Frederic W. Cook & Co., Inc.

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TRENDS IN REALIZED/REALIZABLE PAY DISCLOSURE
TOP 250 COMPANIES

Introduction

The issue of defining "pay" for purposes of evaluating pay-for-performance alignment received increased attention in the last year. Pay can be measured in various ways – granted/target pay, realizable pay and realized pay. Each measure provides insight into executive pay from a different angle. While no one measure is better than the other per se, understanding which definition is most indicative of the alignment between executive pay and actual performance is integral to effective shareholder communication for companies that want to clearly demonstrate pay-for-performance alignment.

In addition to disclosing compensation for their named executive officers (NEOs) based upon rules mandated by the Security and Exchange Commission (SEC), an increasing number of companies have started disclosing the realized or realizable pay of their CEO, and a few for all NEOs, to communicate their pay-for-performance alignment story to investors. Frederic W. Cook & Co. initiated coverage on this topic last year as part of its annual Top 250 survey[1] – an annual survey of long-term incentive grant practices among the "Top 250" publicly-traded U.S. companies (ranked by market capitalization as of February 28, 2013), and released an initial alert letter in November 2012.[2]

Summary of Findings

The number of companies providing supplemental realized/realizable compensation tables or charts in their proxy statements more than doubled from 15 of the Top 250 (6%) in 2012 to 37 (15%) in 2013, indicating that disclosure of realized/realizable pay for companies' CEOs and other NEOs is a growing trend. Increasing disclosure of realized/realizable pay may be primarily attributed to:

- *Distortions in compensation values reported by companies in SEC-mandated proxy tables* – Proxy disclosure rules require a mix of actual and target pay for NEOs' cash and equity compensation, respectively, to be reported in the Summary Compensation Table

[1] http://www.fwcook.com/alert_letters/The_2013_Top_250_Report_Long-Term_Incentive_Grant_Practices_for_Executives.pdf
[2] http://www.fwcook.com/alert_letters/11-06-12_Realized_Pay--New_Approach_For_Measuring_Pay.pdf

  - The grant date fair values of equity compensation may be worth more or less (or even nothing) when vested or paid and because equity values typically make up the majority of total pay for executives, reported pay does not always align with a company's reported financial and market performance

- *Influence of Proxy Advisory Firms* – The two most influential proxy advisory firms, Institutional Shareholder Services (ISS) and Glass-Lewis, modified their policies for qualitative evaluation of companies' pay-for-performance alignment in early 2013 to include a review of the CEOs' three-year realizable pay

  - Even though both proxy advisors have acknowledged the importance of analyzing realizable pay in assessing the overall effectiveness of companies' incentive programs in aligning pay with performance, fundamental differences exist between the proxy advisors' definitions of realizable pay, including valuation of performance-based awards and stock options, and treatment of changes in pension value

Due to the absence of regulatory mandates requiring such disclosure and there being no standardized definitions of "actual (realized/realizable) pay", companies have so far been able to customize their own definitions of "actual pay." In general, there are two broad categories of "actual pay" measures that differ in their treatment of long-term incentive compensation and can be defined as follows:

- ***Realized pay*** refers to the amount that the executive actually earns during the measurement period, and typically includes all gains realized upon exercise of options and vesting full-value equity grants that were exercised or vested during the measurement period, i.e., irrespective of when the grants were made
- ***Realizable pay*** refers to the amount that the executive expects to realize in the near future, and typically includes the tracking value of total long-term incentive compensation awarded during the measurement period, even if such long-term awards have not yet vested or been exercised

Trends with regard to the manner in which companies are disclosing and presenting realized/realizable pay are as follows:

- Disclosure tends to be limited to the CEO, indicating that most companies believe disclosure of their CEO's realized/realizable pay information is sufficient for making a case for their company's pay-for-performance alignment as opposed to disclosing it for all NEOs
- Companies that choose to disclose ***realized pay*** most often include equity awards that vested or were earned or exercised during the measurement period irrespective of when the grants were made

