

September 2011

What it really costs to retain a Chief Executive

Analysing the FTSE 100 over five years:

Total CEO Pay vs. Company Performance 2006-2011*

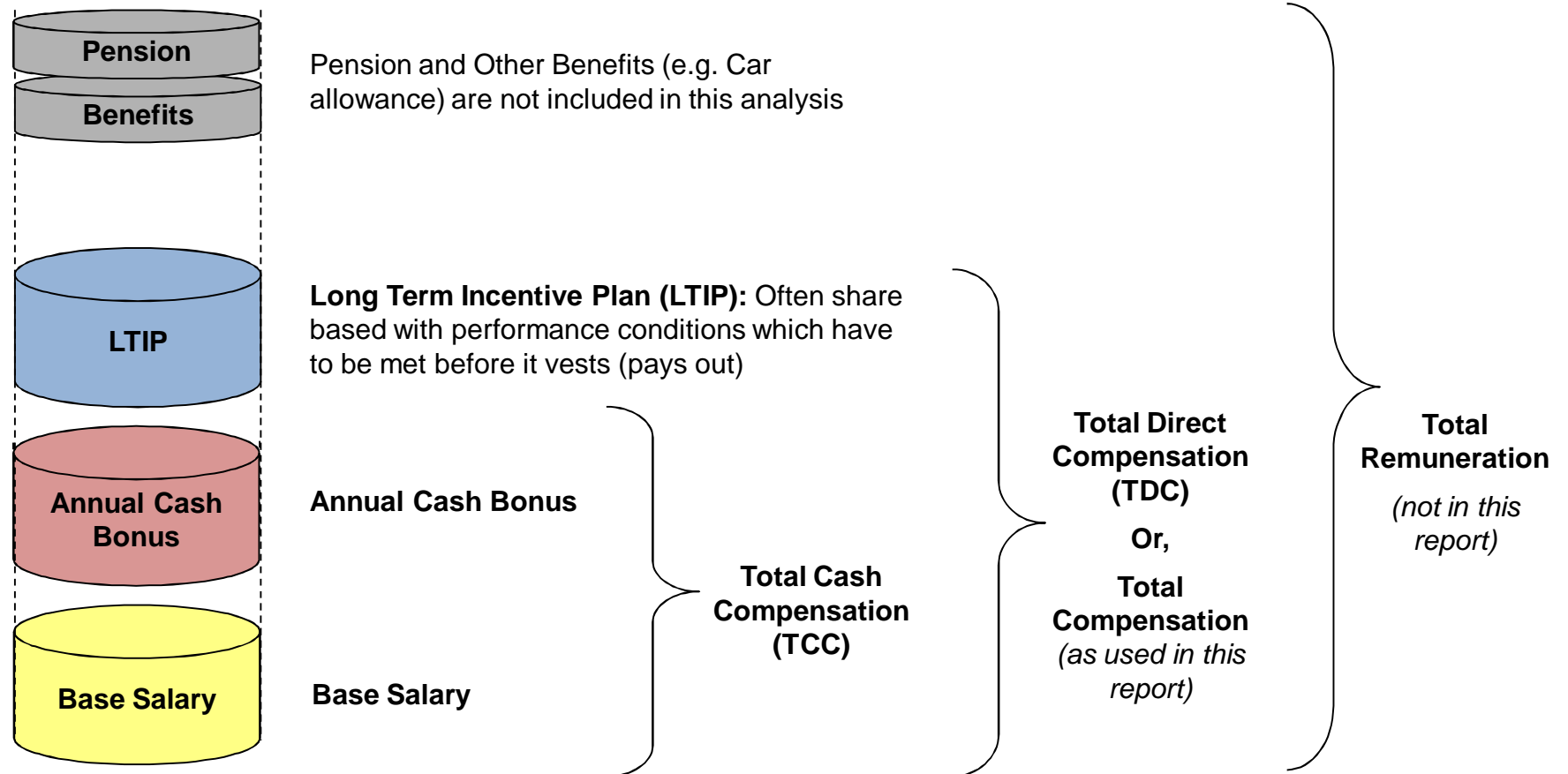
* Analyses for five-year periods ending 2006, 2007, 2008, 2009 and 2010 are also available

