Study Shows CEO Pay Decline as It Tracks Performance

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NOW IN ITS NINTH YEAR, KORN FERRY HAY GROUP'S CEO PAY STUDY CONTINUES TO EXAMINE THE KEY ELEMENTS OF COMPENSATION FOR CEOS AT THE 300 LARGEST US PUBLIC COMPANIES.

Amid challenging economic and market conditions in 2015, compensation committees were more cautious about executive pay decisions. The net result was that increases in CEO pay hit a five-year low last year. For the first time in the say-on-pay era, total shareholder return (TSR) declined (-0.3%) for these 300 companies, causing compensation committees to question pay outcomes and apply more rigor in the CEO pay decision-making process.

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WHAT WERE THE PRIMARY CHANGES LAST YEAR?

In prior years, with banner TSR results—**34.6%** in 2013 and **17.5%** 2014—committee members and shareholders generally were more tolerant of formulaic outcomes generated by incentive programs as well as adjustments that often played out in an executive's favor. But in 2015, characterized by widespread stock-price declines and flat profitability, the mind-set of committee members and shareholders shifted to pay decisions viewed as commensurate with weakened corporate performance:

> **Total compensation climbed only 2.7% to $11.7 million (vs. 4% to 6% in recent years). The primary driver was an increase of 5.1% in long-term incentive increases to a median value of $8.4 million.**

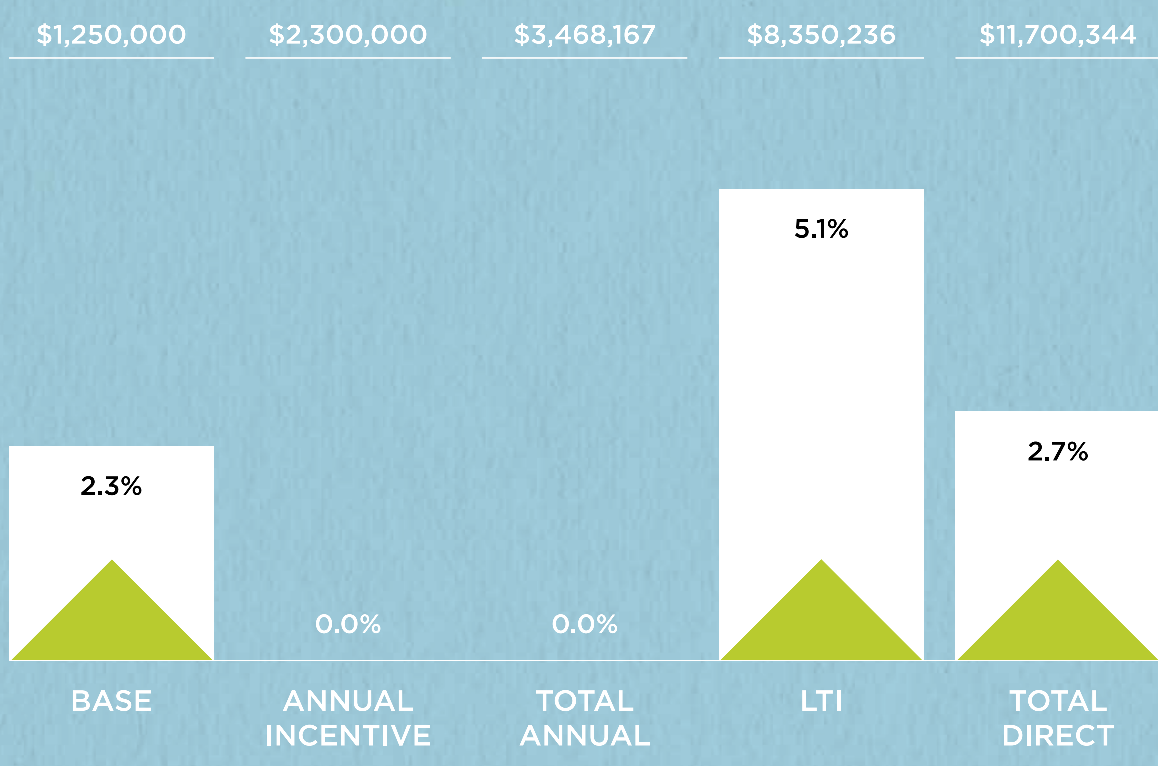
> **Median CEO annual cash compensation (base salary plus annual incentive) was flat at $3.5 million, even after base salary growth of 2.3% to $1.3 million.**

