CEO Pay Strategies Report

2014

EQUILAR

Featuring Commentary From:

MERIDIAN
COMPENSATION PARTNERS, LLC

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Introduction

To the interested observer, CEO compensation plans can serve both as reflections of broader economic circumstances and as beacons that illuminate shareholders' expectations of their chief executives. In 2013, growth in CEO compensation demonstrated the extent to which CEOs benefitted from a strong economy, and the structure of pay plans made apparent the degree to which shareholders expect CEO compensation to correspond to company performance. The following report examines how America's most influential companies motivate and reward their top executives.

Key Findings

Median compensation in 2013:

- S&P 500: $10.1 Million (+9.5% YOY)
- S&P 1500: $5.0 Million (+8.5% YOY)

Performance awards increasingly dominate equity compensation. 75.7% of S&P 500 and 63.8% of S&P 1500 CEOs received performance-based equity grants in 2013, up from 71.0% and 57.0%, respectively. 13.0% of S&P 500 CEOs received only performance-based equity.

Realizable pay exceeds grant date fair value pay. Driven primarily by a robust equity market in 2013, realizable pay, calculated using the methodologies of ISS, Glass Lewis, and the Conference Board Working Group, generally exceeds Grant-Date Fair Value pay.

Options constitute a shrinking portion of CEO pay packages. 17.5% of the value of an average S&P 500 CEO's 2013 pay package consisted of options, down from 18.0% in 2012 and 23.1% in 2009.

CEOs are getting younger. The average age of an S&P 1500 CEO fell from 53.0 in 2009 to 50.8 in 2013, despite rising average tenure over the same time interval.

Executive Summary

With the S&P 500 closing 2013 at a record high and investors in the S&P 1500 earning total returns of 32.8%, it should come as no surprise that CEO compensation also experienced robust growth in 2013. Median S&P 500 compensation climbed to $10.1 million, up from $9.3 million in 2012. In the S&P 1500, pay growth was strongest in the consumer goods and technology sectors, which experienced 16.6% and 14.0% growth, respectively.

Most of the recent growth in CEO compensation derives from stock awards, whose values have climbed in lockstep with the U.S. economy. Median S&P 500 stock compensation rose by $491,019 to $4,268,019, growth of 13.0%. This represents 56.0% of the total growth in median compensation. When equity is measured on the basis of intrinsic value at the end of 2013, the size of equity awards and their importance become even more pronounced.

Growth in stock awards hints at the broader trend in CEO compensation toward equity compensation, particularly toward equity with performance-based vesting conditions. The share of total compensation deriving from equity has never been higher, reaching median values of 62.9% in the S&P 500 and 56.3% in the S&P 1500. Likewise, the share of CEOs receiving some form of performance-based equity in 2013 stood at 75.7% in the S&P 500 and 63.8% in the S&P 1500. Median S&P 500 performance stock compensation grew to $3,407,781 in 2013, up 7.3% from 2012 and 52.0% since 2009. This evolution of CEO pay mix represents a continued convergence toward the vehicles most favored by investors as companies lacking clear alignment between pay and performance face increasing difficulty garnering shareholder support for Say on Pay votes. Options in particular have declined in terms of the average value delivered to a CEO as many investors question whether they are the most preferable compensation vehicle for large, mature companies not expected to experience meteoric growth.

Discretionary bonuses are another form of compensation sometimes considered problematic by the investor community due to their perceived opacity. Only 12.5% of S&P 500 CEOs and 15.0% of S&P 1500 CEOs received such bonuses in 2013, well below the 2012 figures of 15.2% and 19.3%, respectively. Even during the height of the financial crisis in 2009, CEOs were far likelier to receive discretionary bonuses than they are today. In place of these bonuses, CEOs are much more likely to receive short-term incentive plan payouts, whose inner workings and performance linkage are more readily apparent to shareholders. Discretionary bonuses are most popular

among smaller and higher-performing companies.

Though traditionally seen as an old-man's game, CEOs near the top of the age distribution are increasingly being replaced with CEOs in their late 40s and early 50s, and women represent a small, yet rising share of CEOs. The average age of an S&P 1500 CEO fell to 50.8 years in 2013 from 51.3 in 2012 and 53.0 in 2009. The number of female CEOs within the S&P 1500 in place for at least one year stood at 36 in 2009, but has since grown to 53.

The data in this report suggest a compensation regime in 2013 that is profoundly different from the one in effect five years before. In addition to the rise in CEO pay, the types of equity vehicles and bonus plans companies use have been reshaped to meet greater demand for disclosure and performance linkage. Each graph and figure in this report should be approached with reference both to where CEO pay began and to where it may be headed five years hence.

Methodology

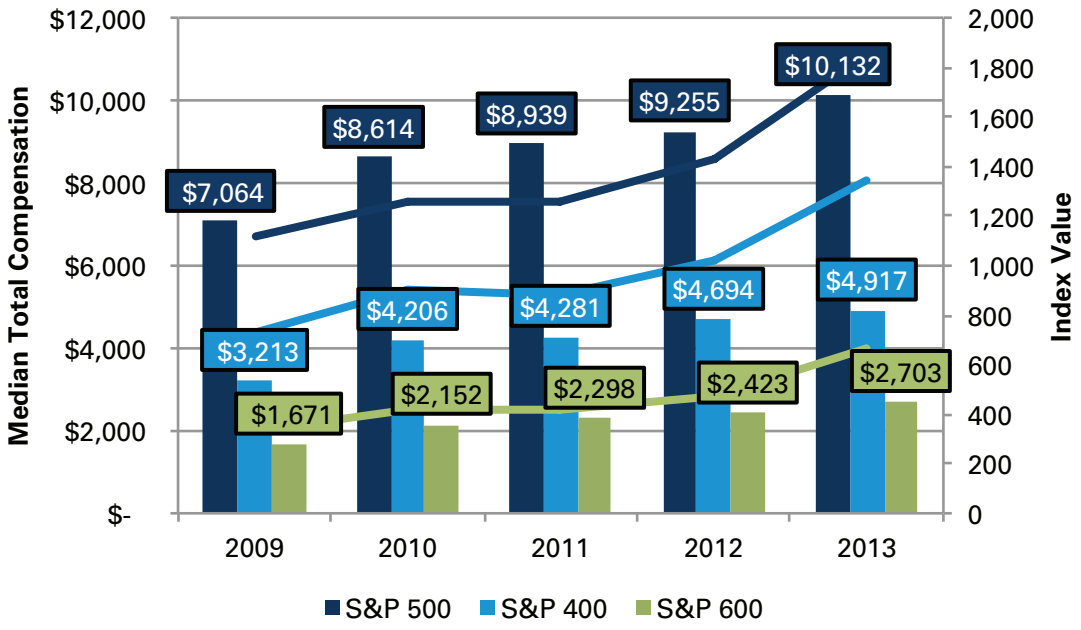
The CEOs in this analysis include all who served in such a position at the end of their company's applicable fiscal year and for the entire year preceding that. Previous versions of this report have excluded CEOs not in place for at least two full years and included only those years in the analysis. The new methodology has the benefit of more accurately reflecting the current makeup of America's CEO population and allowing comparison across any number of years. The period chosen for most graphs and statistics is five years, encapsulating the developments taking place since the financial crisis reshaped the American economy and once again brought increased national attention to compensation-related issues. The conglomerates sector was excluded from graphs displaying sector information due to the small sample of companies. However, those companies and their CEOs were included in all index-level statistics.

Though the graphics provided herein display a wide range of statistical information pertaining to CEO compensation, they are only a small sampling of available information.

Total Compensation

The last year witnessed a continued rise in CEO compensation consistent with recent years, a trend that held across S&P 500, S&P MidCap 400, and S&P SmallCap 600 companies, as shown below. The growth in CEO compensation was commensurate with exceedingly strong stock market performance throughout 2013.

S&P 1500 Median Total Compensation by Index (in thousands)

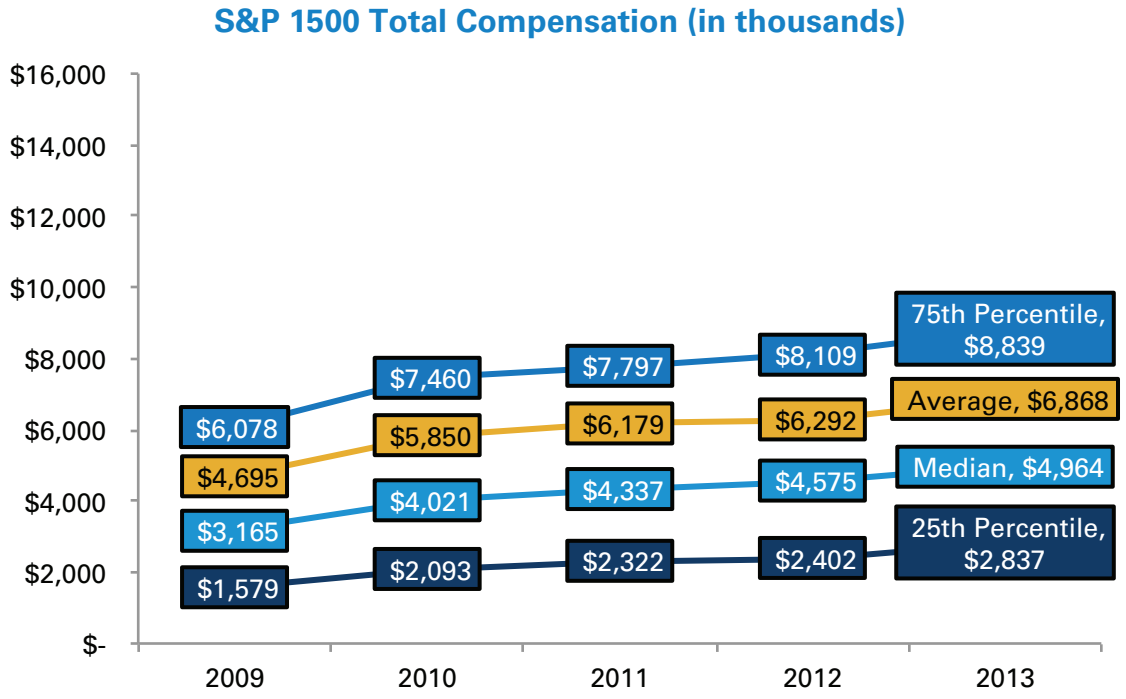


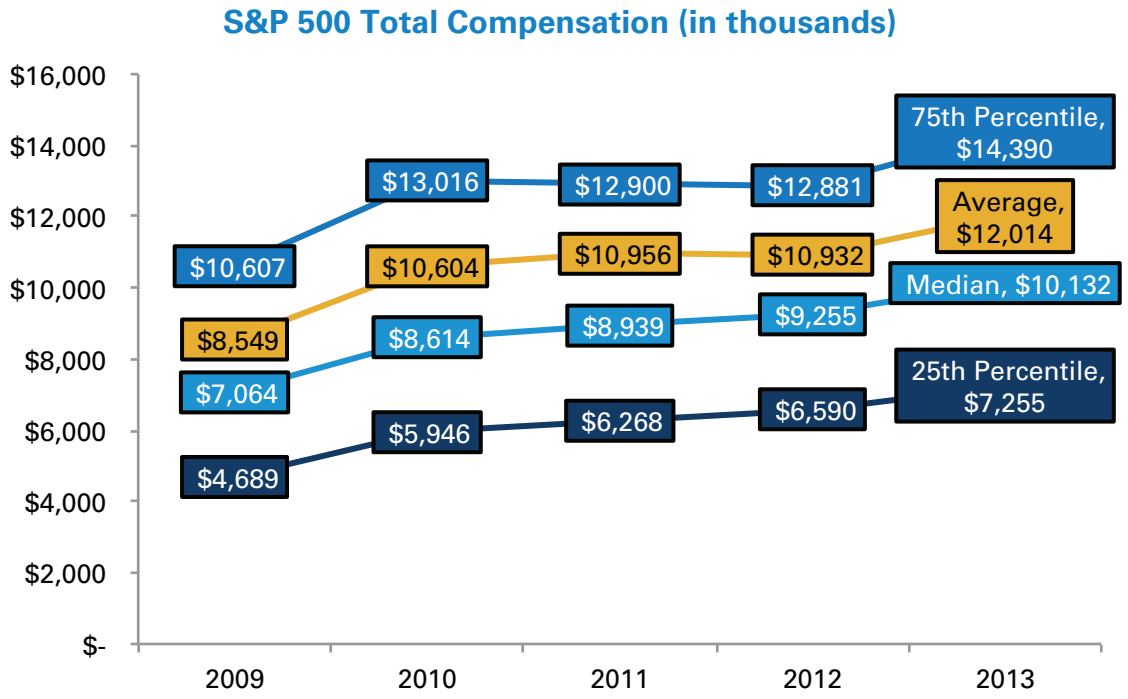
2010 saw a jump in CEO compensation, but the two years after saw much slower growth (and even a decrease at the upper quartile in the S&P 500). In 2013, pay increased significantly with the median of $10.1 million growing 9.5 % over the 2012 median of $9.6 million – compared to 3.5% growth in 2012. While the 75th percentile of pay decreased 1.0% from 2010 to 2012, it grew notably 11.7% from 2012 to 2013.