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Executive Pay: Structure and Definitions

This is how the pay package of a typical Executive might look:



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SUMMARY

Executive Summary: Background & Introduction

- Patterson Associates has researched and published 5-year pay analysis since 2006. We want to show how the investor's total returns in five years compares with the Chief Executive's take home pay during the same five years
- Rather than making assumptions about the value of a pay package in one year, which requires us to guess whether performance conditions may or may not be met, our approach looks at the value of the whole package (salary, annual bonus, vested shares and options) on a single day at the end of five years. Its simple, and **it is not what you will see in an Annual Report.**
- In other words:
 - We collate the company's own published pay data over **five** years – to **fully** capture the cost of retaining a Chief Executive
 - We take the company's own published 5-year performance data
 - We compare the two
- We originally conducted this piece of research in 2006, for the period 2001 to 2006, and have done the same each year since. We have now updated our research five times - ***this report focuses on the period 2006-2011***

IMPORTANT:

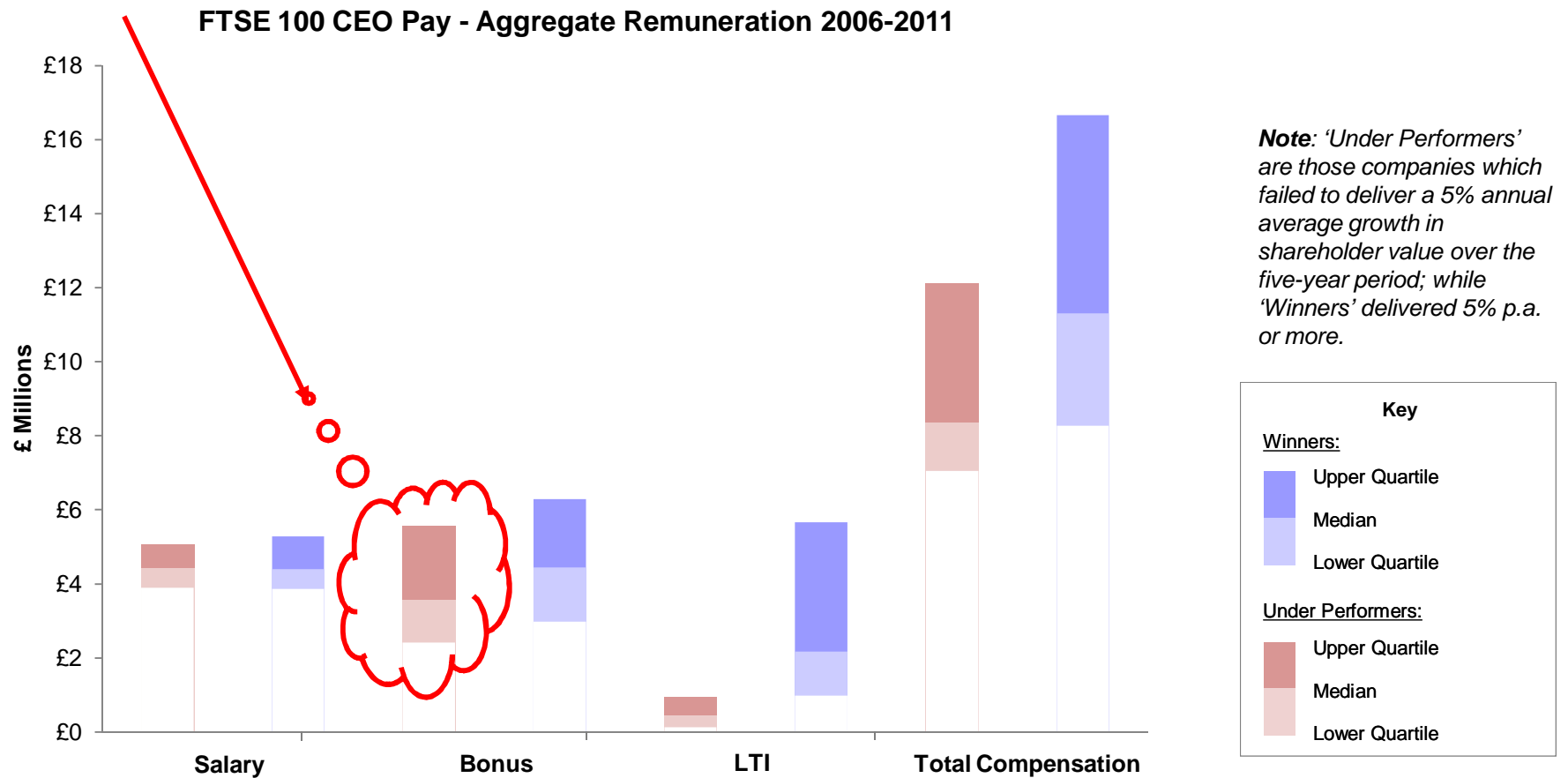
This research clearly shows why pay and performance appear to be disconnected, and why it would a huge mistake to follow current thinking and abandon Long-Term Incentive Plans