"When companies were seeing double-digit returns, boards and shareholders were much more likely to approve higher CEO compensation packages," said Irv Becker, North America Leader for Korn Ferry Hay Group's Executive Pay & Governance practice. "But with today's uncertain market and slower growth rates, compensation committees and shareholders will put CEO pay under a much more intense spotlight."

Historical Data Chart 2015

MEDIAN	2015	2014	2013	2012	2011
CEO Total Compensation Percentage Change	2.7%	4.6%	5.5%	3.6%	2.8%
Annual TSR	-0.3%	16.6%	34.0%	14.4%	3.0%

Median 2015 CEO Compensation Increases and Values



*Values are not additive

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A FOCUS ON LONG-TERM PERFORMANCE

As uncertainty spread in the market, compensation committees once again began to prefer rewarding CEOs by shifting to increased emphasis on longer-term performance. In fact, performance-based awards accounted for 33% of total compensation—the highest level ever. While the prevalence of long-term performance plans continued to rise to demonstrate a compelling pay-and-performance connection, companies also realized the importance of maintaining some retentive pay element as restricted stock remained at 25% of the total long-term incentive value.

TAKE-HOME PAY

Although CEO pay at the largest companies was restrained, stagnant stock price growth in 2015 didn't necessarily translate into poor gains in realized pay from exercises of stock options and the vesting of restricted stock and performance equity; these typically related to awards granted three to five years ago. The momentum on gains from historically high long-term incentive grants may have slowed, but median realized ("take-home") long-term incentive values rose a solid 18% to $9.4 million. Therefore, CEOs may not be "losing" as much as recent award levels may have indicated.

ENGAGEMENT WITH SHAREHOLDERS

Declining stock prices are often accompanied by increasing shareholder pressures and proxy advisory scrutiny. In countering these headwinds, many companies boosted efforts to maintain high levels of support in say-on-pay votes. While 90% of companies continued to receive high approval ratings, various efforts have been required to do so, including increased shareholder outreach, ongoing dialogue with institutional shareholders and proxy advisors to understand desired pay practices, enhanced proxy disclosure, and rigorous testing of the shareholder landscape.

Engaging with and responding to shareholders will be equally, if not more, important in a stalled or depressed market as companies begin to rationalize pay programs that are aligned with the longer-term business strategy rather than "checking the boxes" with proxy advisory groups. In 2015, shareholder outreach continued to gain momentum as companies engaged investors throughout the year to discuss pay issues within the context of the economic climate. We may see a further increase in the use of performance awards and a TSR metric in the next several years from late adopters responding to such pressures.

WHAT'S NEXT?

Aligning pay and performance within the context of economic uncertainty is tricky and entails some difficult judgments: Do you cater to shareholders or the longer-term business strategy where their respective priorities diverge? A balance may require some tough decisions, as not all pay-program changes may fare well with shareholders and proxy advisory groups. Coordinating the pay program with the intended longer-term business strategy will require some trust on the part of shareholders; companies need to be cautious about making pay-program changes that are all about "checking the box" in a down market.

Whatever the compensation committee's decisions on CEO pay, it should be prepared to explain and justify—in clear terms that align with both economic conditions and the company strategy—why the committee arrived at such decisions.