- Companies that choose to disclose ***realizable pay*** most often include equity grants made in the most recent three-year period and value all unearned performance-based awards at target number of shares; all awards are typically valued as of the latest fiscal year-end share price
- Intrinsic value of stock options/SARs is preferred over an updated Black-Scholes value for realized/realizable pay calculations
- Although a majority of companies exclude all elements of indirect compensation, such as change in pension value and perquisites/benefits, including the latter in realized/realizable pay calculations is relatively more prevalent
- Rather than presenting a comparison against peers, most companies compare realized/realizable pay against their company's actual performance (typically total shareholder return, or TSR) and/or their target or Summary Compensation Table pay amounts
- Companies use charts similar to ISS' Relative Degree of Alignment chart when doing relative pay-for-performance comparisons versus peers and ISS' Absolute Pay-TSR Alignment chart when doing absolute pay and TSR comparisons. Comparisons against target or Summary Compensation Table pay amounts are done using either simple bar charts or tabular data
- Most companies that disclose realized/realizable pay report equity values that are lower than the grant-date equity compensation values reported in the Summary Compensation Table

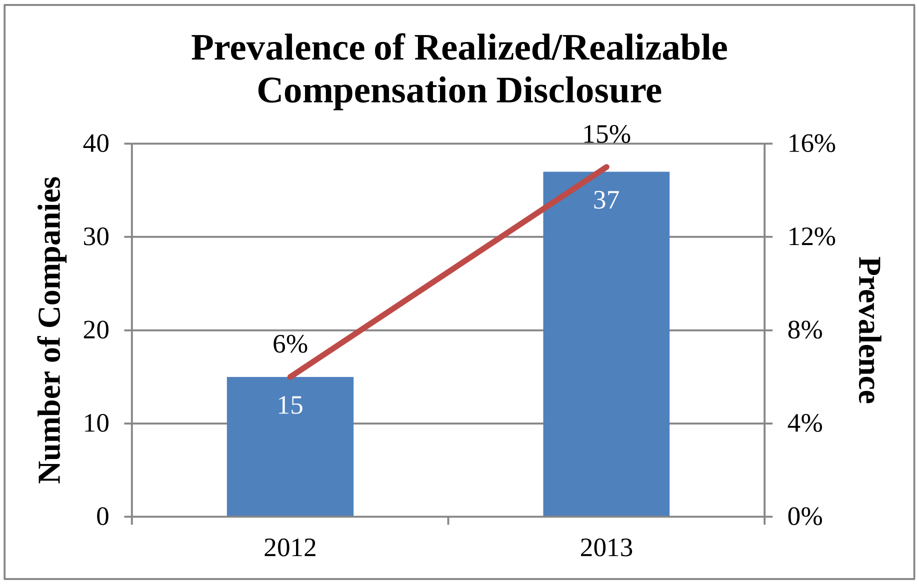
This report presents a summary of prevalence and practices, as well as emerging trends, related to realized/realizable pay disclosures.

Market Practices and Trends

Frederic W. Cook & Co. has researched market practice and trends relating to alternative definitions of pay among the "Top 250" publicly-traded U.S. companies also used in the Frederic W. Cook & Co. 2013 Top 250 survey. The sample companies used for studying market practices and trends on realized/realizable pay include all companies that provided supplemental compensation tables among these 250 companies.

