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The Next Generation of Long-Term Incentive Design

Todd Gershkowitz, State Street

Robert Head, Interim Reward Consultant

Eric Hosken, Compensation Advisory Partners

Kelly Malafis, Compensation Advisory Partners

Agenda

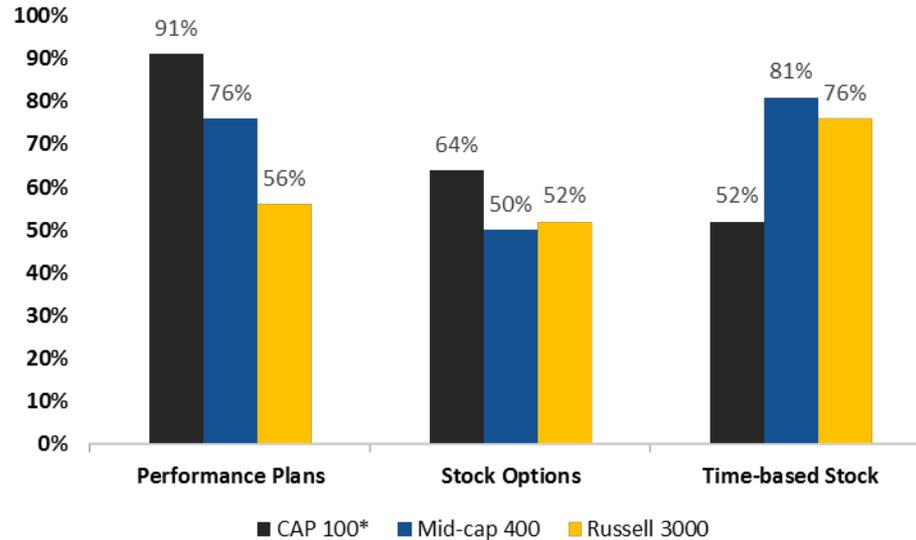
- The current state of LTI design
- Issues with current LTI design
- Case studies
- Next generation LTI design
- Conclusions & questions



The current state of LTI design



There are three main varieties of long-term incentive awards used in public companies



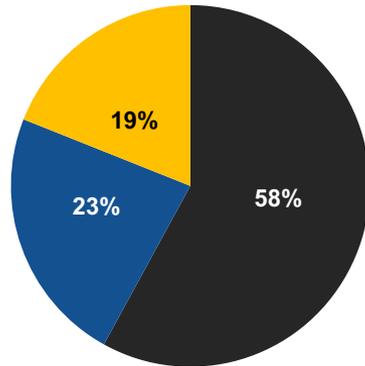
* Compensation Advisory Partners (“CAP”) reviewed 2015 proxy disclosures at a sample of 100 companies among the Fortune 500 representing nine industry groups. For the companies studied, the median revenue size and market capitalization was \$34B and \$56B, respectively.



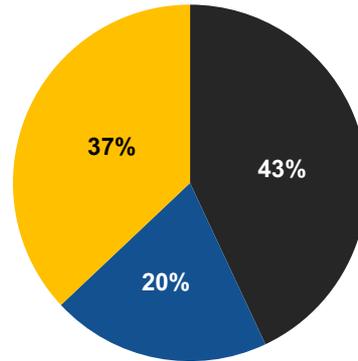
Performance-based LTI is most heavily weighted