- Median CEO pay increased 8.5% in 2013, the highest rate of growth since 2010.
- In the S&P 500, median CEO pay increased 9.5% in 2013.

Meridian Commentary

- As companies gradually emerged from global recession over the last five years, CEO compensation continued to increase its sensitivity to pay-for-performance, with the vast majority of total compensation delivered via annual- and long-term incentives. As a result, CEO compensation increased commensurately with improving external economic conditions, growth in the stock market, stronger internal operating performance, and overall increasing company size through consolidation and organic growth.
- CEO compensation in any year reflects two critical aspects – performance over the past few years and expected performance in the next few years. CEO total compensation must be viewed in its entirety over a longer-term time horizon as sources of year-over-year movement in pay can often be hard to isolate and explain. Equity-based compensation, which constitutes a majority of CEO total compensation, is intended to reflect performance over 3 years or more and is subject to the vagaries of the market. Nevertheless, we see that, directionally, CEO pay has been generally moving up with the market.



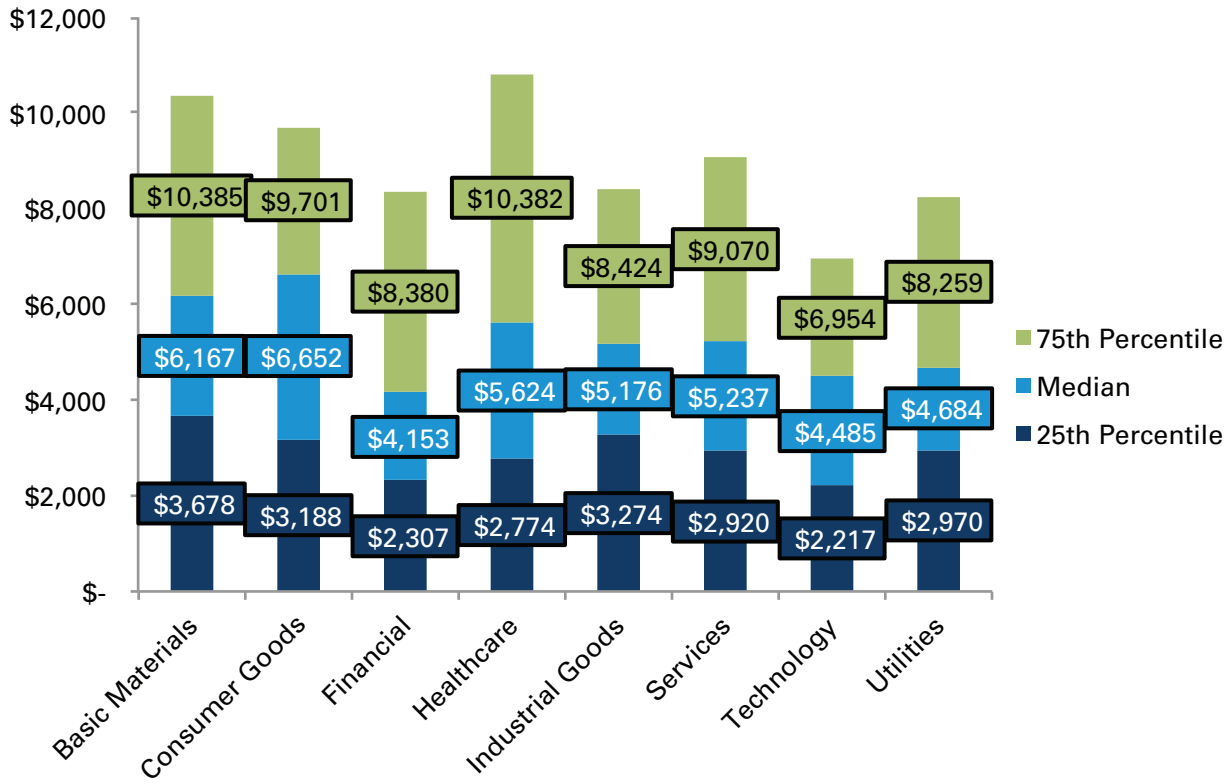


Meridian Commentary

- With the majority of compensation delivered via equity, there is greater potential for outliers on the high-side, as illustrated by average pay being consistently higher than median pay levels. This upwardly skewed phenomenon is a primary reason that shareholders are often critical of disclosed compensation philosophies that target the 75th percentiles.
- Shareholders tend to be more open to targeting a range (like 50th to 75th percentiles), suggesting some comfort when companies retain flexibility in targeting the competitive market and enabling an ability to reflect all aspects of individual pay drivers, including experience, competence, and scarcity of talent that can require target compensation to be above median. Pure 75th percentile pay positioning outside of a few circumstances (like being the largest in the peer group) is limited.

- Median compensation was highest in the consumer goods sector and lowest in the financial sector.
- At the upper quartile of the compensation spectrum, healthcare had the highest 75th percentile of pay, and technology had the lowest.

S&P 1500 Total Compensation by Sector (in thousands)

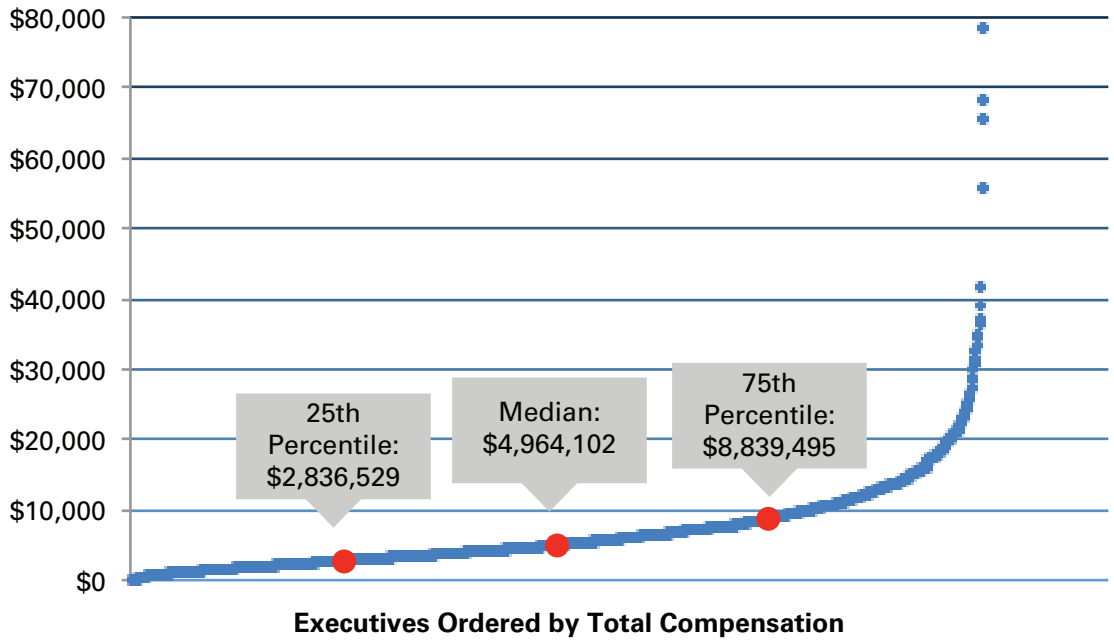


Meridian Commentary

- Industry matters, particularly for mid-size companies (as we note later, large companies tend to pay more like other large companies), with some industries simply paying more for CEOs than others. Over time, industries will move in and out of leading pay positions relative to other industries. Financial services and technology are two industries once known as above-average payers, whereas today we see their position has shifted. These shifts are a function of macro-economic movements, supply of talent and capital, newer, smaller market entrants, and regulation.
- Regulation had a remarkable impact on financial services in terms of both pay levels and pay structure, with regulators favoring fixed over variable pay with lower leverage on incentive pay as a way to mitigate perceived systemic risks within the industry.
- The healthcare sector has witnessed a series of industry consolidations in recent years, which has created fewer bigger-players paying compensation levels commensurate with their size, complexity, and talent base.

The graph below depicts the distribution of total compensation of every CEO in the S&P 1500, arranged in order of increasing pay. While the distance between executives' pay remains small as the line slowly slopes to $15 million, it then experiences a distinct turn upward. The majority of the spectrum of CEO pay is evenly distributed with a sharp increase in pay after the $15 million mark.

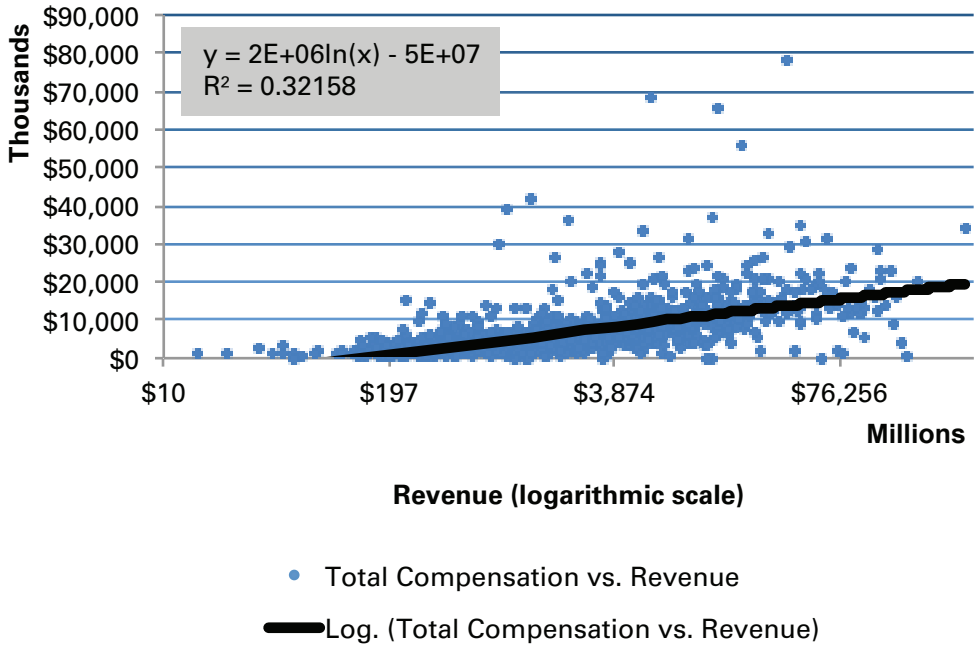
S&P 1500 CEOs Ordered by Total Compensation (in thousands)



Perhaps the most important determinant of CEO compensation is company size as larger companies typically pay their CEOs far more than smaller companies. As seen above, median CEO pay in the S&P 500 is $10.1 million, over twice the median of $4.9 million in the S&P MidCap 400. Revenue size also plays a factor in the scale of CEO pay.