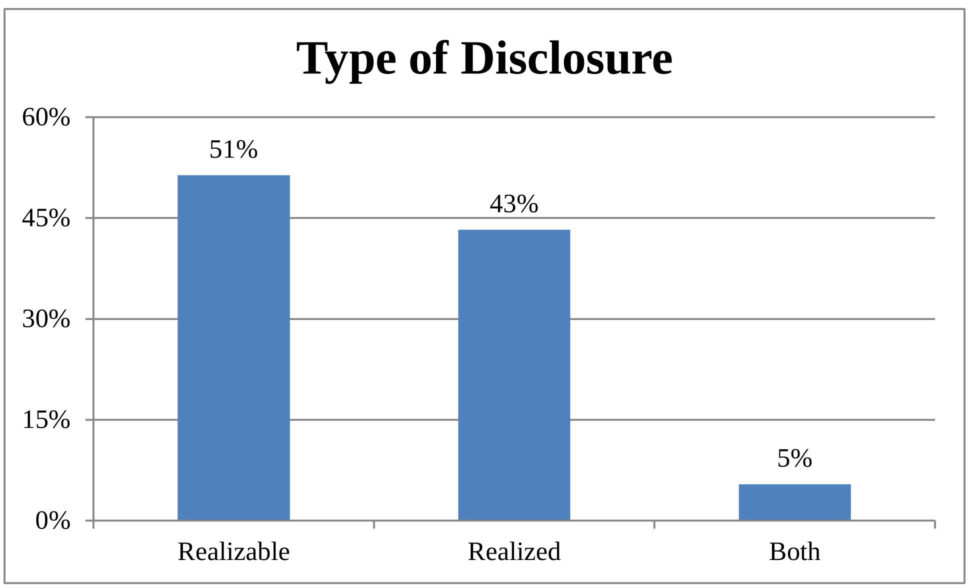
A. Realized/Realizable Pay Prevalence

- Thirty-seven of the Top 250 companies (15%) provided supplemental realized and/or realizable compensation tables or charts in their 2013 proxy statements for some or all of their NEOs, up from 15 (6%) in 2012

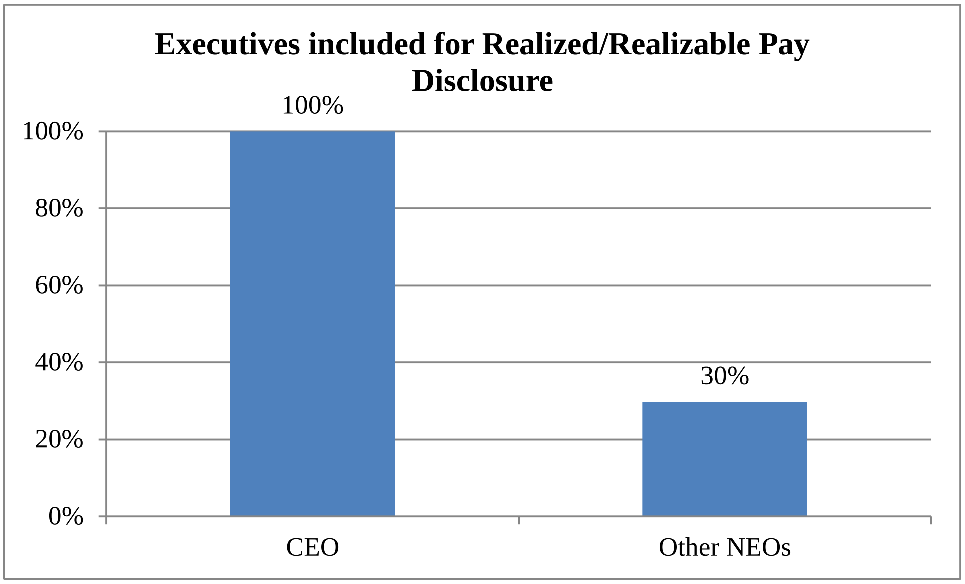


➢ Of the 15 companies that disclosed realized/realizable pay in 2012, 11 companies continued the same practice in 2013 (e.g., Boeing, Deere & Co., Eaton) while four companies chose not to disclose realized/realizable pay in 2013 (e.g., Allstate)

- Of the 37 companies, approximately half disclosed realizable pay (e.g., Adobe Systems, Coach, United Technologies) and slightly less than half disclosed realized pay (e.g., Exxon Mobil, Gap, Hewlett-Packard). Two companies disclosed both realized and realizable pay (i.e., CME Group and International Paper)