- Average LTI mix over-time has shifted towards performance-based LTI

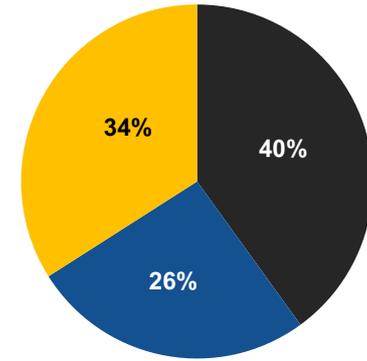
CAP 100



S&P Mid-Cap 400



Russell 3000

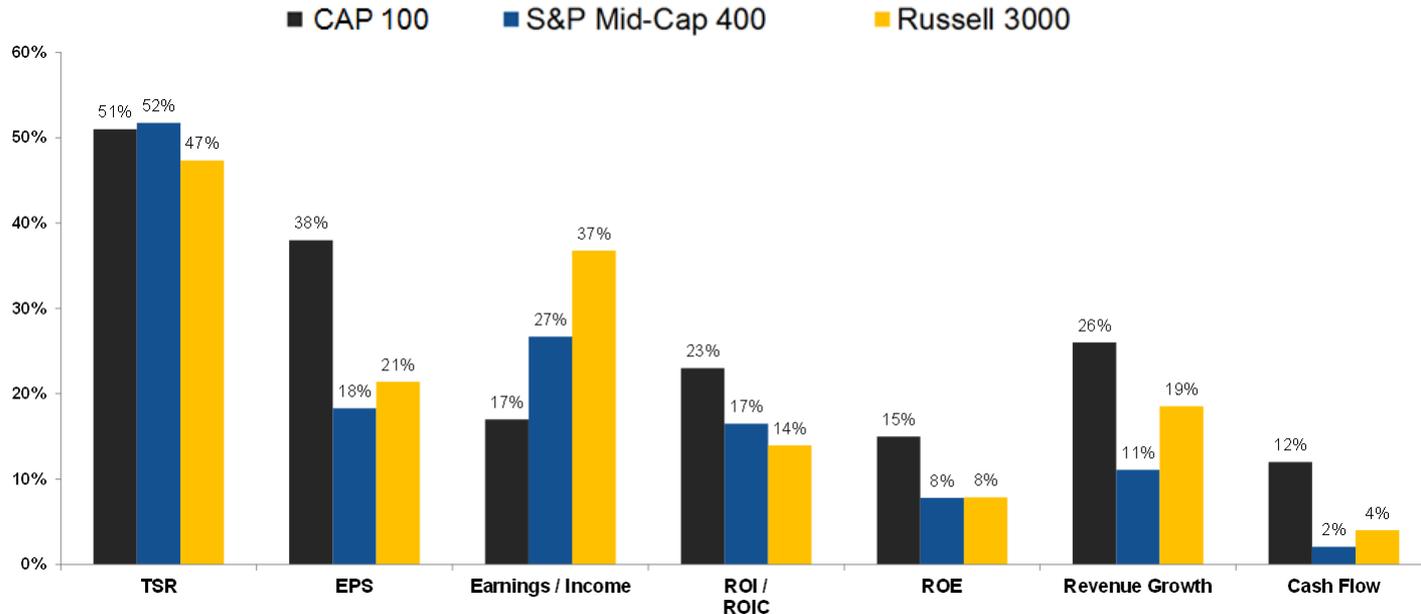


■ Performance-Based LTI ■ Stock Options ■ Time-Based Restricted Stock

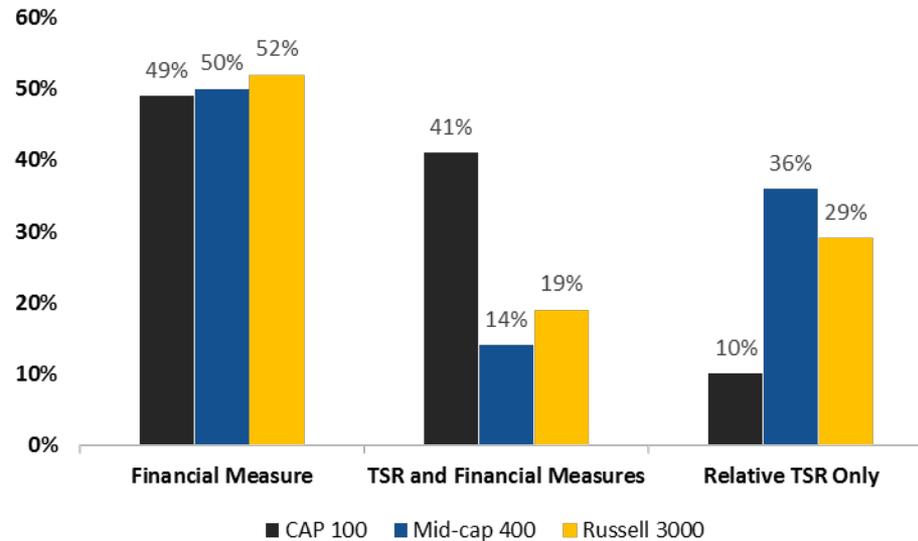


TSR is the single most prevalent measure