The following plot shows the relationship between total compensation and revenue among S&P 1500 companies with revenue expressed on a logarithmic scale for clarity. The relationship is clear: revenue alone explains 32.2% of the variation in CEO total compensation in 2013.

S&P 1500 Total Compensation (in thousands) v. Revenue (in millions, logarithmic scale)



Meridian Commentary

- Although there is a clear positive relationship between revenue size and total compensation levels, it is important to note that revenue is a better predictor of base salary since performance is largely eliminated as a variable from this pay component, reflecting more of the scope and complexity of the company rather than its relative performance.
- Companies that use regression analysis to determine target compensation levels for executives may be better served by using regression statistics to predict salary. Once salary is determined, apply the company's pay philosophy and pay mix to "build" target total compensation rather than predicting total compensation with regression analysis and then dividing pay into the various components.
- While a positive correlation between company revenues and CEO compensation holds true for a vast majority of industries, this is less true for financial services (which comprises 18.5% of companies in the S&P 1500), where other factors, such as assets, may be a more appropriate scope measure for regression analysis.

Realizable Pay

The increasing desire for pay for performance transparency brings with it a need to define pay and performance. There is general acceptance that a company's performance can be represented by a measure such as total shareholder return (TSR) or a combination of financial metrics, including revenue and earnings per share (EPS). CEO pay, however, does not invoke the same consensus.

A number of different calculations are used to determine total CEO compensation. Grant-Date Fair Value has historically been a popular choice because it relies on figures from the SEC-mandated tables found in annual proxies and provides a level of compensation targeted by the company. However, a calculation that is quickly growing in popularity is Realizable Pay, which provides the strongest alignment between the performance of the company and the resulting pay for a given period. The relative novelty of Realizable Pay has led to a variety of calculation methods.

The proliferation of Realizable Pay definitions has resulted in inconsistency when they are used in pay for performance comparisons. As more companies begin to use them, three different calculations will likely prove most influential. The calculations used by ISS, Glass Lewis, and The Conference Board Working Group are currently the most influential, and one of those methods will likely gain wide-spread adoption.

The table below summarizes the most popular definitions of Realizable Pay and compares them to Grant- Date Fair Value (Summary Compensation Table) pay.

<table>
<tr><th></th><th>Grant-Date Fair Value (SCT) Pay[1]</th><th>ISS Realizable Pay[2]</th><th>Glass Lewis Realizable Pay[2,3]</th><th>CBWG Realizable Pay[2,3]</th></tr>
<tr><td>Salary</td><td>Actual salary earned</td><td colspan="3">Actual salary earned</td></tr>
<tr><td>Bonus</td><td>Actual non-incentive bonus and STIP cash awards received</td><td colspan="3">Actual non-incentive bonus and STIP cash awards received</td></tr>
<tr><td>LTIP Cash Awards</td><td>Actual value of LTIP cash awards earned</td><td colspan="3">Value of LTIP cash awards granted and earned</td></tr>
<tr><td>Time-Based Stock</td><td rowspan="2">Disclosed value of stock granted</td><td colspan="3">Intrinsic value of stock granted</td></tr>
<tr><td>Performance Stock</td><td colspan="3">Intrinsic value of stock granted and earned</td></tr>
<tr><td>Time-Based Options</td><td rowspan="2">Disclosed value of options granted</td><td>Black-Scholes value of options granted</td><td colspan="2">Intrinsic value of options granted</td></tr>
<tr><td>Performance Options</td><td>Black-Scholes value of options granted and earned</td><td colspan="2">Intrinsic value of stock granted and earned</td></tr>
<tr><td>Pension and Deferred Compensation</td><td>Change in pension and deferred compensation earnings realized</td><td>Change in pension and deferred compensation earnings realized</td><td colspan="2">N/A</td></tr>
<tr><td>Other Compensation</td><td>Actual all other compensation paid</td><td colspan="2">Actual all other compensation paid</td><td>N/A</td></tr>
</table>

[1] All equity grants are valued upon the date of grant

[2] All equity grants are valued upon the last day of the evaluation period

[3] Target amounts for performance awards are used when payout amounts are not available

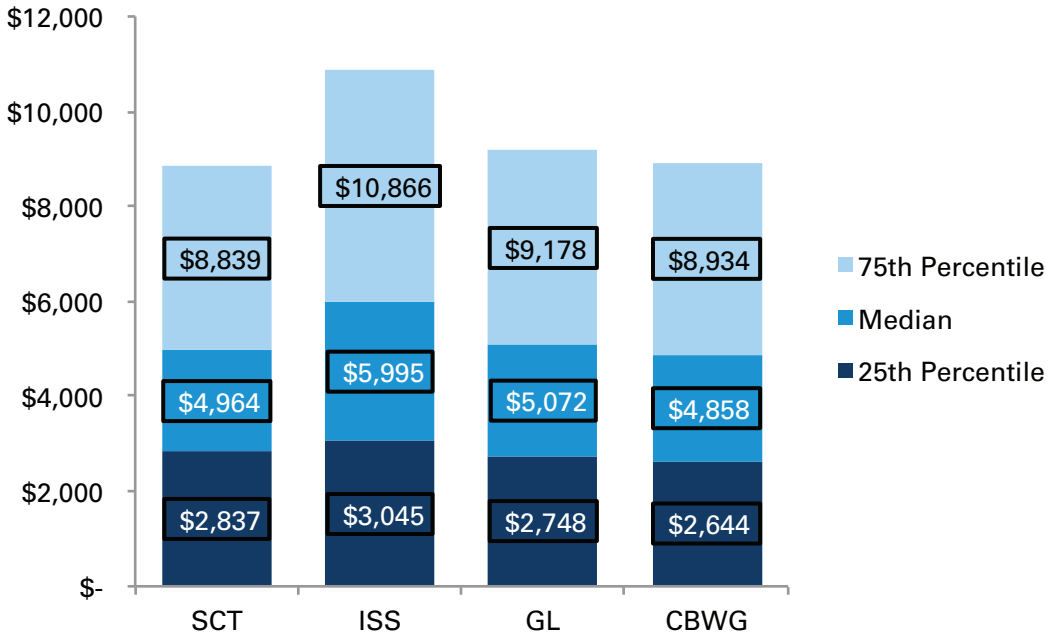
[4] Excludes new hire awards

The following chart compares S&P 1500 CEO pay using the four methodologies described above. Due to strong economic performance during 2013, many equity awards have values exceeding those disclosed on a Grant-Date Fair Value basis earlier in the year. Thus, Realizable Pay tended to exceed grant-date fair value pay during 2013, as shown below.

ISS's Realizable Pay figures are the highest, in part because pension and deferred compensation are included. ISS also uses the Black-Scholes method to value options rather than intrinsic value. This last point is crucial because it incorporates an additional time-based element into option valuation absent from other calculations.

- Using ISS and Glass Lewis definitions of Realizable Pay, CEO compensation exceeded grant-date fair value pay at the median. At the 75th percentile, all three definitions exceeded grant-date fair value pay.

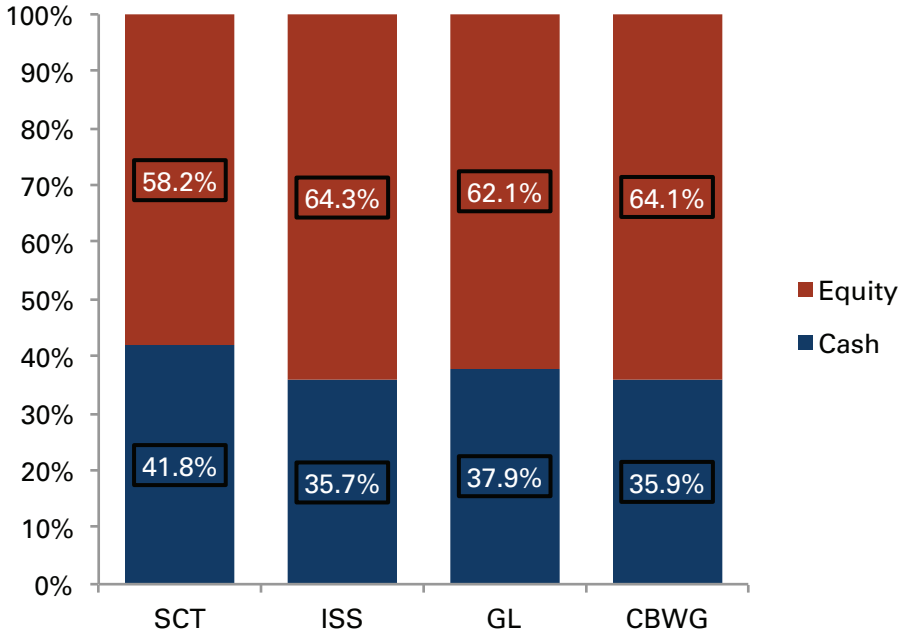
S&P 1500 2013 Realizable Pay Values by Definition (in thousands)



The graph below shows the percentage of S&P 1500 CEO compensation attributable to cash or equity, broken down by pay definition. Using the valuation methods commonly employed in Realizable Pay calculations for the year 2013 generally had the effect of boosting equity values.

- Equity made up a larger share of Realizable Pay totals than Grant-Date Fair Value totals across all definitions.
- Most of the discrepancy between Realizable Pay values and Grant-Date Fair Value (SCT) values is attributable to the greater amounts of equity in Realizable Pay calculations.

S&P 1500 2013 Realizable Pay Cash/Equity Mix



Meridian Commentary

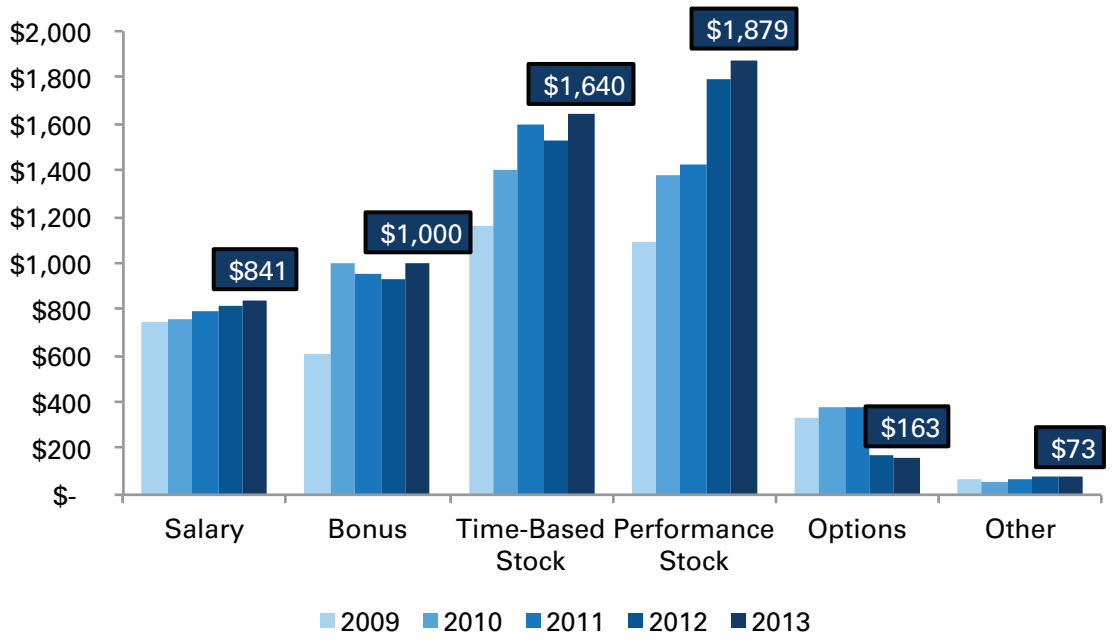
- The emergence of multiple, yet fairly similar Realizable Pay methodologies illustrates the challenge in fully reconciling the timing of pay relative to performance, the timing of pay disclosures, and the timing of compensation decisions. While each approach has its merits and limitations, this issue is indicative of how companies and shareholders must triangulate in on compensation to truly understand the quantum of pay in relation to performance over a multi-year time horizon.
- Companies can model and test different realizable pay methodologies to help identify potential issues and be prepared for potential questions. These methodologies can also be customized to better reflect the company's compensation program.
- Companies are split on including realizable pay in their CD&As as they can sometimes create more questions than answers. For many companies, these analyses are simply done for internal purposes to better monitor pay and performance.

