Executive Compensation Trends 2012

July 11, 2012
Big Picture Summary
Big Picture Summary

The following section reflects observations based on our consulting knowledge and experience.

2011–2012

- In terms of overall compensation structure and mix, this was mostly a “status quo” year after several years of extreme volatility
- Companies highly focused on external governance and pay for performance concerns
  - Incentive plan structure (short-term and long-term)
  - Long-term Incentive grants and share use
- Emphasis on accurate and effective incentive goal-setting and performance measurement

2013 and Upcoming

- Monitor and execute compensation systems consistently with business strategy and results
- Continued shift towards performance-based compensation, balanced with “risk mitigation”
- Reduction and elimination of “entitlements” and perquisite-oriented elements
- More clear, “interesting”, and informative CD&As—shift from compliance to telling the company’s story clearly
Big Picture Summary

Companies continue to focus heavily on the stability of executive compensation delivery and program design. This is in reaction to several years of adaptive programmatic changes due to economic turmoil and an enhanced regulatory spotlight.

Boards of Directors and management will continue to focus strongly on the following to enhance program delivery and design:

- Formalizing, documenting, and refining their total pay philosophy
- Enhancing corporate governance practices
- Mitigating problematic pay practices
- Aligning pay-for-performance and shareholder interests
- Efficiently managing share pools
- Actively communicating with shareholders

Companies and Boards will be challenged in the coming years to balance business strategy, compensation best practices, and the views of governance watchdog groups.
Big Picture Summary

- **Base Salary**
  - Merit increase budgets remain at modest levels (2.5–3.5%)—this is expected to remain a longer term trend, with norms hovering near 3%
  - Few organizations have 0% budgets, however, individual executive salary increases are not automatic

- **Annual Incentives**
  - Annual incentives continue to exceed targeted opportunities, but 42% of organizations indicate that payout levels for fiscal year 2011 will be lower than payouts made for fiscal 2010
  - Companies continue to assess and align plan metrics with payout opportunities

- **Long-term Incentives**
  - Long-term incentive grants are expected to be similar to or greater than 2011 levels (88% of responses)
  - Organizations continue to adjust mix of vehicles used to deliver LTI value, with an increased emphasis on performance plans and balancing the portfolio of vehicles

- **Supplemental Executive Benefits and Perquisites**
  - Limited activity “steady state” regarding these programs
  - Perquisites experiencing greater impact due to Say-on-Pay concerns (declining)
  - Many of the problematic programs have been mitigated or eliminated over the past few years
Big Picture Summary

- **Severance and Change-in-Control**
  - Reduced benefit levels and a migration to double trigger design
  - Existing programs are likely not to be modified so as to not expose problematic designs to the scrutiny of proxy advisor firms
Big Picture Summary

- **2012 Hot Topics**
  - The evaluation and assessment of the alignment between compensation and performance continues to be an important theme for organizations, and a trend that we expect to continue
    - Consistent with 2011, the delivery of competitive compensation programs remains the top priority of organizations for 2012
    - Issues such as preparation of compensation-related disclosures, risk-related impacts on compensation programs, and the review of governance policies continue to be on the radar of some organizations
  - While most survey respondents (86%) share the belief that executives are satisfied with the total compensation packages provided to them, they indicate that their executives are most concerned with long-term incentive programs and pay for performance elements of their compensation packages

<table>
<thead>
<tr>
<th>Areas of Concern</th>
<th>Prevalence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-Term Incentive Opportunities</td>
<td>52%</td>
</tr>
<tr>
<td>Attainment of Performance Goals</td>
<td>42%</td>
</tr>
<tr>
<td>Payout Opportunities in Performance Plans</td>
<td>39%</td>
</tr>
<tr>
<td>Base Salary Opportunities</td>
<td>32%</td>
</tr>
<tr>
<td>Short-Term Incentive Opportunities</td>
<td>30%</td>
</tr>
<tr>
<td>Line of Sight</td>
<td>21%</td>
</tr>
<tr>
<td>Elimination of Benefits/Perquisites</td>
<td>8%</td>
</tr>
<tr>
<td>Ownership Requirements</td>
<td>6%</td>
</tr>
<tr>
<td>Severance Levels</td>
<td>3%</td>
</tr>
</tbody>
</table>