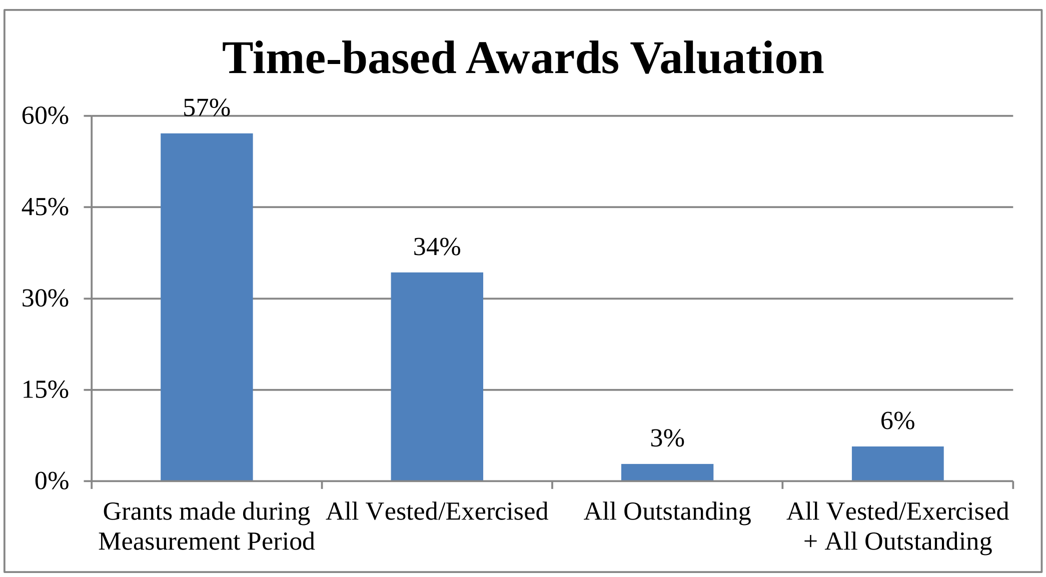


- All companies that disclosed realized/realizable pay reported it for the CEO and approximately one-third of the companies also reported it for NEOs other than the CEO (e.g., General Electric, Newmont Mining)



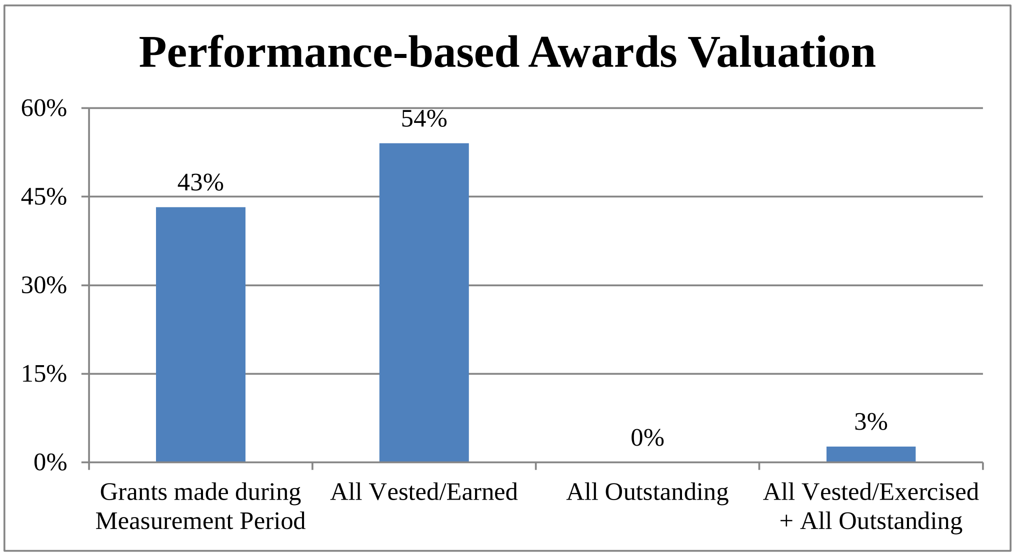
B. Valuation Methodology

- Thirty-three of the 37 companies (89%) granted time-vesting equity awards and disclosed their realized/realizable compensation valuation methodology for such awards
  - Of the 33 companies, slightly more than half included only awards made during the measurement period (e.g., Corning, Johnson Controls), approximately one-third of the companies included only awards that vested or were exercised during the measurement period (e.g., Coca-Cola, Eli Lilly), while only one company included all outstanding awards (CME Group). One company included both vested/exercised awards as well as all outstanding awards (CVS Caremark) and another (Ensco) included awards under all three categories but for separate analyses, i.e., grants made during the measurement period only for its relative pay-for-performance alignment analysis versus its peer group, and vested/exercised awards plus all outstanding awards for its absolute pay-for-performance alignment analysis (i.e., comparison of actual pay versus company's own performance)