Pay Components

The graphs below vividly illustrate the degree to which CEO compensation trends over the last five years have been driven by stock awards. Median values of all other compensation elements are either flat over the time interval or down slightly, while median stock awards have grown sharply, in large part, thanks to growth in performance-based stock compensation. The graphs below show the median value for each pay type with 2013 values labeled.

- From 2009 to 2013, the median value of performance-based stock compensation in the S&P 1500 increased 49.8% from $1,089,832 to $1,879,465, while bonuses increased 7.2% and the median salary value just 3.4%.
- Options were the only component that diminished, with the median value falling to around half of its 2009 figure of $331,556.

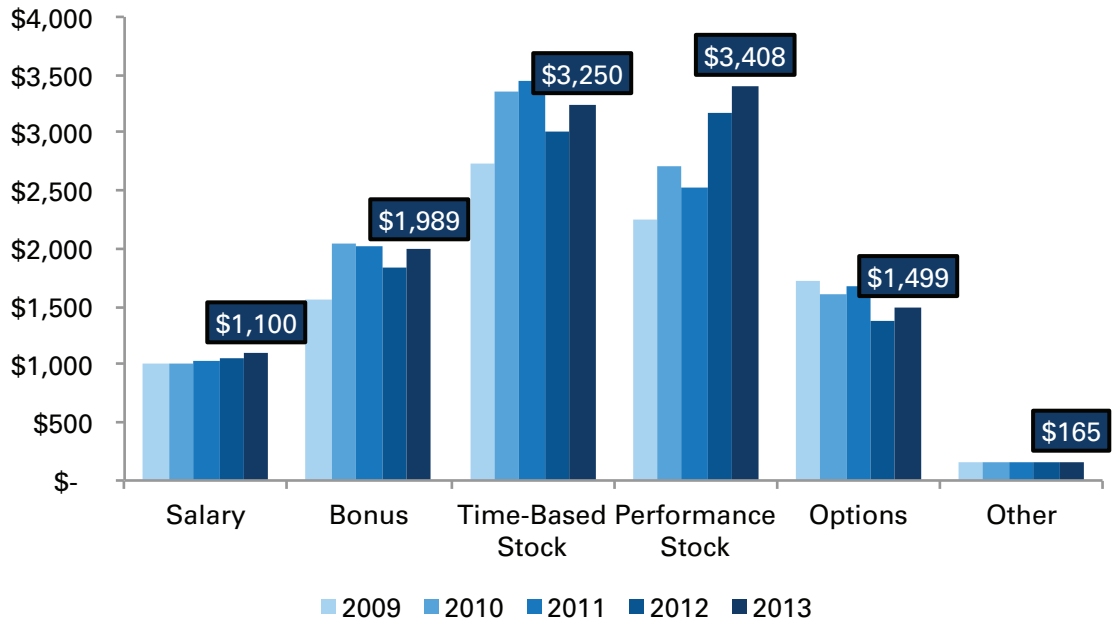
S&P 1500 Median Pay Component Values by Year (in thousands)



In the S&P 500, the same trends play out at higher values, and stock plays a larger role in compensation packages. While the ratio of median stock values to median salary values was about 2.3:1 in the S&P 1500 in 2013, the gap was much greater among the larger companies in the S&P 500, with median stock at nearly four times the median salary.

- In the S&P 500, median performance-based stock compensation increased 52.0% since 2009 and 7.3% since 2012.
- Options have not decreased as steadily as in the S&P 1500, and from 2012 to 2013, the median values granted instead rose, growing 9.5%.

S&P 500 Median Pay Component Values by Year (in thousands)



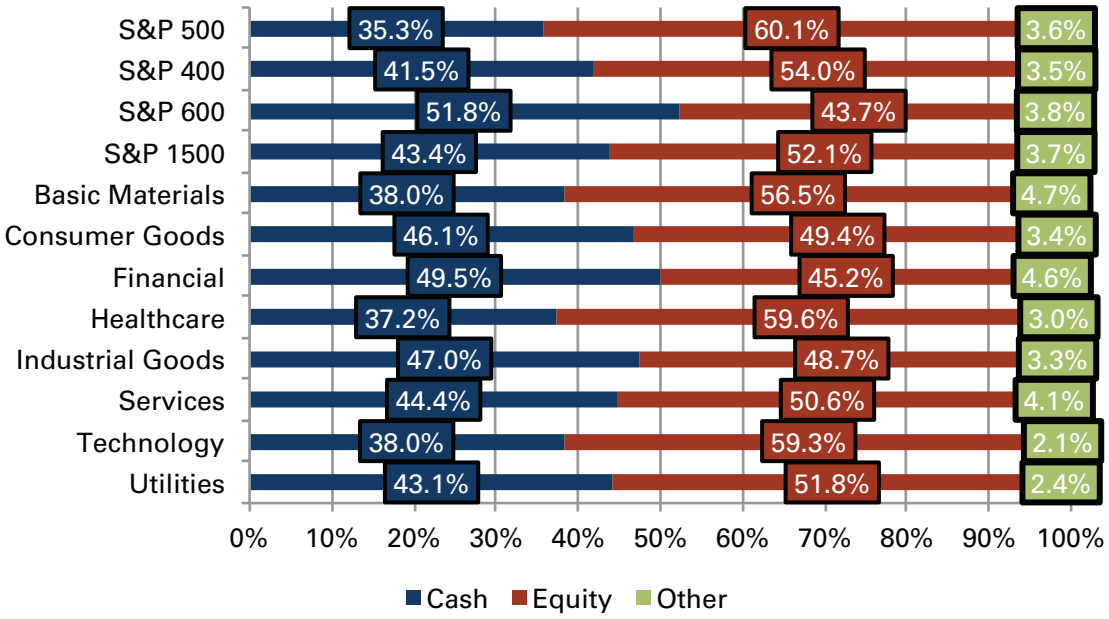
Meridian Commentary

- First, it is important to note that each category above is calculated independently, so it is not appropriate to add all the components to arrive at median total direct compensation level as not all companies grant all forms of equity.
- With ISS categorizing stock options as nonperformance-based and the continuing negative press stemming from the dot-com era, the WorldCom/Enron era, and the financial crisis, companies have reduced their emphasis on stock options in favor of performance-based, full-value equity awards, such as Performance Stock.
- With the prompt from ISS, companies were generally quick to see the benefits of performance stock plans as they are the one pay vehicle that can most easily be designed to meet all 3 primary objectives of LTIs: 1) Retain: performance plans are more likely to retain value than stock options; 2) Reward for sustained operating performance: performance plans are often tied to operating metrics over 3 years; 3) Aligned with shareholders: performance plans are typically settled in shares and often have share price as an underlying metric.

Economic sectors vary in the degree to which they rely on various compensation vehicles. The following graph breaks down CEO compensation according to its component sectors and indices and by the main components of pay, cash, and equity (as well as 'other,' which includes deferred compensation, benefits, and perquisites). Larger companies, as well as technology, basic materials, and healthcare companies, all rely particularly heavily on equity. For the S&P 1500 as a whole, the percentage of compensation paid in equity stood at 52.1% and cash at 43.4%. However, average equity rose from small- to mid- to large-cap companies, with equity at 60.1% of the average pay mix among S&P 500 companies. For each CEO, Equilar calculated the percentage of total compensation deriving from each pay vehicle. The graph below shows the average percentages.

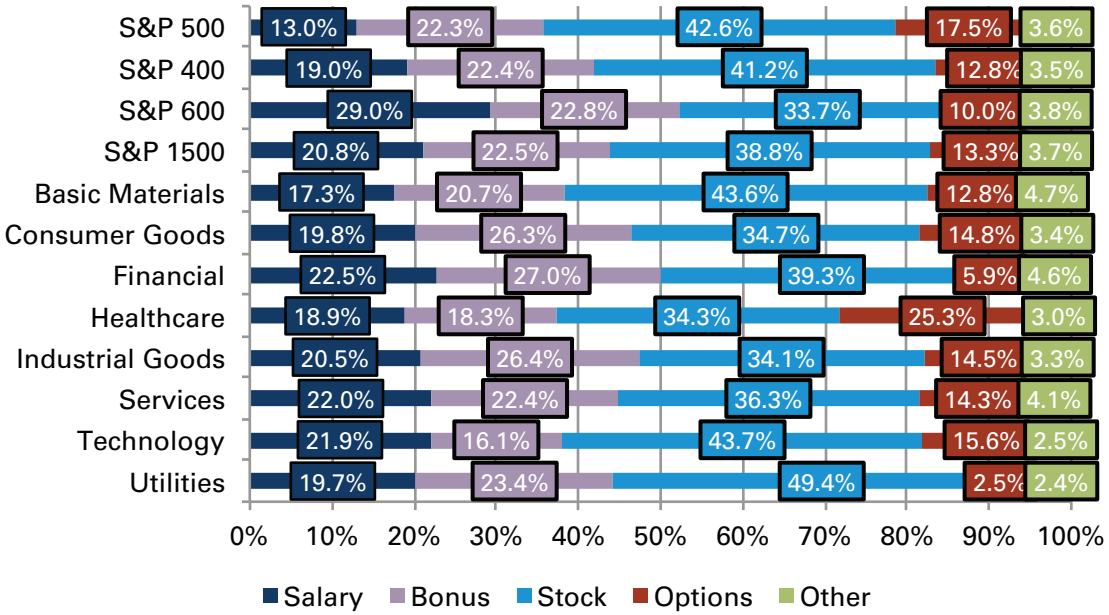
- S&P SmallCap 600 companies had the highest percentage of pay attributable to cash at 51.8%, higher than any individual sector.
- The technology and healthcare sectors each had relatively high equity at 59.3% and 59.6%, respectively, of the average pay mix. The only sector to have a higher percentage of pay in cash than equity was the financial sector, which had a mix of 49.5% cash and 45.2% equity.

S&P 1500 Average Pay Mix (Cash/Equity) by Index and Sector



- Bonuses had the highest average percentage of total compensation within the financial and consumer goods sectors at 39.3% and 34.7%, respectively.
- Options were particularly important within the healthcare sector at 25.3% compared to 13.3% on average in the S&P 1500.
- The highest salaries as a percentage of total compensation were in the S&P SmallCap 600, while salaries made up a much lower percentage of total compensation at S&P 500 companies.