Executive Summary: Our Research

- We identified FTSE100 “Winners” – those with Total Shareholder Returns [‘TSR’] of >5% over 5 years) and “Under-Performers” - those with TSR of <5% from 2006-2011
- We compared the performance of FTSE “Winners” with “Under-Performers”
 - Salary levels are very similar in both groups
 - “Under-performers” are paid far more than one would expect.....but their Long-Term Incentives are (as one WOULD expect) near valueless
 - Because unexplained annual (cash and/or deferred) bonus fills the pockets left near empty by low Long-Term Incentive (LTI) pay-outs, Total Compensation of both good and bad performers is similar
- Long-term incentives (LTIs) **are** working in that failing companies’ programmes either do not vest or are worth a lot less, for example our research shows median LTI value (as a % of median Total Compensation) is:
 - **19%** for “Winners”
 - **5%** for “Under-performers”
- But, because bonuses continue to be paid to companies who are not performing well... the total package is de-coupled from underlying performance
- Astonishingly, the result of THIS may be that Remuneration Committees begin to feel LTIs ‘don’t work’ (i.e. they don’t pay out, or because executives feel the outcome of an LTI is too uncertain) and seek to replace them...with salary and bonus
- **It cost the FTSE survivors between £7m and £15.6m to retain a CEO over the last 5 years. The median was £10m**

Executive Summary: Our Research

For “Under-performers” the Long Term Incentive component of pay does not vest and IS WORTH VERY LITTLE. However, large bonuses are still paid, regardless. This leads the public, the government , and shareholders to the view that ALL pay is unrelated to performance



Executive Summary: 5 Year Compensation Totals 2006 - 2011

5 Year Compensation Totals for FTSE 100 'Survivors' 2006-2011:					
	Salary	Bonus	Total Cash Compensation	Long Term Incentives	Total 5 Year Compensation
Upper Quartile	£5,262,298	£6,185,345	£11,182,847	£3,194,059	£15,570,481
Median	£4,433,500	£4,040,698	£8,433,000	£1,437,378	£10,164,378
Lower Quartile	£3,876,567	£2,755,300	£6,888,000	£426,992	£7,560,800

Note:

Total Cash Compensation is the sum of salary and cash bonus

Total 5 Year Compensation is the sum of Total Cash Compensation plus Long Term Incentives

Executive Summary: The Way Forward

- **Remuneration Committees must rely on market data to make decisions**
- **However, simply benchmarking pay against other companies has proven to be a blunt instrument at best. At worst, it is fuelling executive pay inflation**
- **We believe companies, and shareholders, should base their pay decisions on the basis of pay AND performance**
- *This 'Alignment' approach to pay transparency was developed by our partners in the US*, is now in use by S&P500 companies, and is being introduced by us in Europe*
- *Basically, companies define a range of reasonable pay levels for a given performance*
- *Unlike the single snapshot that benchmarking exercises provide, it considers historical and prospective pay and performance to determine whether a remuneration programme is aligned with performance, or not*

* *Farient Advisors LLC (Los Angeles, New York)*

What Are Other Groups Saying?