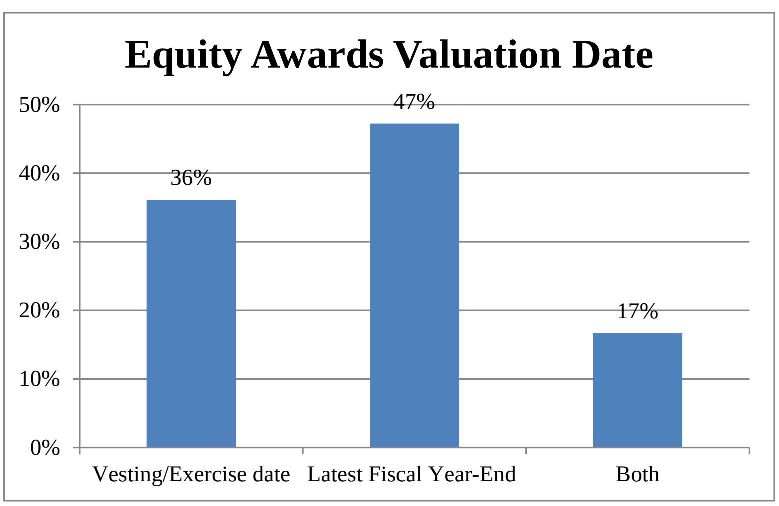


- Thirty-five of the 37 companies (95%) granted performance-vesting equity awards and disclosed their realized/realizable compensation valuation methodology for such awards

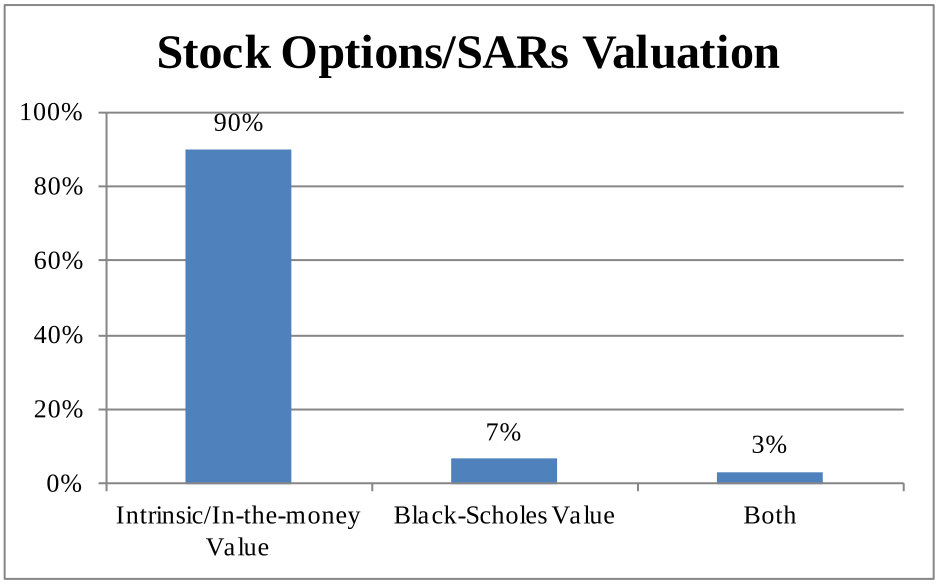
  - Of the 35 companies, slightly less than half included only grants made during the measurement period (e.g., Apache, Prudential Financial), and slightly more than half included only awards that were earned or fully vested during the measurement period (e.g., Ingersoll-Rand, Nucor). None of the companies included all outstanding awards. In line with its treatment of time-based awards, one company (Ensco) included grants made during the measurement period only for its pay-for-performance alignment analysis versus its peer group, but vested/exercised awards plus all outstanding awards for its absolute pay-for-performance alignment analysis



- To value NEOs' equity awards, approximately one-third used the vesting or exercise date for each award (e.g., CSX Corp., CVS Caremark), approximately half the companies valued awards as of the latest fiscal year-end (e.g., Baker Hughes, PG&E Corp.), while six of the companies (mostly with realizable pay disclosure that included both vested and unvested awards) valued vested/exercised awards as of their vesting or exercise date and unvested/unexercised awards as of the latest fiscal year-end (e.g., Sherwin-Williams)