S&P 1500 Average Pay Mix by Index and Sector

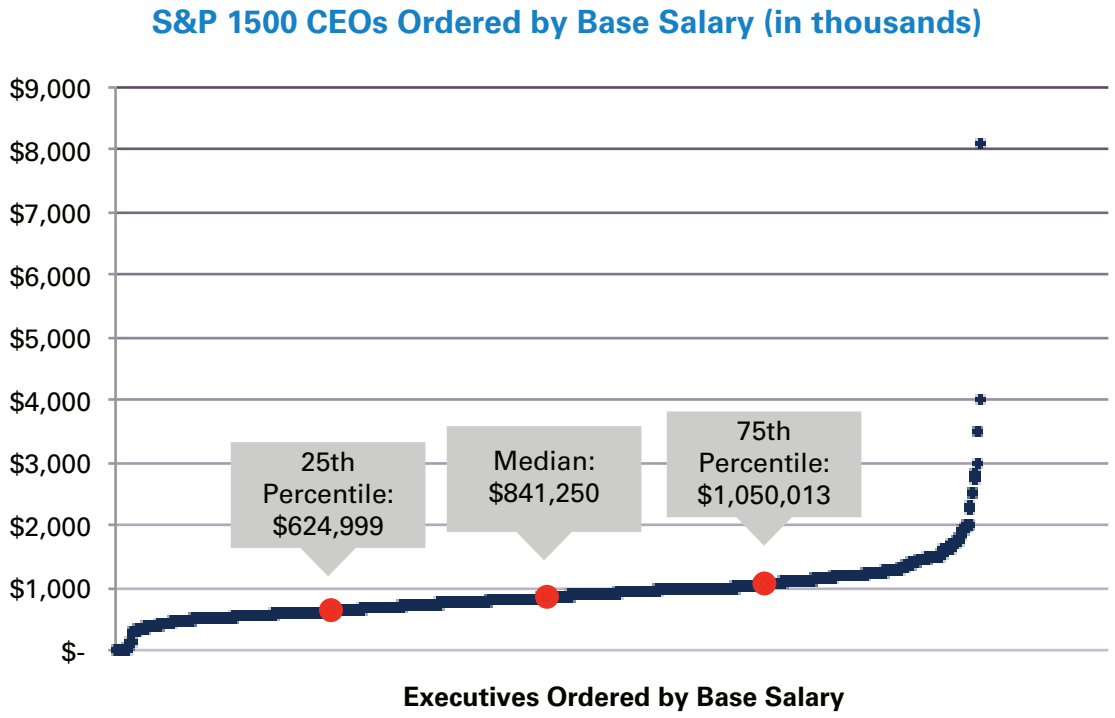


The chart below shows salaries of S&P 1500 CEOs ordered by increasing value. Section 162(m) of the tax code limits the amount of deductible compensation that a company can pay to the CEO and top four other most highly paid officers to $1 million annually. Exceptions to the deduction limitation only include performance-based compensation elements meeting certain requirements. For this reason, many companies attempt to keep cash compensation lacking a performance element (e.g., salary) at or below $1,000,000.

- 4.8% of S&P 1500 CEOs had base salaries of exactly $1 million.
- 71.5% had base salaries of $1 million or less.
- 1.2% had base salaries of under $2.

Meridian Commentary

- For big companies (i.e., S&P 500), size tends to matter more when choosing peers than for mid-market companies where industry tends to be more important. As a group, the S&P 500 places more emphasis on long-term incentives than any industry. That is to say, large companies in a given industry are more likely to use a pay structure similar to other big companies than to companies in their industry that are smaller. This difference relates to the scale and scope of a business. There is a tipping point for CEOs when the desired skill set becomes more about the ability to lead large organizations than being a leader in a given industry.
- Smaller cap companies are often at the growing phase with greater uncertainty. This necessitates the need to provide more stable, lower to moderate risk compensation compared to the higher risk typically associated with long-term compensation at S&P 500 companies.

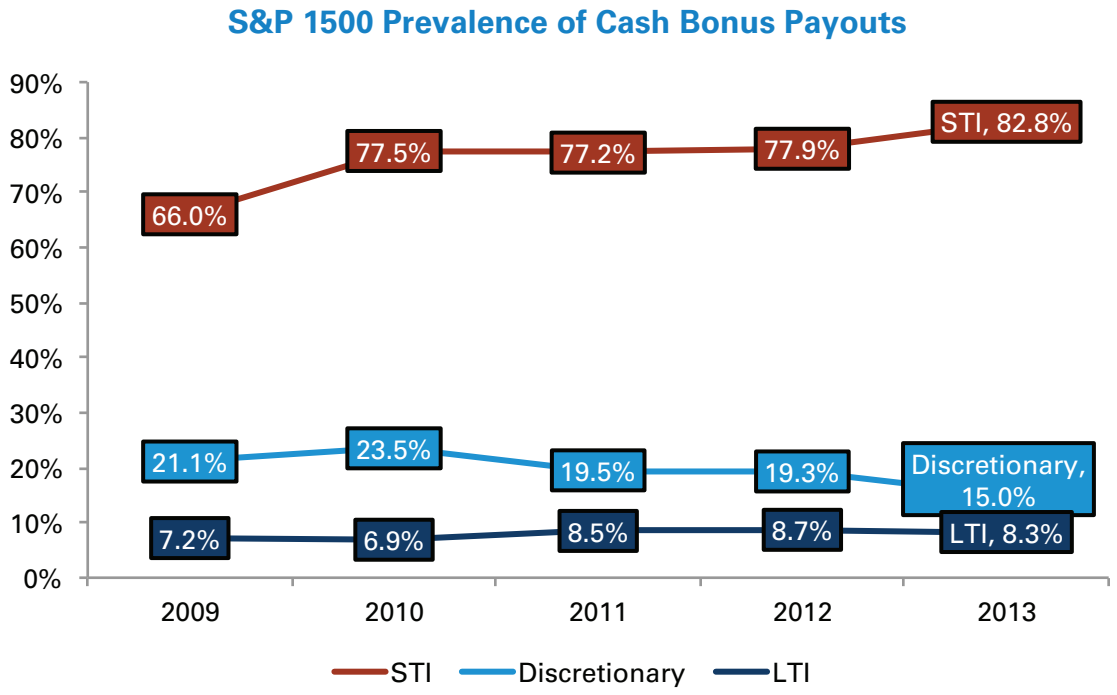


Meridian Commentary

- Base salary continues to be the slowest growing pay component due to its multiplicative effect on incentive-based pay and benefits and deduction limitations under IRC Code 162(m). However, a number of pending legislations propose various and significant changes that would virtually eliminate the 162(m) deduction entirely and make all compensation above $1 million non-tax deductible.
- A looming question is whether CEO salaries increase faster with the elimination of the million dollar cap under 162m or make the $1 million pay level a more sturdy watermark. The effect will likely be more pronounced in the mid-market space, where the loss of a tax deduction may have a more material impact to company earnings. Many large companies already pay well above $1 million, and the loss of the deduction may not be material.

As can be seen below, cash bonus payments have remained an important pillar of CEO compensation plans over the period studied, though the form those bonuses take has changed notably. In 2009, only 66.0% of S&P 1500 CEOs received short-term incentive plan bonuses, compared to 82.8% in 2013. By contrast, the share of CEOs receiving discretionary bonuses fell from 21.1% to 15.0%.

- The prevalence of discretionary bonus payouts declined significantly among both S&P 1500 companies as a whole and the subset of S&P 500 companies.
- Conversely, the prevalence of short-term cash incentive payouts increased across the board, growing from 66.0% to 82.8% prevalence from 2009 to 2012 in the S&P 1500, and long-term cash incentive payouts have remained relatively stable.

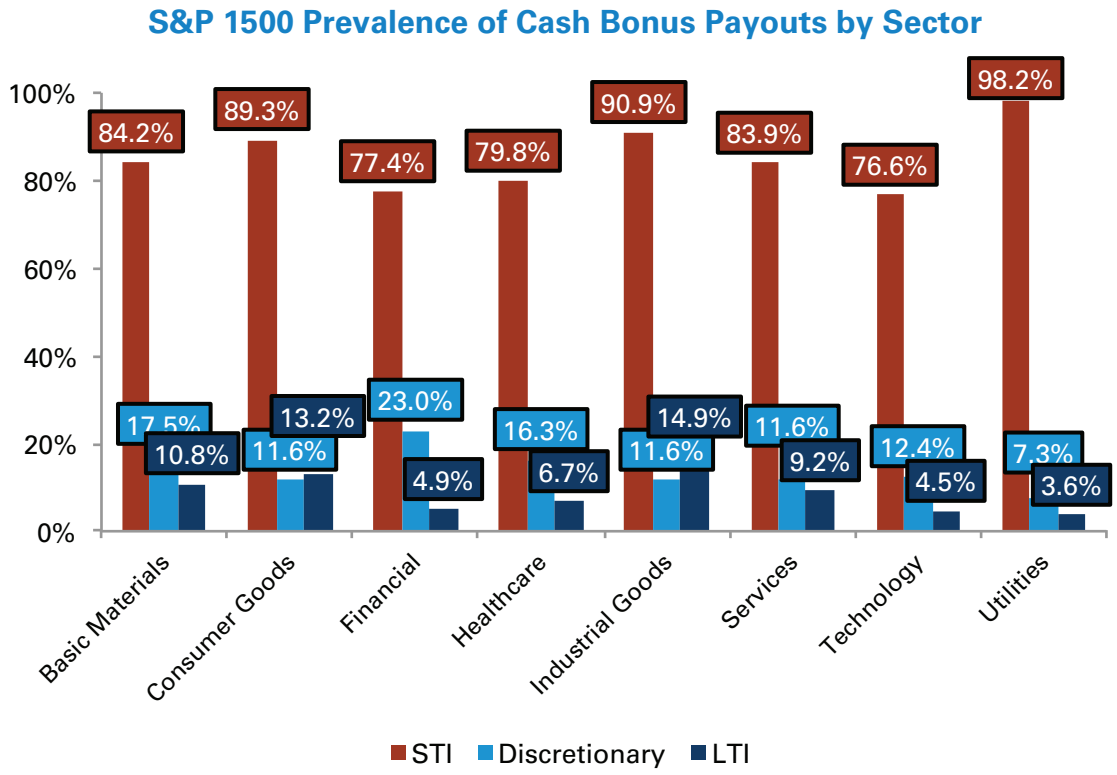


Meridian Commentary

- An important distinction must be made between 162(m) compliant umbrella plans that can be designed to allow for positive discretion versus pure discretionary bonus plans, which are not prevalent (consistently under 10%). In reality, there is a greater amount of discretion being applied in determining CEO incentive pay; however, it is often done under a 162m plan that is also based on quantitative measures.
- Another important consideration should be given to the fact that almost all incentive plans provide the Compensation Committee the ability to exercise discretion – and this is a good thing. Ideally, incentive plans should always deliver pay levels that are reflective of performance, however, sometimes they don't. Unexpected economic shifts, regulatory changes, and other influences may create situations where quantitative incentive plan payouts do not reflect actual performance, so committees must use discretion judiciously and in the best interest of the company.

While overall trends of increasing STI payouts, keeping stable LTI payouts, and decreasing discretionary bonuses have been consistent across the last five years, the breakdowns vary significantly by sector.

- Discretionary bonuses were most common in the financial sector, present at 23.0% of companies compared to 15.0% in the overall S&P 1500.
- The utilities sector had a very high prevalence of STI payouts, present at 98.2% of companies compared to 82.8% in the overall S&P 1500.