- **A recent report released by Manchester Square Partners collated current Chairmen's views on remuneration:**
 - Over 80% of participants were sceptical as to whether LTIs were achieving their purpose with many beginning to reconsider their current design
 - Approximately 80% of participants suggested that they would like to return to a simpler package of salary and bonus whilst significantly simplifying the LTI element
 - Chairmen consider discretion as an essential way to offset the sometimes inexplicable changes in the market. By giving greater discretion it is thought that Executives would have more confidence in receiving a fairer package

In contrast to these views PA LLP research in this report illustrates a very different situation:

- **We show that LTIs are tied to company performance**
- **We show that bonuses which are heavily discretionary are not tied to company performance**
(Where performance is measured as TSR)

*Source: Chairmen's Research Group: CEO Remuneration, Chairmen's Views on Current Issues, Sept 2011, Manchester Square Partners
Analysis by Patterson Associates LLP*

What Are Other Groups Saying?

- **The High Pay Commission (HPC) released results of an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK:**
 - “There is rarely a link between directors’ incentives and the way a company performs” (Foreword of the report)
 - There has been incredible growth in the average value of LTIP awards, which have gone up by over 700% since 2000



A key focus of the HPC report is identifying a disproportionately large increase in pay relative to performance – i.e. they are concerned by the high level of pay we see today.

This report does not deal with defining an ‘appropriate’ level of pay. We make a distinction between the size of pay and the sensitivity of pay to performance.

*Source: What are we paying for? Exploring executive pay and performance: Discussion Papers, Sept 2011
Analysis by Patterson Associates LLP*

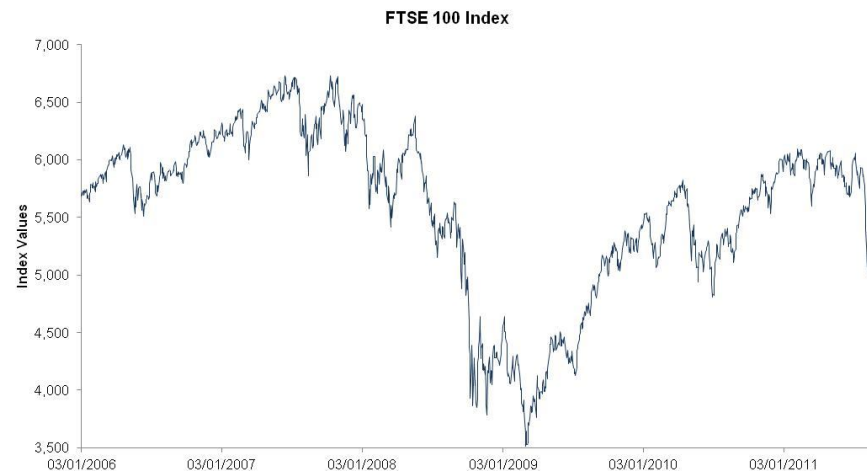
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BACKGROUND

2007 through 2011 was a terrifying, but fascinating five year period

- A period of dramatic volatility in the stock markets, a credit crunch and massive economic downturns in parts of the world
- Huge efforts to impact executive pay (see next page)
- Publication of numerous reports showing how executive pay has risen at extraordinary rates since 2001, and how executive pay rises despite falling share values
 - *‘Pay for performance has added to the staggering complexity of executive packages and yet there is no clear evidence that it works. Boards need to think again about how to structure their pay awards’* (High Pay Commission, September 2011)
- Private studies* showing how Remuneration Committees lack confidence in current incentive compensation designs (particularly long-term incentives), and are unsure of the way forward



* Chairmen's Research Group – CEO Remuneration: Chairmen's Views on Current Issues (Manchester Square Partners, IDS) Sept 2011

Many Regulatory guidelines – but executive pay is still The Big Issue

- CADBURY REPORT (1992)

Set out recommendations on the arrangement of company Boards and accounting systems to reduce corporate governance risks and failures.

The report's recommendations were adopted to varying degrees by the European Union, the US and the World Bank amongst others.

- HAMPPEL REPORT (1998)

Reviewed the Code established by the Cadbury Report to determine whether it was achieving its purpose.

Hampel concluded that there was no need for a revolution of the UK corporate governance system, implementing smaller changes including that all forms of remuneration should be disclosed.