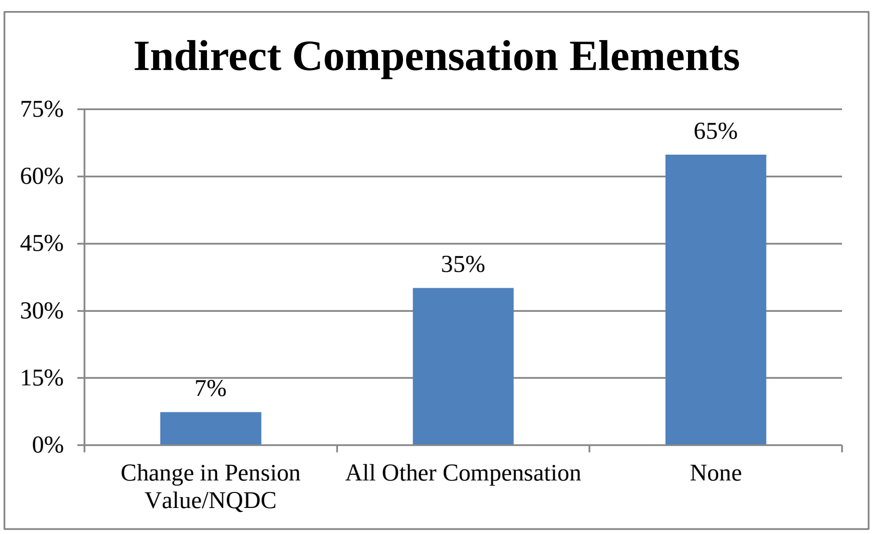
- For stock option/SARs valuation, nearly all of the companies included only the intrinsic or in-the-money value (e.g., Kimberly-Clark, WellPoint) versus the updated Black-Scholes value (e.g., Deere & Co.), which also includes the remaining time-value of stock options/SARs



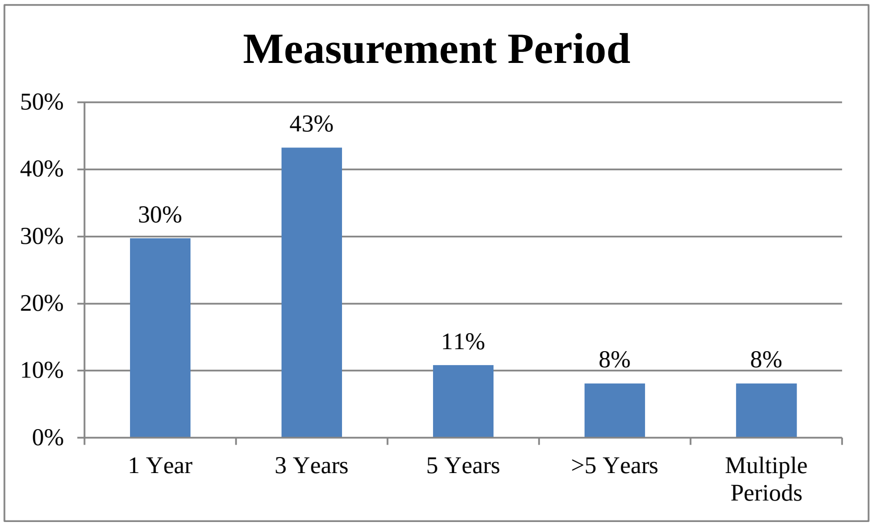
- Because there were only three companies that included all outstanding awards (i.e., all awards outstanding irrespective of when the grants were made) in their realized/realizable pay calculations, there were not sufficient data to determine if there is a specific trend with regard to how companies value all outstanding awards

  - Out of the three companies, two included only the net change in the values of all outstanding awards during the measurement period and one company included the total value of all outstanding awards

- While indirect compensation elements, such as change in pension value and other benefits and perquisites, are required to be included in the Summary Compensation Table in companies' proxy statements, a majority of companies excluded these elements from realized/realizable pay calculations