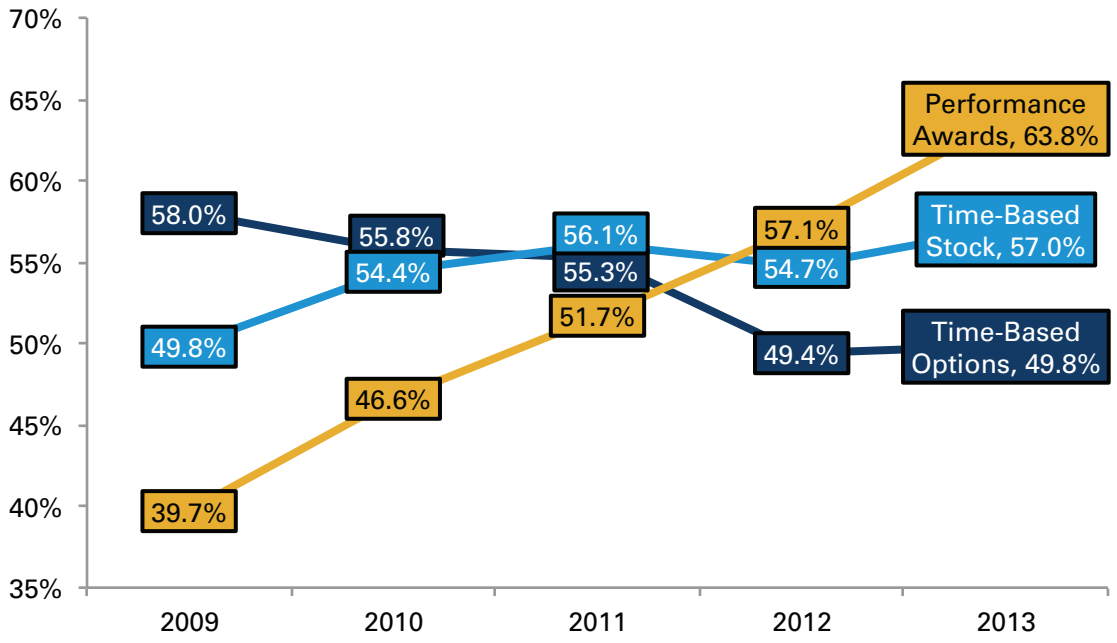


Performance Equity and Equity Mix

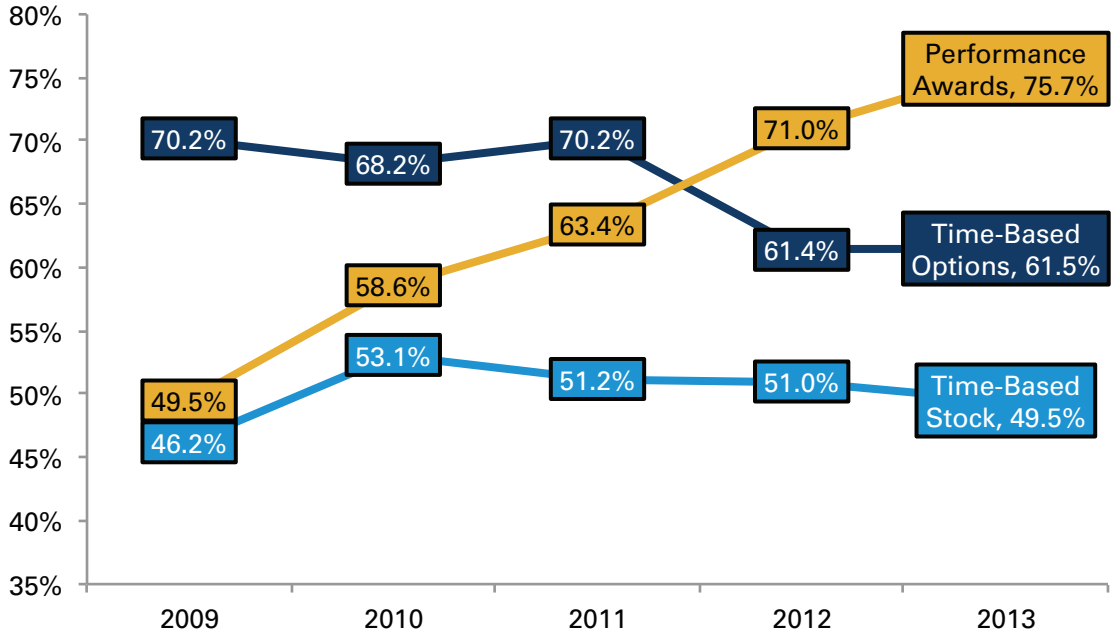
The type of equity that large American companies use to incentivize their executives has changed profoundly over the period studied. The years since 2009 have seen performance-based equity take center stage with the share of S&P 1500 CEOs receiving it rising from 39.7% to 63.8%. Performance-based equity is even more popular within the S&P 500, received by 75.7% of CEOs. Options, meanwhile, have declined from a prevalence of 58.0% among S&P 1500 companies in 2009 to 49.8% in 2013, though the last year appears to buck the trend of decline with prevalence levelling out. Larger companies are more likely to grant each type of equity and generally rely on a greater diversity of equity vehicles.

- Performance awards are now a more popular vehicle for S&P 1500 CEO awards than either time-based options or time-based stock.
- While S&P 500 companies have been the quickest to adopt performance awards, the rate of growth is similar at overall S&P 1500 companies.

S&P 1500 Equity Vehicles Grant Prevalence



S&P 500 Equity Vehicles Grant Prevalence



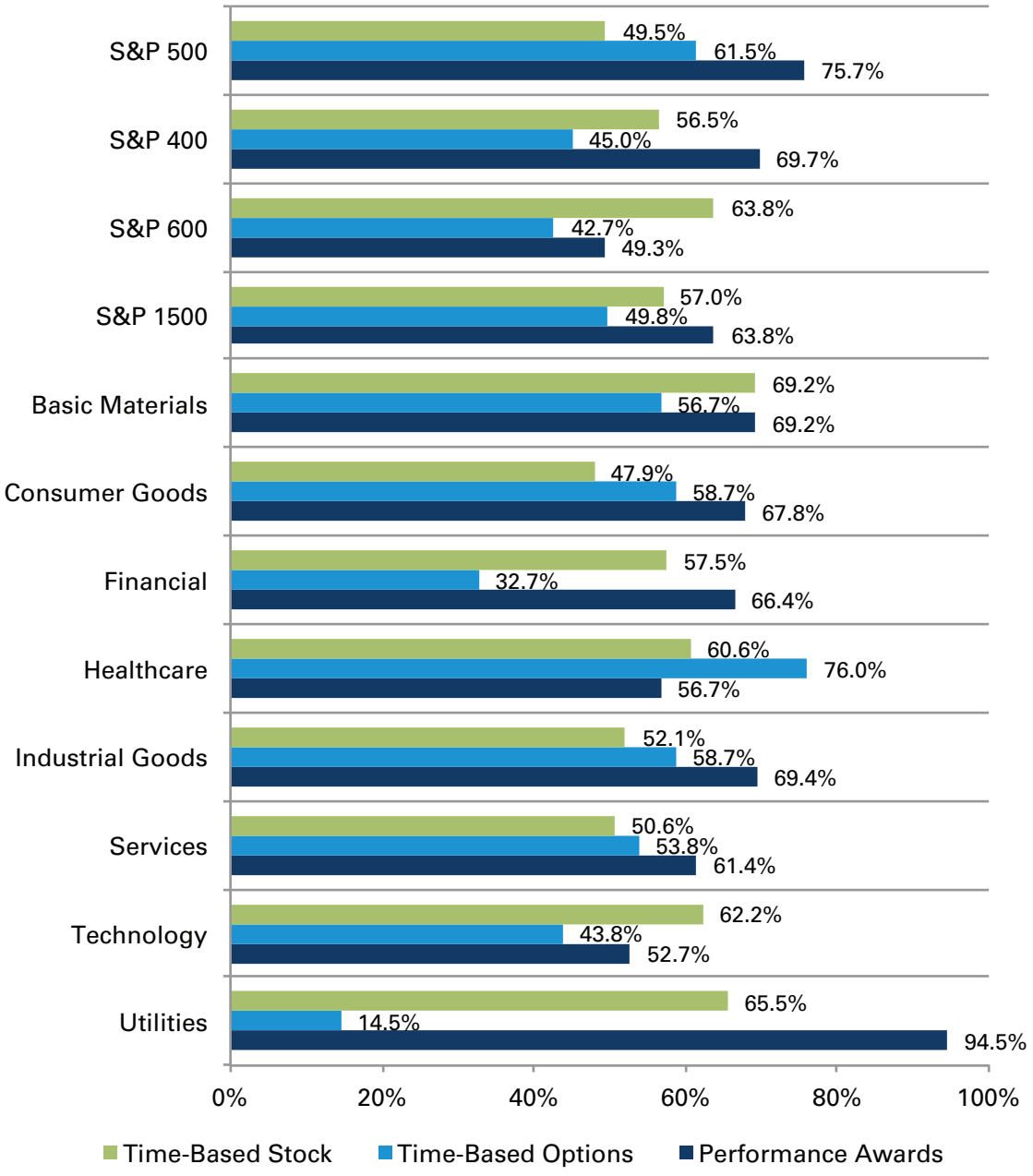
Meridian Commentary

- Each long-term incentive vehicle plays an important role in the overall objective of compensation: Stock options provide shareholder alignment, time-based equity supports retention of talent, and performance-based equity encourages sustained operating performance. While they each continue to hold importance, what we see now is a change in priorities. Five years ago, as companies were struggling with the impact of the recession, focus centered on executive retention and improving shareholder value versus performance plans, where setting long-term operating goals was a greater challenge. However, today with more stable economic conditions, companies are focused on long-term operating performance, and therefore, performance-based equity awards are on rise.
- As mentioned earlier, the popularity of performance-based equity can be attributed to its hybrid features that combine the leverage and performance orientation of stock options with the lesser risk aspects of time-based awards. Additionally, in this Say on Pay environment, companies are being influenced by shareholder advisory firms' endorsement of performance-based equity over other equity vehicles.

While performance-based awards were more prevalent than time-based stock or options, this was most pronounced among the largest companies. In the S&P MidCap 400, the gap between performance award and time-based stock prevalence narrows, and in the S&P SmallCap 600, performance awards are less common than time-based stock. The sectors are split between those where performance awards are the most common equity vehicle and those where time-based stock is most common.

- The utilities sector had the highest prevalence of performance-based equity awards at 94.5%, while the lowest prevalence was in the technology sector with a prevalence of 52.7%.
- The utilities sector also had the lowest prevalence by far of time-based options at just 14.5%, compared to 49.8% in the S&P 1500 as a whole. The financial sector had a large gap between performance awards and options as well, with options at 32.7% prevalence and performance awards at 66.4%.

