Fundamentals of Long-Term Incentives

Long-term incentives ("LTI") are forms of variable ("at risk") compensation based on the achievement of longer-term performance and objectives. Primary objectives are to:

- Align executive interests with shareholders and align executive pay with company performance and strategy.
- Balance annual incentives with focus on long-term (3- to 10-year) results.
- Retain executives.
- Facilitate long-term executive stock ownership.

The three most common categories of LTI are shown below, along with their trends, pros and cons.

Vehicle	Trend	Pros	Cons
Stock Options Appreciation-only vehicle with a term of 7 to 10 years	▪ Stock option prevalence and their proportion of the LTI mix have decreased steadily in recent years due to expensing requirements, stock market volatility and other factors such as ISS focus on performance-contingent plans ▪ Used by approximately 60% of the 250 large cap companies in Meridian's 2015 survey and represented on average 22% of the value of CEO LTI grants ▪ Survey data suggests that prevalence has significantly declined in the last 10 years	▪ Reward for absolute growth in stock price ▪ High upside potential and leverage ▪ Easy to understand and track value	▪ Provides no operational guidance ▪ Arguably pay for broad market movements rather than management expertise — Can pay out even if company underperforms peers — Market volatility and long and severe market downturns decrease their perceived value ▪ High upside may cause short-term focus ▪ Have high share usage and extended overhang ▪ Will create an accounting charge even if the options expire worthless

Vehicle	Trend	Pros	Cons
Performance Plans Shares or dollars can be earned based on a range of performance goals, usually over a 3-year period	▪ Wide variety of structures, performance metrics and payout maximums, though generally 3-year duration capped at 200% of target ▪ Have increased significantly in prevalence in recent years due to a focus on pay for performance by committees and proxy advisory firms such as ISS ▪ Used by approximately 93% of the 250 large cap companies in Meridian's 2015 survey and represented on average 56% of the value of CEO LTI grants	▪ Strong pay-for-performance orientation absent exceptions ▪ Focuses a recipient's efforts on performance criteria deemed critical to the company ▪ Shareholders and proxy advisors typically perceive positively ▪ Can use substantially fewer shares than stock options to deliver same pay opportunity	▪ Can be challenging to select appropriate and meaningful performance measures that drive shareholder value creation ▪ If relative measures are used, can be difficult to select an appropriate peer group ▪ If non-relative measures are used, may require longer term goal-setting, which can be challenging
Time-Based Restricted Stock or Restricted Stock Units (RSUs) Full-value award based solely on continued employment, usually over 3 to 5 years	▪ Used by approximately 2/3 of the 250 large cap companies in Meridian's 2015 survey and represented on average 22% of the value of CEO LTI grants ▪ Became more common when stock options began to be expensed and due to stock market volatility	▪ Supports retention since value is not wholly dependent on creating stock price appreciation ▪ Requires fewer shares than stock options do to deliver an equivalent benefit	▪ Performance disconnect — Not tied to financial performance — May deliver benefit even if stock price declines or underperforms the market — High stock appreciation will create less of an impact than in stock options