- Among CAP 100 companies, TSR has had the biggest increase in prevalence

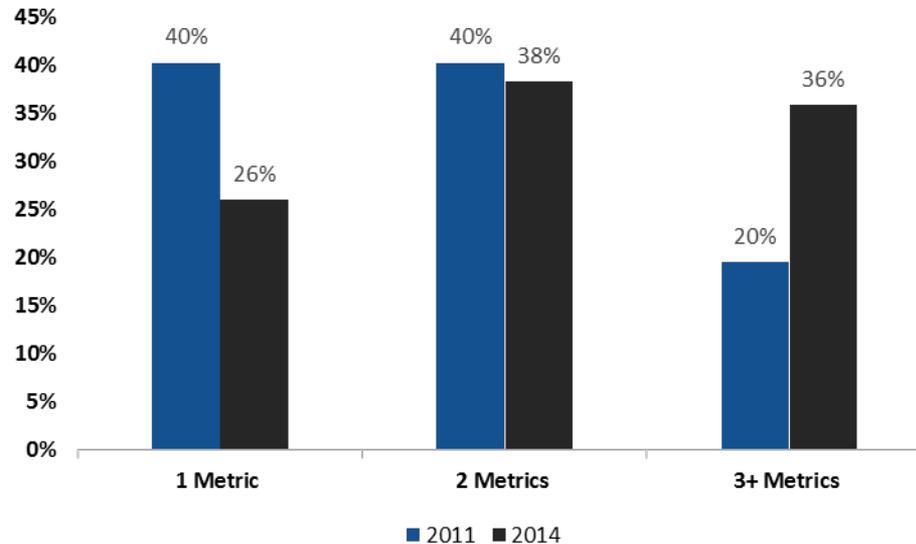


Large companies combine TSR with financial measures



Most companies use two or three metrics in their design

- Companies are more likely to use two or more metrics, as the emphasis on performance-based LTI increases