**Note:** Prevalence totals will not equal 100% due to multiple responses.

1Source: Aon Hewitt’s 2012 Hot Topics in Executive Compensation Survey Findings
Governance & Regulatory Update
Governance & Regulatory Update

- **Governance**
  - Formally benchmarking executive compensation levels is occurring annually
  - Implementation of clawback policies have stalled as companies are waiting on final prescriptions
  - Limited actions are being taken as a result of Say-on-Pay votes (less than 13% of survey participants indicate that they will modify pay practices to address concerns raised by shareholders)
  - Active engagement with large shareholders to discuss pay issues is starting to occur

- **Proxy Advisory**
  - Balancing the views and recommendations of the shareholder advisory firms with the company’s specific business needs will be a heightened challenge for management and Boards
  - Shareholder communication and outreach efforts will remain critical
  - Enhanced CD&A disclosure detailing the company’s “story” in order to mitigate any challenging negative voting recommendations
  - Increased discussion regarding peer group selection and increased activity focused on tracking peer groups constructed by advisory firms in order to mitigate any surprises due to future comparisons
Governance & Regulatory Update

- **Dodd-Frank**
  - The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law July 21, 2010
  - Several rules were in effect for all shareholder meetings starting in January 2011:
    - Say on Pay
    - Say on Golden Parachutes
  - On June 20, 2012, the SEC issued final rules regarding listing standards relating to independence of compensation committee members and retention of compensation committee advisors (see next slide for additional information)
  - Under consideration currently is disclosure by institutional investment managers of votes on executive compensation
  - Additional rules are still awaiting regulatory action; we anticipate future proxies will need to comply with these impending regulations:
    - Pay for Performance Disclosure
    - Pay Ratio Disclosure
    - Anti-Hedging Policies
    - Clawbacks
    - Broker Voting on Other Significant Matters
Governance & Regulatory Update

- **Dodd-Frank: SEC Independence Standards for Compensation Advisors**
  - On June 20, 2012, in support of Dodd-Frank, the SEC adopted final rules listing six independence factors for compensation committees to consider relative to a compensation advisor. These rules do not require compensation committees to retain an "independent" compensation adviser, but rather that compensation committees should consider six “independence factors” before selection. Importantly, the SEC upheld the committees' use of discretion in determining adviser independence.

  **Six Independence Factors**

  - The provision of other services to the company by the firm that employs the advisor
  - The amount of fees paid to the firm as a percentage of the firm’s revenues
  - The policies and procedures in place by the advisor’s firm that are designed to prevent conflicts of interest
  - Any business or personal relationship of the compensation advisor with a member of the compensation committee
  - Any business or personal relationship between the compensation advisor and the executive officers of the company
  - Any stock of the company owned by the compensation advisor
Governance & Regulatory Update

- **Say-on-Pay\(^1\)**
  - Of the more than 850 public companies that have held shareholder meetings:
    - 98% have received “for” votes on Say-on-Pay (SOP) with an average support of 90%
    - 12% of companies have received “against” vote recommendations from Institutional Shareholder Services (ISS)
      - Of this 12%, approximately 15% have failed their SOP (e.g., Citigroup and KB Home)
      - Of this 12%, approximately 19% have had their SOP proposals pass with less than 70% shareholder support
  - Clearly, many companies benefited from extensive outreach to investors on executive compensation and governance issues—in some cases, overcoming negative ISS comments and recommendations

\(^1\)Source: Institutional Shareholder Services (effective May 15, 2012)
Pay Trends
Pay Trends: Data Sources

Unless otherwise noted, the source of competitive data for this report section is Aon Hewitt’s 2012 Hot Topics in Executive Compensation Survey.