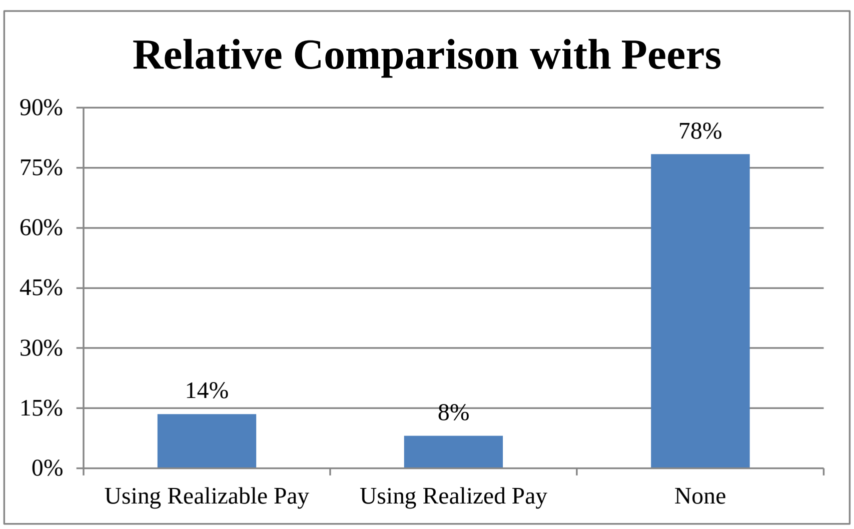


- In terms of the measurement period, most companies used pay and performance for the latest three-year period to calculate realized/realizable pay (e.g., Adobe Systems, Coach) followed by a one-year period (e.g., Devon Energy). Approximately one-fifth of the companies used a measurement period of five or more years (e.g., Marathon Oil)

