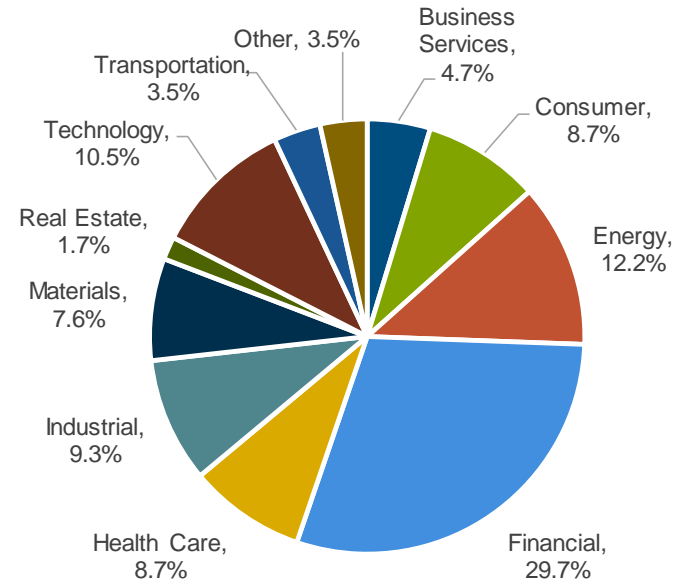
About the Survey

About the Survey

Firm Revenue



Primary Industry



A total of 257 organizations participated in the survey, 173 of which were public companies
 Respondents included 193 senior executives and HR professionals, along with 64 non-employee Board members
 Survey was conducted online in August, 2015



About Pearl Meyer

Pearl Meyer is the leading advisor to Boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.



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