- Overview of the actions we can expect in the executive compensation landscape for 2012
- Results show that organizations are continuing to assess the most effective way to deliver compensation to their executives and keep pace with the evolving executive compensation environment
- The survey contains data from 174 companies representing a cross section of industries
- Data on the size of the companies is presented below

Prevalent Revenue and Employee Sizes of Participating Organizations

<table>
<thead>
<tr>
<th>Revenue Size</th>
<th>Prevalence</th>
<th>Employee Size</th>
<th>Prevalence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $499.9 million</td>
<td>6%</td>
<td>Less than 500</td>
<td>2%</td>
</tr>
<tr>
<td>$500 to $999.9 million</td>
<td>5%</td>
<td>500 to 999</td>
<td>2%</td>
</tr>
<tr>
<td>$1.0 to $2.4999 billion</td>
<td>14%</td>
<td>1,000 to 2,499</td>
<td>7%</td>
</tr>
<tr>
<td>$2.5 to $4.999 billion</td>
<td>18%</td>
<td>2,500 to 4,999</td>
<td>16%</td>
</tr>
<tr>
<td>$5.0 to $9.999 billion</td>
<td>19%</td>
<td>5,000 to 9,999</td>
<td>16%</td>
</tr>
<tr>
<td>$10.0 to $24.999 billion</td>
<td>20%</td>
<td>10,000 to 24,999</td>
<td>24%</td>
</tr>
<tr>
<td>Greater than $25.0 billion</td>
<td>17%</td>
<td>Greater than 25,000</td>
<td>32%</td>
</tr>
</tbody>
</table>
Pay Trends: Salary

- The prevalence of merit increases has stabilized over the past two years
  - Consistent with 2011 expectations, executive salary increases range from 2.5% to 3.5%
Pay Trends: Annual Bonus—Payouts

- In general, organizations are providing bonuses for 2011 performance that is either at target or above target.

In previous years, organizations were making annual incentive design changes in response to economic uncertainty. In 2011 and looking forward, modifications to annual incentive plans will be focused on better alignment between performance and pay.

- Most recent trend in modifications of annual incentive design include – adjusting maximum payouts up and minimum payouts down – increasing an executive's upside for outstanding performance, while decreasing payouts for threshold level performance.
Pay Trends: Annual Bonus—Performance Measures

- Revenue growth and earnings-based metrics such as operating income and earnings per share continue to be the most common noted financial metrics, while business unit/team initiatives are the most frequently noted non-financial objective.

**Exec Comp Hot Topic Survey Companies**

**Financial Measures**

- Revenue Growth: 44%
- Operating Income / EBIT: 33%
- Earnings Per Share: 30%
- Net Income: 20%
- Free Cash Flow: 20%
- Return Measures: 19%
- EBITDA: 17%
- Operating Expense: 14%
- Working Capital: 8%
- Operating / Gross Margin: 5%
Pay Trends: LTI Actions

- Fewer organizations in 2012 relative to the prior year (49% vs. 55%) expect to make changes to how they deliver their long-term incentive programs in 2012, performance metrics and long-term incentive mix continue to be the most frequently noted actions taken by organizations.

### Exec Comp Hot Topic Survey Companies – CEO Only

<table>
<thead>
<tr>
<th>Long-Term Incentive Actions</th>
<th>Prevalence</th>
<th>2012 Prevalence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change mix (weighting) of LTI delivery by using existing vehicles or in conjunction with introducing/eliminating vehicles</td>
<td>63%</td>
<td>54%</td>
</tr>
<tr>
<td>Change performance metrics in long-term performance plan</td>
<td>46%</td>
<td>34%</td>
</tr>
<tr>
<td>Revise administrative/design provisions (e.g., vesting and termination provisions)</td>
<td>17%</td>
<td>25%</td>
</tr>
<tr>
<td>Restrict incentive eligibility</td>
<td>8%</td>
<td>13%</td>
</tr>
<tr>
<td>Broaden incentive eligibility</td>
<td>4%</td>
<td>14%</td>
</tr>
<tr>
<td>Increase LTI award sizes for employees outside the U.S.</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Decrease LTI award sizes for employees outside the U.S.</td>
<td>1%</td>
<td>2%</td>
</tr>
</tbody>
</table>

- These results support the expectations that organizations will be continuously working to enhance Pay-for-Performance alignment.
Pay Trends: LTI Grant Levels and Determination

- Most organizations indicate that they will provide long-term incentive grants to executives in 2012 at similar levels as the prior year.
- Company performance is the most prevalent factor considered when determining long-term incentive grant levels, followed by the change in company stock price and the competitive positioning of the executive pay.