- HIGGS REPORT (2003)

Commissioned by the British government, this report reviewed the role and effectiveness of non-executive directors recommending some additional modifications to the Cadbury and Greenbury Codes.

- WALKER REVIEW (2009)

Recommended substantial changes to the way the Boards of banks and large financial institutions operated in terms of corporate governance. Its main recommendations were:

- Shift to deferred bonus schemes for high-paid executives
- Increased disclosure
- Chairman of the remuneration committee to face re-election if report gets less than 75% approval

- THE COMBINED CODE (2010)

Developed in accordance with the European Commission adopting the CRD3 and both the Walker and Turner Reviews. The Code focuses on setting an appropriate ratio between fixed and variable remuneration, significant bonus deferral and payment of variable remuneration in shares. It also introduced a proportionality tiered system which enables firms to align remuneration policies with their size, nature and risk.

1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011

- GREENBURY REPORT (1995)

Addressed the growing concerns surrounding the level of director's remuneration. It altered the Cadbury Code as follows:

- Each Board should have a remuneration committee that excludes executive directors
- An element of Directors' remuneration should be based on long term performance and this should be disclosed annually

- TURNBULL REPORT (1999)

Recommended that Directors should be responsible for internal financial and auditing controls

- DIRECTORS REMUNERATION REPORT REGULATIONS (2002)

These regulations require quoted companies to prepare a directors' remuneration report which complies with the regulations and to put the report to a non-binding shareholder vote ("say on pay".)

- TURNER REVIEW (2009)

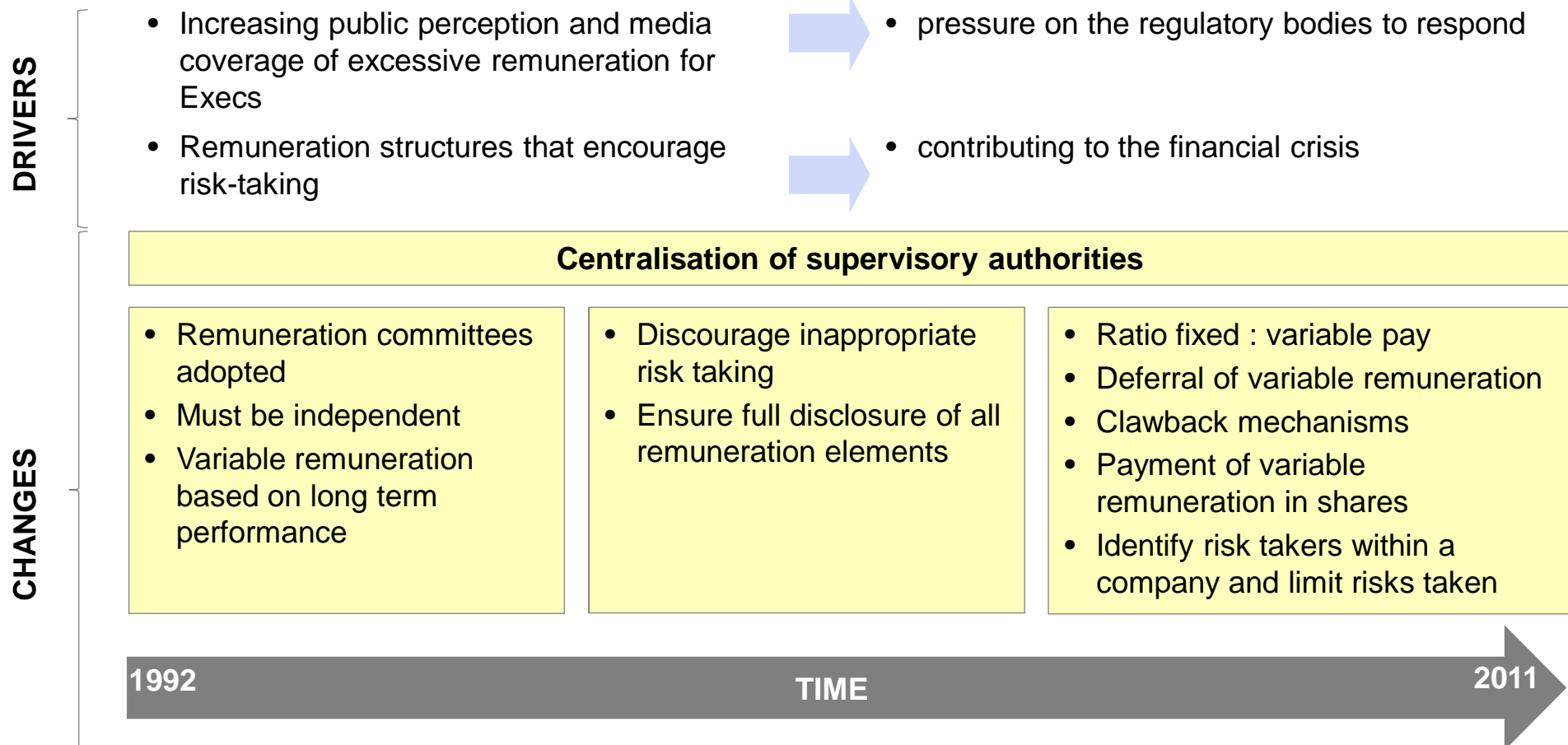
Set out a number of recommendations in response to the financial crisis. Amongst its many conclusions the review concluded that directors should not be incentivised for taking undue risks. It also focussed on the need to adopt a global approach to regulations.