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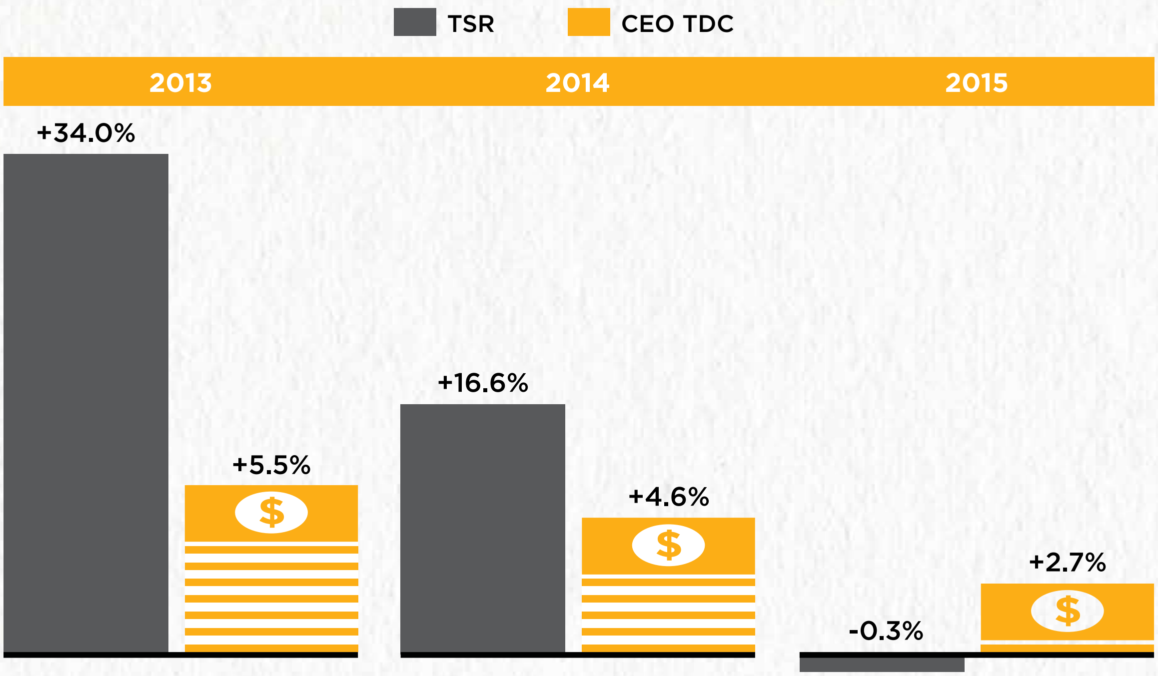
KORN FERRY HAY GROUP
2015 CEO PAY STUDY