### Exec Comp Hot Topic Survey Companies

**2012 Long-Term Incentive Expectations Compared to 2011**

- Plan not to grant: 3%
- Grant less: 9%
- Grant similar: 66%
- Grant more: 22%
Pay Trends: LTI Program Mix

- Vehicles such as stock options and restricted stock remain prevalent, performance-based share/unit arrangements continue to grow in popularity
  - Shift in LTI pay mix is in response to increased company focus on aligning pay and performance

**Exec Comp Hot Topic Survey Companies – CEO Only**

<table>
<thead>
<tr>
<th>Share Type</th>
<th>2011</th>
<th>2012</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Options</td>
<td>63%</td>
<td>61%</td>
<td>2%</td>
</tr>
<tr>
<td>Restricted Stock</td>
<td>51%</td>
<td>41%</td>
<td>-10%</td>
</tr>
<tr>
<td>Performance Shares / Units</td>
<td>68%</td>
<td>75%</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>6%</td>
<td>6%</td>
<td>0%</td>
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</table>

**Exec Comp Hot Topic Survey Companies – All Other Execs**

<table>
<thead>
<tr>
<th>Share Type</th>
<th>2011</th>
<th>2012</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Options</td>
<td>52%</td>
<td>56%</td>
<td>4%</td>
</tr>
<tr>
<td>Restricted Stock</td>
<td>52%</td>
<td>41%</td>
<td>-11%</td>
</tr>
<tr>
<td>Performance Shares / Units</td>
<td>58%</td>
<td>68%</td>
<td>10%</td>
</tr>
<tr>
<td>Other</td>
<td>5%</td>
<td>8%</td>
<td>3%</td>
</tr>
</tbody>
</table>
In general, performance-based LTI arrangements are determined by a financial-based metric.

Among the financial measures used in performance-based programs, metrics based on earnings, profits, shareholder returns, and revenues continue to be most prevalent.

**Exec Comp Hot Topic Survey Companies**


- Return Measures: 35% in 2011, 30% in 2012
- Total Shareholder Return: 32% in 2011, 30% in 2012
- Revenue-based: 29% in 2011, 30% in 2012
- Earning Per Share: 24% in 2011, 20% in 2012
- Operating Income / EBIT: 15% in 2011, 13% in 2012
- EBITDA: 12% in 2011, 8% in 2012
- Net Income: 13% in 2011, 10% in 2012
2012 Form 4 Analysis: A Look at This Year’s LTI Awards
2012 Form 4 Analysis: A Look at This Year’s LTI Awards

- Findings and commentary on the following pages are based on Aon Hewitt’s 2012 Form 4 Analysis findings
- 2012 equity incentive grant date values have grown at a 4% annual compound growth rate since 2008
  - Based on 2012 Form 4 filings through March 2012
- Our analysis finds 2012 equity incentive median grant values rose 5% over 2011, while the median stock price remained almost flat year-on-year
- While still rising, the 5% growth rate in equity grant values between 2011 and 2012 reflects a much slower pace than in 2011 (13% growth) and in 2010 (23% growth)
  - From 2008 pre-recession levels through 2012, equity incentive grant values have grown a total of 17%
- Fairly flat (+2%) year-on-year stock prices reflect the one-step forward one-step back nature of the economic recovery in the past few months
- Organizations did more with more
  - The growth in 2012 equity grant values was delivered via the use of an increased number of shares (+7% over 2011)
    - Sharp contrast to 2011, when the growth in grant value was fueled by share price growth, not by increased share usage
2012 Form 4 Analysis: A Look at This Year’s LTI Awards

2011 to 2012 LTI Analysis: All Industries (152 Companies)