- AIFMD (2011)

Alternative Investment Fund Managers Directives – is intended to broadly have the same impact as the new combined Code. It however will effect the remuneration structures of alternative investment fund managers.

Change in Focus

As time goes on there has been a shift in the issues dealt with by guidelines

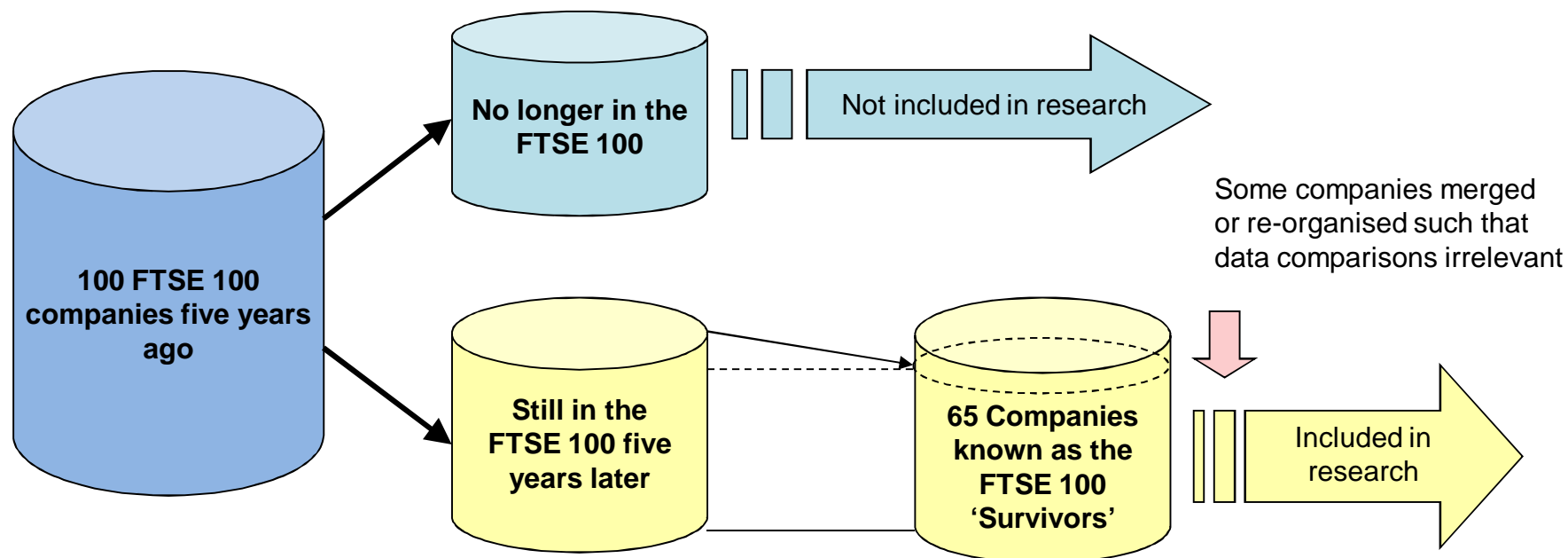


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METHODOLOGY

Which Companies Have We Looked At?