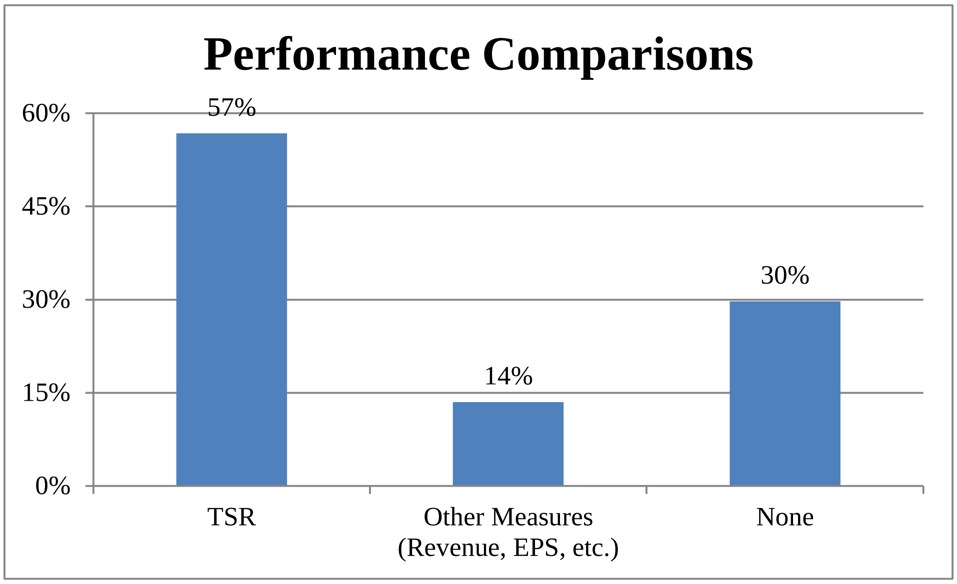


C. Types of Comparisons

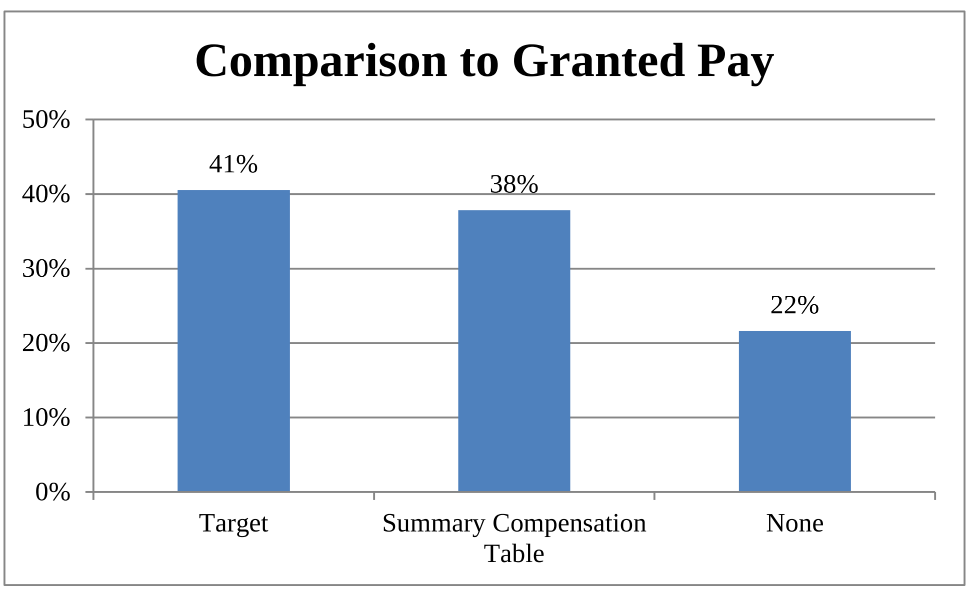
- Of the 37 companies that disclosed realized/realizable pay in 2013, nearly one-quarter made relative pay-for-performance comparisons of their CEO's pay versus the company's compensation peer group (e.g., CVS Caremark, International Paper)
  - There was no definite trend in which pay definition companies believe to be more relevant in making relative comparisons against peer companies; however, more companies used realizable pay than realized pay
  - To demonstrate relative comparisons, most companies plot the percentile ranking of their realized/realizable pay against their respective TSR percentile ranking



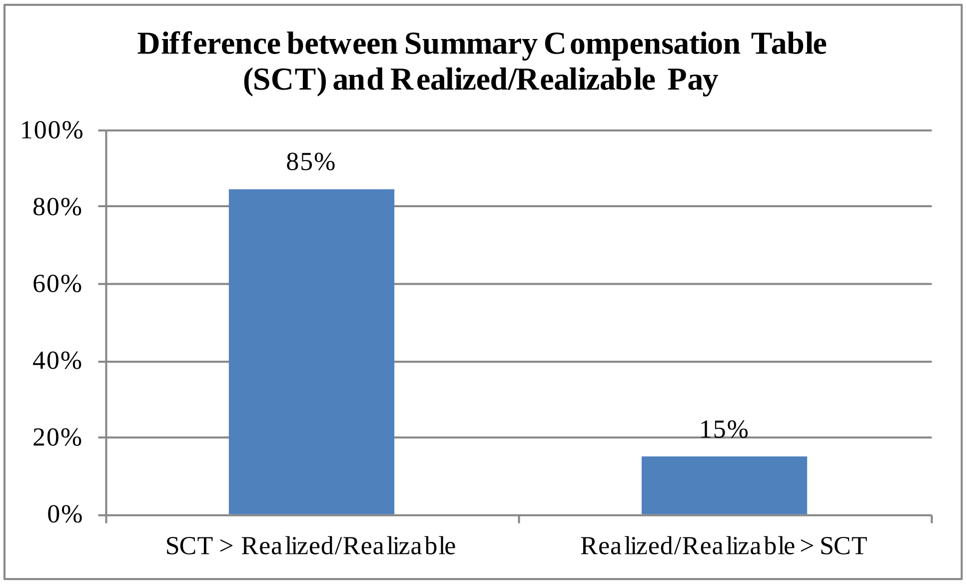
- Nearly three-quarters of the companies made realized/realizable pay comparisons against their company's actual performance (e.g., Eli Lilly, Exelon) during the measurement period
    - ➢ A majority of companies used TSR to compare executives' realized/realizable pay against their performance, while only a few companies used other measures such as revenue, EPS, etc.



- Slightly more than three-quarters of the companies compared realized/realizable pay with executives' target pay or the pay disclosed in the Summary Compensation Table (e.g., Exxon Mobil, Newmont Mining)
    - ➢ An approximately equal number of companies made comparisons against target pay and Summary Compensation Table pay



- Of the 33 companies that disclosed the realized/realizable pay values for their CEO/NEOs, the vast majority disclosed realized/realizable pay values that were lower than the figures disclosed under the Summary Compensation Table



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This report was authored by **Arjun Prakash** with research assistance from other Frederic W. Cook & Co. consultants. Questions and comments should be directed to Mr. Prakash at aprakash@fwcook.com or (914) 460-1104. Copies of this report and other published materials are available on our website, www.fwcook.com