<table>
<thead>
<tr>
<th>2011 to 2012 Change</th>
<th>Restricted Stock Value</th>
<th>Stock Options Value</th>
<th>Performance-Based Awards</th>
<th>LTI Economic Value</th>
<th>Stock Price</th>
<th>Share Usage</th>
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<tbody>
<tr>
<td>75th %ile</td>
<td>18%</td>
<td>18%</td>
<td>19%</td>
<td>16%</td>
<td>14%</td>
<td>21%</td>
</tr>
<tr>
<td>50th %ile</td>
<td>8%</td>
<td>5%</td>
<td>8%</td>
<td>5%</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>25th %ile</td>
<td>-1%</td>
<td>-11%</td>
<td>0%</td>
<td>-7%</td>
<td>-14%</td>
<td>-5%</td>
</tr>
<tr>
<td>Average</td>
<td>17%</td>
<td>4%</td>
<td>17%</td>
<td>5%</td>
<td>0%</td>
<td>11%</td>
</tr>
</tbody>
</table>
2012 Form 4 Analysis: A Look at This Year’s LTI Awards

Market Trends - Long Term Incentive Value Relative to Stock Price

LTI Values
Stock Price

Early 2008 | Early 2009 | Early 2010 | Early 2011 | Early 2012

100% | 80% | 86% | 111% | 117%

60% | 104% | 106%

Early 2008 | Early 2009 | Early 2010 | Early 2011 | Early 2012

Market Trends - Long Term Incentive Value Relative to Stock Price
LTI Values
Stock Price
2012 Form 4 Analysis: A Look at This Year’s LTI Awards

- **Industry Analysis**
  - Growth in equity incentives varies dramatically by industry
  - Consumer Discretionary and Utility companies increased their equity grant date values at the same or higher rate than their stock prices, while Consumer Staples companies increased equity grant date values, but at a lower rate compared to their stock price increase
  - Despite a decline in stock price from the prior year, Energy and Financial Service companies increased grant date values for 2012

<table>
<thead>
<tr>
<th>GICS Industry Classification</th>
<th>Count</th>
<th>Restricted Stock Value</th>
<th>Stock Options Value</th>
<th>Performance-Based Awards</th>
<th>LTI Economic Value</th>
<th>Stock Price</th>
<th>Share Usage</th>
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<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>21</td>
<td>8%</td>
<td>9%</td>
<td>14%</td>
<td>12%</td>
<td>8%</td>
<td>7%</td>
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<tr>
<td>Consumer Staples</td>
<td>6</td>
<td>24%</td>
<td>-7%</td>
<td>I/D</td>
<td>7%</td>
<td>15%</td>
<td>1%</td>
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<td>Energy</td>
<td>20</td>
<td>14%</td>
<td>14%</td>
<td>9%</td>
<td>8%</td>
<td>-5%</td>
<td>9%</td>
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<tr>
<td>Financials</td>
<td>30</td>
<td>10%</td>
<td>11%</td>
<td>11%</td>
<td>9%</td>
<td>-7%</td>
<td>19%</td>
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<tr>
<td>Health Care</td>
<td>14</td>
<td>-1%</td>
<td>2%</td>
<td>7%</td>
<td>0%</td>
<td>7%</td>
<td>-5%</td>
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<tr>
<td>Industrials</td>
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<td>-1%</td>
<td>8%</td>
<td>0%</td>
<td>1%</td>
<td>3%</td>
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<tr>
<td>Information Technology</td>
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<td>12%</td>
<td>6%</td>
<td>-6%</td>
<td>5%</td>
<td>-1%</td>
<td>7%</td>
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<tr>
<td>Materials</td>
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<td>6%</td>
<td>10%</td>
<td>6%</td>
<td>6%</td>
<td>-2%</td>
<td>12%</td>
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<tr>
<td>Utilities</td>
<td>9</td>
<td>5%</td>
<td>10%</td>
<td>22%</td>
<td>10%</td>
<td>10%</td>
<td>6%</td>
</tr>
</tbody>
</table>

1 Excluded Telecommunications due to insufficient data.
I/D: Insufficient data.
Questions
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