Issues with current LTI design



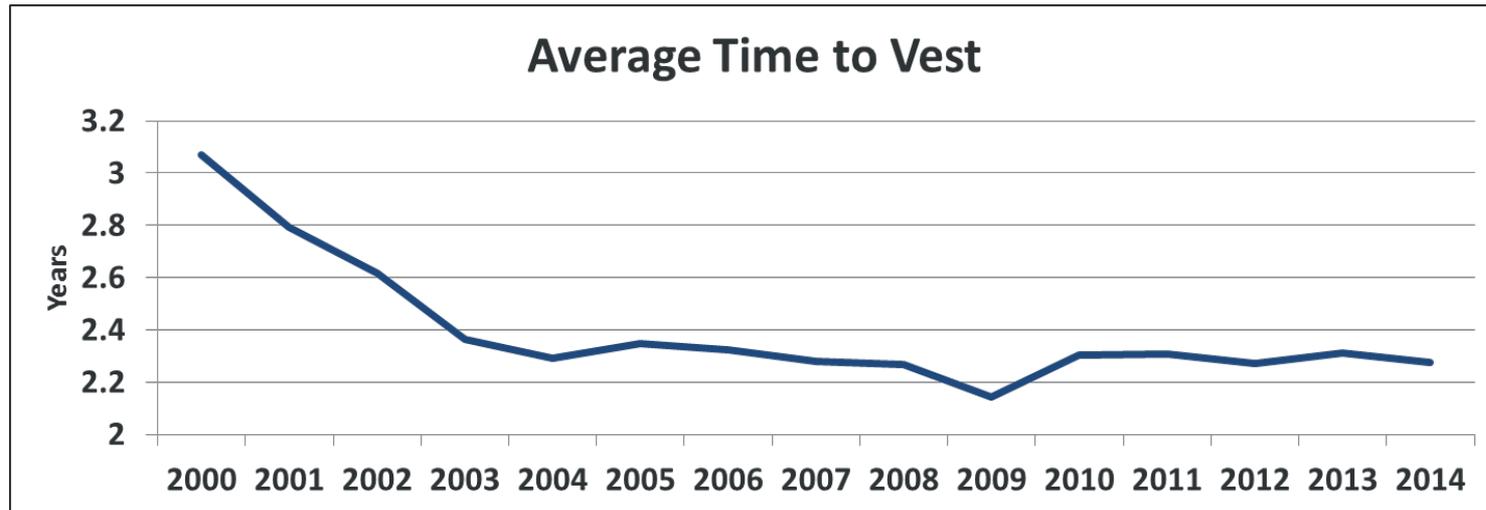
Issues with current LTI design

Issue	Description
Complex	<ul style="list-style-type: none">• Multiple vehicles / measures / performance periods• Hard to understand• Frequent design changes
Not valued	<ul style="list-style-type: none">• Limited “currency” value
Limited line-of-sight	<ul style="list-style-type: none">• TSR plans• Complex financial measures
Not really long-term	<ul style="list-style-type: none">• Is 3 years long-term?• Diminished role of stock options



Vesting periods have decreased

- Vesting periods for options and restricted stock have declined for Executive and CEO awards



Options have a longer time-frame

- CEOs have typically held their options for more than 5 years

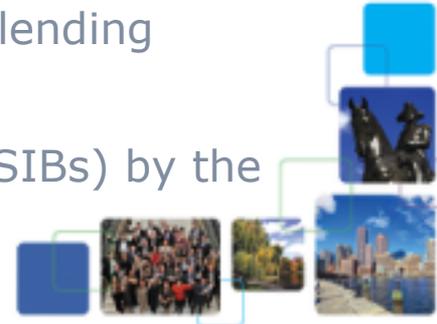


Case studies



State Street

- A global financial services company, with over \$10 billion in revenue and over 30,000 employees
- Primarily provides Investment Servicing and Investor Management services to institutional investors across the world
- Responsible for 11% of the world's assets
 - \$28 trillion in assets under custody and administration
 - \$2 trillion in assets under management as of December 31, 2015
- Global leader in investment research, trading and securities lending
- Serving clients in 30 countries and more than 100 markets
- Identified as 1 of 29 Globally Systemic Important Banks (G-SIBs) by the Financial Stability Board



Long-term incentives at State Street

Eligibility



Performance-Based RSUs (PRSU)

Equity-based compensation subject to time-based vesting

Performance Measurement: 3-year performance period, single absolute metric of GAAP ROE, limited upside leverage at 1.2x target

Vesting: 100% cliff vesting at the end of the performance period



Deferred Stock Award (DSA)

Equity-based compensation subject to time-based vesting

Vesting: 4 year annually for Management Committee, other Section 16 officers, and EU Identified Staff; 4 year quarterly for all others



Deferred Value Award (DVA)

Deferred-cash units representing a notional investment in a money-market fund, subject to time-based vesting

Rate of Return: Number of actual units awarded is increased to provide an annual return above the current money-market rate

Vesting: 4-year quarterly



SSGA LTIP

Deferred-cash units representing a notional investment in a money-market fund, subject to time-based vesting

Fund Selection: 3 ETF choices for each location with varying risk profiles: conservative, moderate, aggressive

Vesting: 4-year quarterly



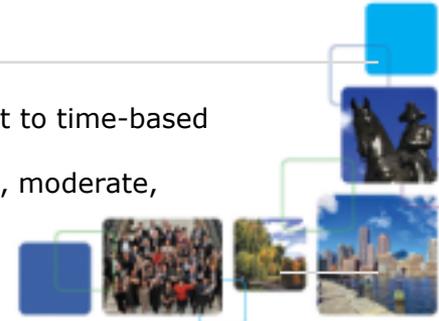
Management Committee (*Top 12*)



EVPs (*Next 60*)



Senior Management (*SVPs, MDs, VPs*)



Long-term incentives at State Street

- Most difficult strategic challenge within our compensation program is our cash/ deferral mix
- Creative strategic compensation solutions were implemented to improve the delivery of deferrals, but have not yet addressed the underlying issue
 - Accelerated vesting period from annual to quarterly to improve cash flow
 - Introduced deferred cash to address the single-security risk
- Considering other strategic programs to provide greater performance alignment for senior management and top performers/ high potentials