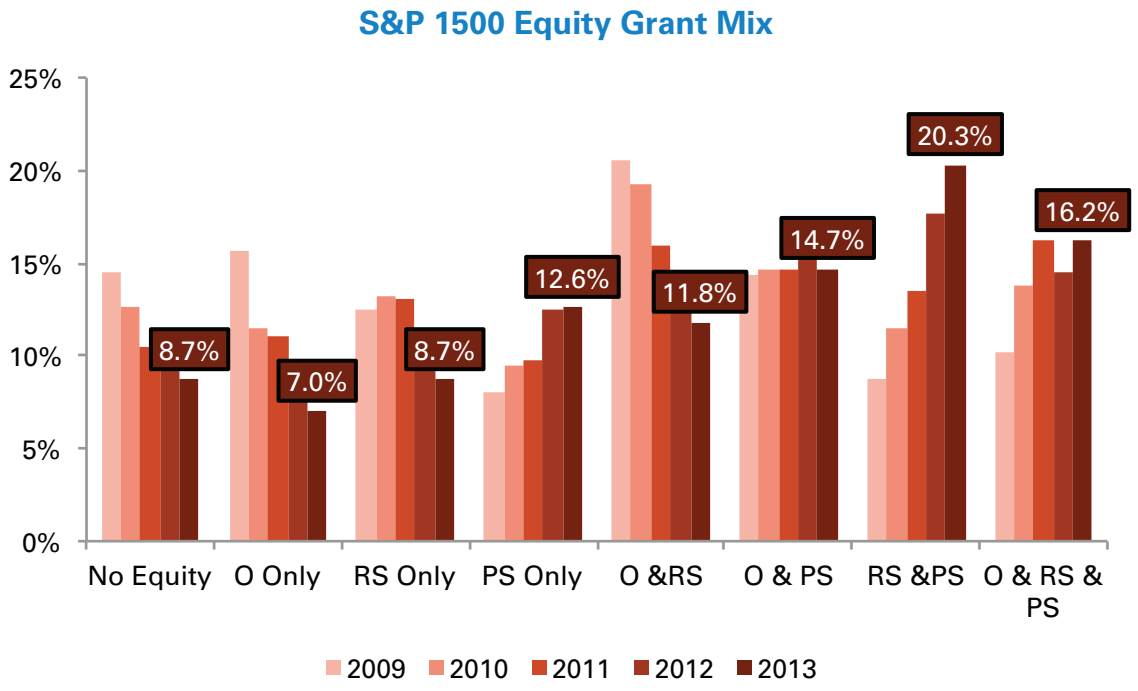
S&P 1500 Equity Vehicles Grant Prevalence by Index and Sector

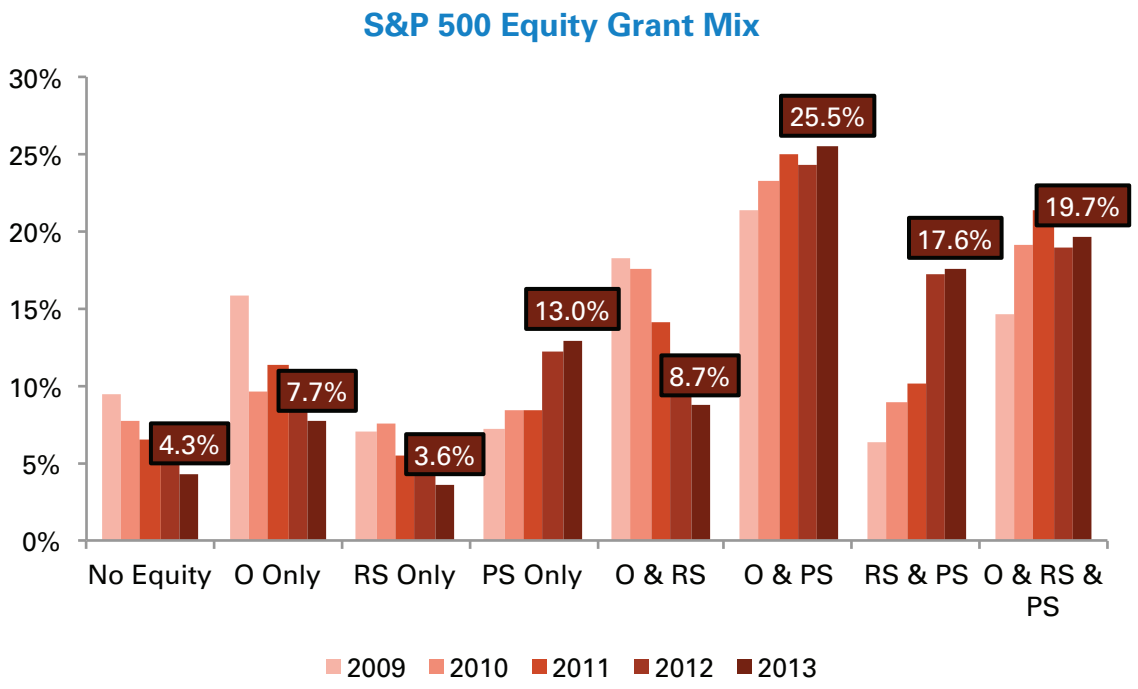


The following two charts show the mix of equity vehicles (time-based options, time-based stock, and performance-based equity) awarded to CEOs from 2009 to 2013. A mix of time-based stock and performance-based equity was most common in both years and across both indices. The percentage of companies granting no equity to their CEOs fell from 2012 to 2013 in both indices. In addition, equity mixes increasingly favor performance awards and disfavor mixes featuring only one award type.

- Equity mixes that included performance-based awards had the highest prevalence in 2013. All such mixes were up sharply in prevalence over the five-year period except for the combination of options and performance shares.
- All equity grant mixes that decreased in prevalence over the last year, including single-vehicle equity mixes, were mixes which either included options or did not include performance stock. The greatest decline was in grants of restricted stock only, which fell 24.3% from 11.5% prevalence in 2012 to 8.7% in 2013.

- In the S&P 1500, the most common equity vehicle mix was a combination of restricted stock and performance.





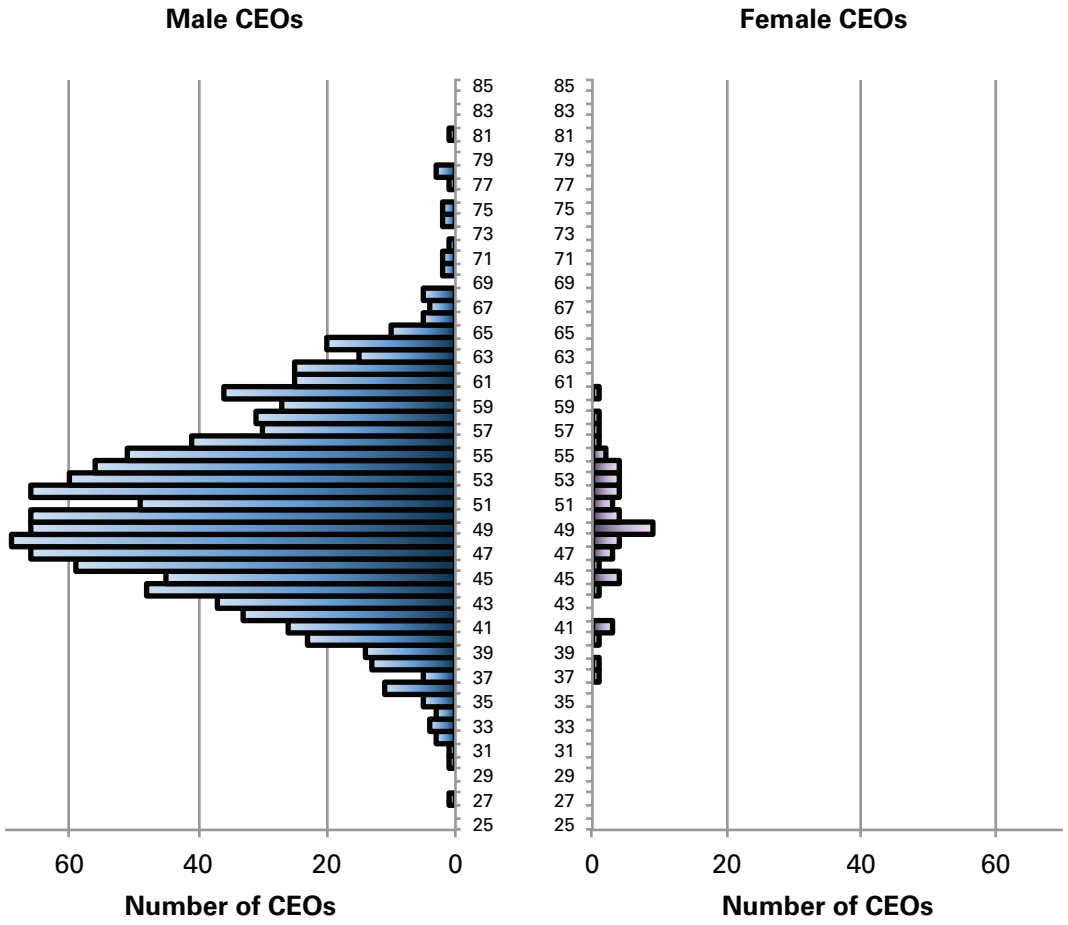
Demographics

It is a truth universally acknowledged that the demographics of American CEOs do not mirror those of the country more generally and that CEOs tend to be significantly older and more male. The population pyramid below shows the age and gender of each CEO representing year 2013 in this report.

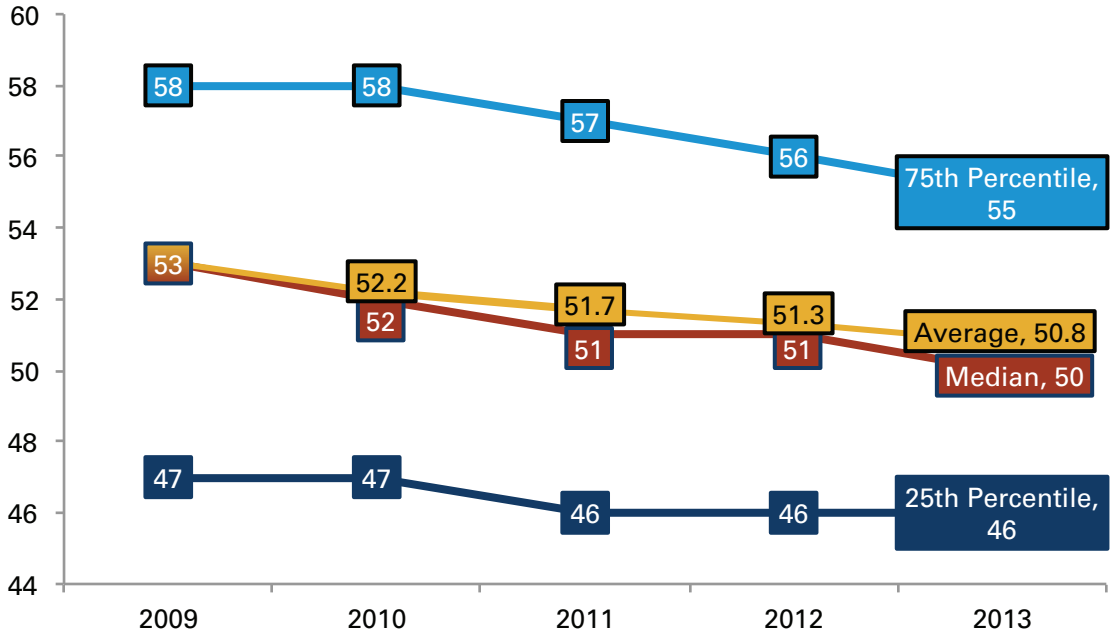
S&P 1500 CEOs have gotten younger over the last five years with the average age falling from 53.0 years in 2009 to 50.8 years in 2013. The reasons for this trend are unclear, though the change has been driven by declines at upper percentiles. The 75th percentile S&P 1500 CEO age fell from 58 to 55 over the period studied.

- The average age of S&P 1500 CEOs has fallen by 2.2 years since 2009.