CEO PAY CONTINUES TO TRACK PERFORMANCE—EVEN IN A DOWN YEAR

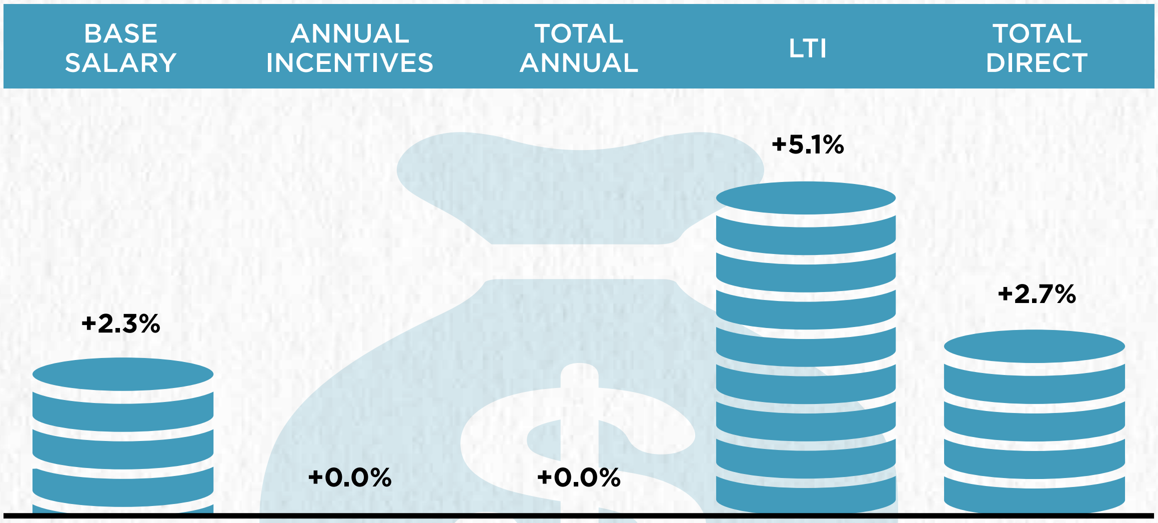
FINDINGS FROM OUR 2015 CEO PAY STUDY

WHAT HAPPENED IN 2015?

Boards approached pay in 2015 with more caution as financial performance and market conditions deteriorated.



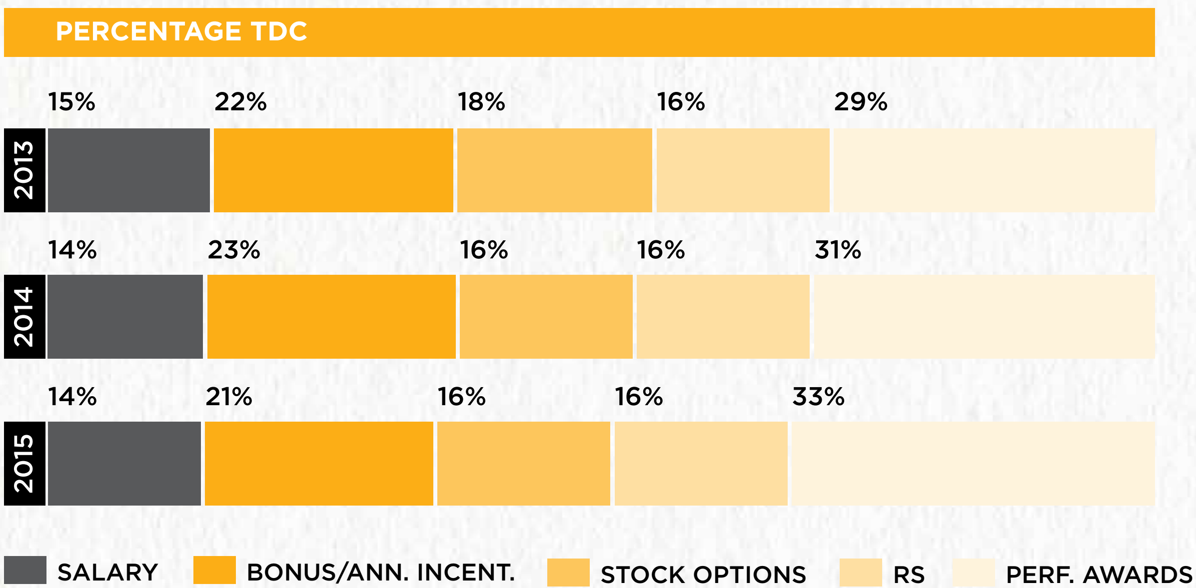
CEO total direct compensation (TDC) was up 2.7% to $11.7 million.



The primary driver of the TDC increase was a 5.1% growth in long-term incentives to $8.4 million.

A FOCUS ON LONG-TERM PERFORMANCE CONTINUES TO GROW

As uncertainty spread in the market, companies continued to reward CEOs by focusing on long-term performance, with **LTI awards** accounting for **33%** of total compensation.



Stagnant stock price growth didn't necessarily translate into poor gains in realized LTI take-home pay.

Median take-home long-term incentive value: **up 18% to $9.4 million**

WHAT'S NEXT?

1 Shareholder outreach activity continues to intensify and should carry into 2016 as companies rationalize pay decisions that balance performance alignment and retention.

2 Companies are working hard at improving pay program disclosures—a trend expected to continue with more depth in annual incentive and performance-based LTI disclosures.

3 Aligning pay and performance within the context of economic uncertainty may require tough decisions, as not all pay program changes may fare well with shareholders and proxy advisory groups.