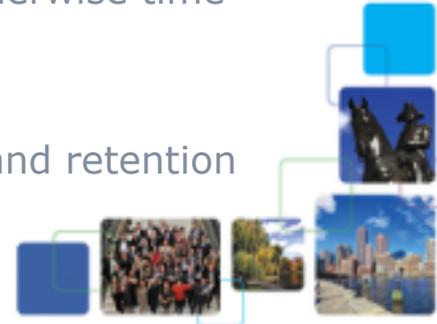
Pearson

- World's largest education company
- 40,000 people in more than 70 countries
- Working to help people of all ages to make measurable progress in their lives through learning
- Provide range of education products and services to institutions, teachers and students everywhere
- Current market capitalisation of around £7bn and revenues of some £5bn in 2015
- Listed on London and New York stock exchanges



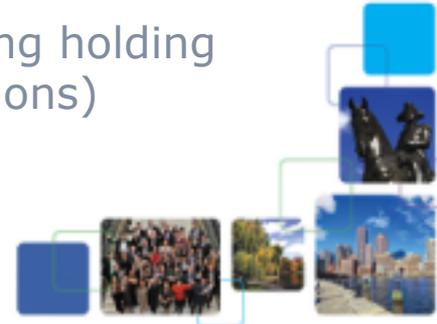
Long-term incentives at Pearson

- Portfolio long-term plan since 2001; last approved by shareholders in 2011
- Performance and restricted shares
- Executive directors and executive committee:
 - performance-related (relative TSR, ROIC and EPS growth)
 - 3-year performance period with 2-year holding
- Other executives and managers:
 - performance-related (EPS growth) for senior leadership group; otherwise time-vesting
 - 3-year performance/retention period with no holding
 - annual awards based on potential and performance for attraction and retention
 - 5% of all employees below executive committee
 - consistent 'one Pearson' award guidelines



Some UK issues and thoughts

- Complexity and simplification
- Link to business strategy (performance measures and targets)
- Link to remuneration philosophy & principles (sustainability and affordability, pay for performance, alignment)
- Performance, outcomes and value (realized pay, single-figure, CEO value index)
- Performance measures and periods
- Shareholding and behaviour of senior executives (post-vesting holding periods, shareholding guidelines, mandatory dealing restrictions)



Next generation LTI design



Simplify LTI design

- Use one or two vehicles
- Maintain design structure over time
- Select measures that employees understand
- Use 1 or 2 performance measures



Establish line-of-sight

- Select measures that participants can impact
- Consider business unit performance measures
- Describe to participants how they impact value
 - i.e. break performance measures into component parts
- Demonstrate alignment with near and long-term business objectives



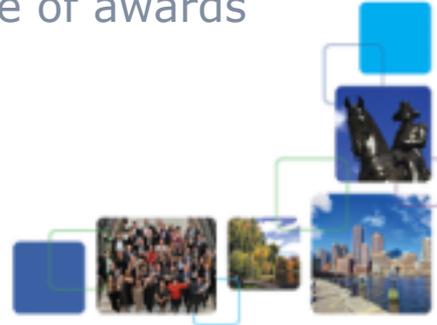
Emphasize long-term alignment for the C-Suite

- Use TSR and/or stock options for this population
- Break the three-year barrier on relative TSR performance period
- Design stock price based vehicles to be settled after five years (even if vested in three)



Communicate, communicate, communicate

- Engage with all stakeholders
- Communicate the design repeatedly through multiple channels
- Illustrate the potential value of the plan under realistic scenarios
- Update on progress relative to plan goals and projected value of awards



Conclusions & questions



Thank you

Todd Gershkowitz
State Street
tgershkovitz@statestreet.com

Eric Hosken
Compensation Advisory Partners
eric.hosken@capartners.com

Robert Head
Interim Reward Consultant
robert.head88@outlook.com

Kelly Malafis
Compensation Advisory Partners
kelly.malafis@capartners.com



Thank you



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