S&P 1500 CEOs by Age and Gender

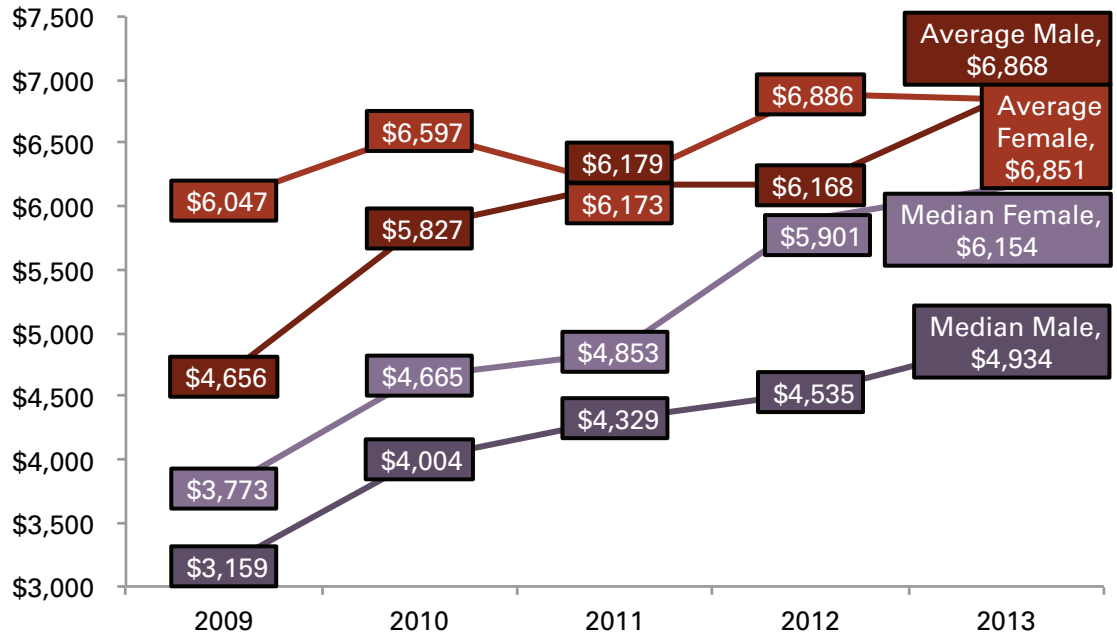


S&P 1500 CEO Age

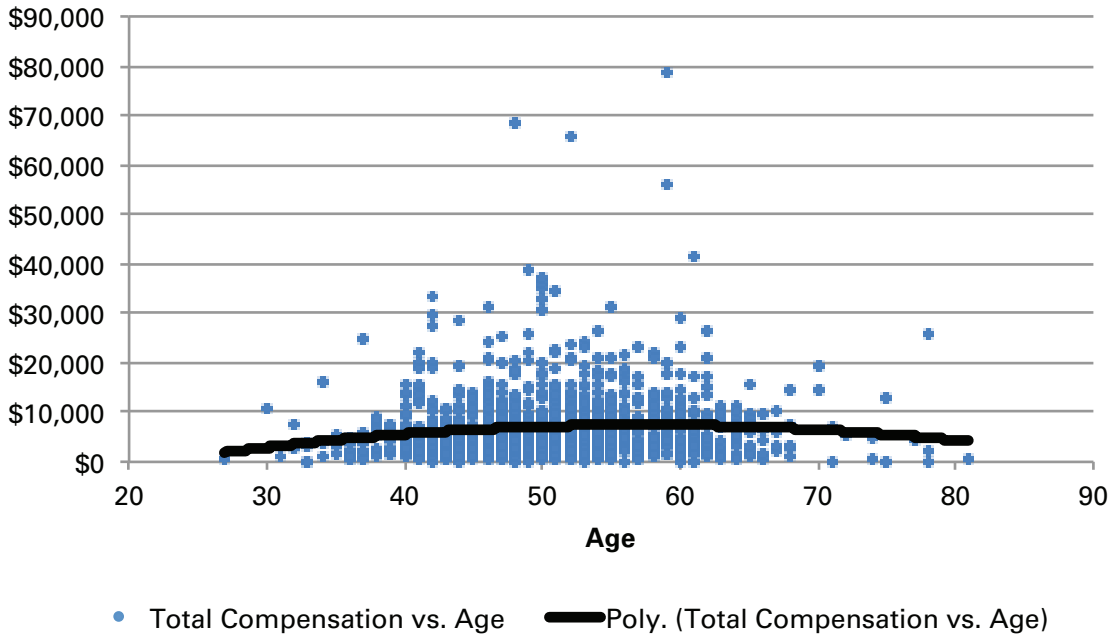


- Women CEOs earn more than their male counterparts both at average and median values.
- Median female CEO pay has grown 63.1% since 2009, while median male CEO pay has grown 56.2%.
- Median revenue for S&P 1500 companies with a female CEO was $2.5 billion in 2013 versus $2.0 billion for companies with a male CEO. The larger size of companies headed by female CEOs helps to explain the higher median and average pay.

S&P 1500 Total Compensation by Gender (in thousands)



S&P 1500 Total Compensation (in thousands) v. Age



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Report Partner:

About Meridian

We are independent executive compensation consultants providing trusted counsel to Boards and Management at hundreds of large companies. We consult on executive and Board compensation and their design, amounts and governance.

Our many consultants throughout the U.S. and in Canada have decades of experience in pay solutions that are responsive to shareholders, reflect good governance principles and align pay with performance. Our partners average 20+ years of executive compensation experience and collectively serve over 300 clients, primarily at the Board level. As a result, our depth of resources, content expertise and Boardroom experience are unparalleled.

Our culture is one in which we regularly share our consulting experiences with each other to the benefit of all of our clients. This knowledge management approach creates shared learning and increases our effectiveness in solving challenging client issues.

Our scale means that we have the ability to help companies through all phases of the economic cycle, as well as transactions and special situations.

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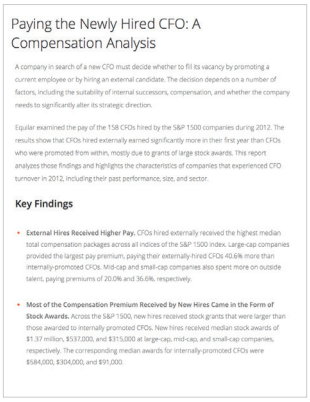


Paying the Newly Hired CFO: A Compensation Analysis

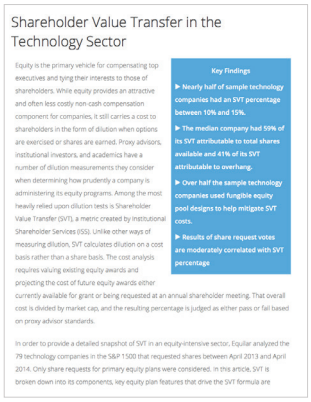
A company in search of a new CFO must decide whether to fill its vacancy by promoting a current employee or by hiring an external candidate. The decision depends on a number of factors, including the suitability of internal successors, compensation, and whether the company needs to significantly alter its strategic direction.

Equilar examined the pay of the 158 CFOs hired by the S&P 1500 companies during 2012. The results show that CFOs hired externally earned significantly more in their first year than CFOs who were promoted from within, mostly due to grants of large stock awards. This report analyzes those findings and highlights the characteristics of companies that experienced CFO turnover in 2012, including their past performance, size, and sector.

Key Findings

- **External Hires Received Higher Pay.** CFOs hired externally received the highest median total compensation packages across all indices of the S&P 1500 index. Large-cap companies provided the largest pay premium, paying their externally-hired CFOs 40.6% more than internally-promoted CFOs. Mid-cap and small-cap companies also spent more on outside talent, paying premiums of 20.0% and 36.6%, respectively.
- **Most of the Compensation Premium Received by New Hires Came in the Form of Stock Awards.** Across the S&P 1500, new hires received stock grants that were larger than those awarded to internally promoted CFOs. New hires received median stock awards of $1.37 million, $537,000, and $315,000 at large-cap, mid-cap, and small-cap companies, respectively. The corresponding median awards for internally-promoted CFOs were $584,000, $304,000, and $91,000.

Paying the Newly Hired CFO: A Compensation Analysis



Shareholder Value Transfer in the Technology Sector

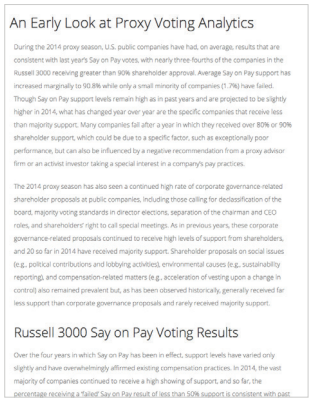
Equity is the primary vehicle for compensating top executives and tying their interests to those of shareholders. While equity provides an attractive and often less costly non-cash compensation component for companies, it still carries a cost to shareholders in the form of dilution when options are exercised or shares are earned. Proxy advisors, institutional investors, and academics have a number of dilution measurements they consider when determining how prudently a company is administering its equity programs. Among the most heavily relied upon dilution tests is Shareholder Value Transfer (SVT), a metric created by Institutional Shareholder Services (ISS). Unlike other ways of measuring dilution, SVT calculates dilution on a cost basis rather than a share basis. The cost analysis requires valuing existing equity awards and projecting the cost of future equity awards either currently available for grant or being requested at an annual shareholder meeting. That overall cost is divided by market cap, and the resulting percentage is judged as either pass or fail based on proxy advisor standards.

In order to provide a detailed snapshot of SVT in an equity-intensive sector, Equilar analyzed the 79 technology companies in the S&P 1500 that requested shares between April 2013 and April 2014. Only share requests for primary equity plans were considered. In this article, SVT is broken down into its components, key equity plan features that drive the SVT formula are

Key Findings

- ▶ Nearly half of sample technology companies had an SVT percentage between 10% and 15%.
- ▶ The median company had 59% of its SVT attributable to total shares available and 41% of its SVT attributable to overhang.
- ▶ Over half the sample technology companies used fungible equity pool designs to help mitigate SVT costs.
- ▶ Results of share request votes are moderately correlated with SVT percentage

Shareholder Value Transfer in the Technology Sector



An Early Look at Proxy Voting Analytics

During the 2014 proxy season, U.S. public companies have had, on average, results that are consistent with last year's Say on Pay votes, with nearly three-fourths of the companies in the Russell 3000 receiving greater than 90% shareholder approval. Average Say on Pay support has increased marginally to 90.8% while only a small minority of companies (1.7%) have failed. Though Say on Pay support levels remain high as in past years and are projected to be slightly higher in 2014, what has changed year over year are the specific companies that receive less than majority support. Many companies fall after a year in which they received over 80% or 90% shareholder support, which could be due to a specific factor, such as exceptionally poor performance, but can also be influenced by a negative recommendation from a proxy advisor firm or an activist investor taking a special interest in a company's pay practices.

The 2014 proxy season has also seen a continued high rate of corporate governance-related shareholder proposals at public companies, including those calling for declassification of the board, majority voting standards in director elections, separation of the chairman and CEO roles, and shareholders' right to call special meetings. As in previous years, these corporate governance-related proposals continued to receive high levels of support from shareholders, and 20 so far in 2014 have received majority support. Shareholder proposals on social issues (e.g., political contributions and lobbying activities), environmental causes (e.g., sustainability reporting), and compensation-related matters (e.g., acceleration of vesting upon a change in control) also remained prevalent but, as has been observed historically, generally received far less support than corporate governance proposals and rarely received majority support.

Russell 3000 Say on Pay Voting Results

Over the four years in which Say on Pay has been in effect, support levels have varied only slightly and have overwhelmingly affirmed existing compensation practices. In 2014, the vast majority of companies continued to receive a high showing of support, and so far, the percentage receiving a 'failed' Say on Pay result of less than 50% support is consistent with past

An Early Look at Proxy Voting Analytics

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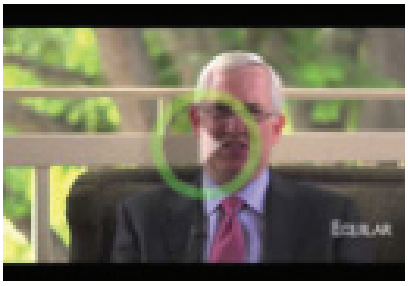
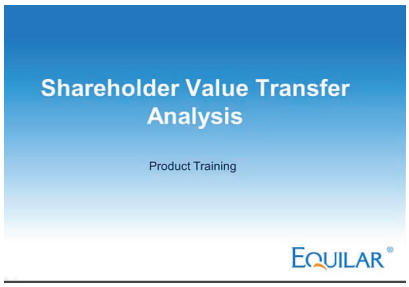


Behind The Numbers Say on Pay

Clawbacks 101



Shareholder Value Transfer Analysis

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