All companies which were in the FTSE 100 both on 30th April 2006, and also on 1st May 2011 (65 companies in total).



Throughout this report we use five year Total Shareholder Return (TSR) (as published in each company's annual report) as a measurement of performance.

The report frequently refers to 'Winners' and 'Under Performers'. 'Winners' refers to those companies who have delivered a five year TSR of 5% p.a. or more whilst 'Under Performers' are those who have not. (There are 42 'Winners' and 23 'Under Performers')

Methodology

- We examined the performance of FTSE 100 companies over their last five financial years, and the aggregate pay of the CEOs of those companies over the same period. All data was taken from the companies' annual reports.
- Note that it would be possible – and reasonable – to evaluate the pay packages using a number of different methodologies. We chose the approach defined below because it is simple and transparent, and captures the effect of the company's performance on the CEO's wealth. Most importantly, we have applied the same methodology throughout, thereby valuing each company fairly and consistently.

Company Performance:

- Five year Total Shareholder Return (TSR), as reported in the company's most recent Annual Report. i.e., The return an investor would have received if he had bought £100 worth of shares and kept it for five years until the end of the most recent financial year, reinvesting any dividends he received.

Aggregate Pay:

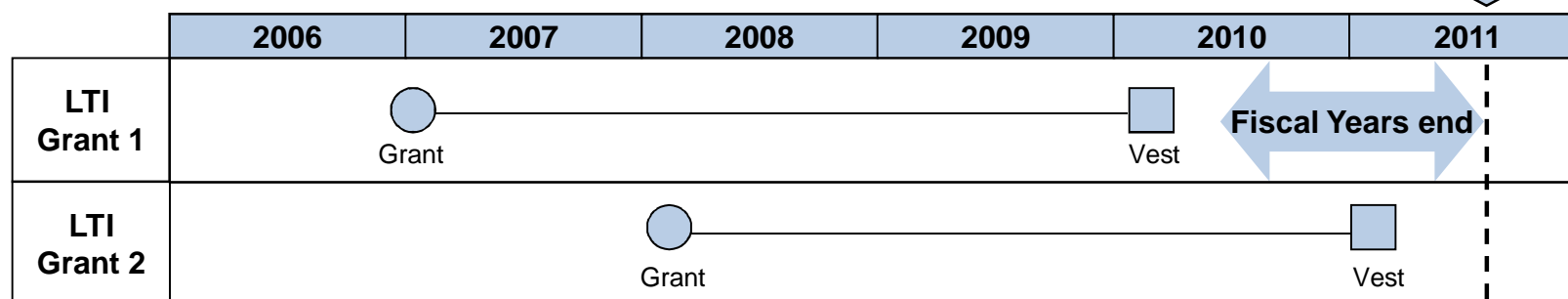
- All salaries and actual (not target) cash bonuses awarded to the CEO during the last five financial years, plus the value of any long-term incentives (LTIs) – deferred bonus shares, matching shares, performance shares and share options - which vested in the last two Financial Years, valued at the company's share price on 5th Sept 2011.
- Since most LTIs have a performance period (i.e. time from grant to vesting) of three years, there would typically be time for two years' worth of grants to be granted and vest within the five year window. This approach also assumes that the CEO held his shares and/or options after they vested until 5th September 2011.

- We did not include the value of any benefits or pensions. Note that in many cases there was a change of CEO during the five year window. In these cases, we added the pay of the individuals during the time that each was CEO, so that the numbers we ended up with represent the amount paid to the CEO position, not necessarily to any particular individual.
- Source: Compensation data & performance data derived from each company's published annual report, Analysis: Patterson Associates LLP.

How We Measured Pay...

Remuneration Elements	Included in the Research
Short-Term Pay:	
Salary	Included all 5 years
Annual Cash Bonus	Included all 5 years
Benefits	Not included
Pension	Not included
Long-Term Pay:	
Deferred Bonus Shares	Those awards granted during the 5 years and vested during the 5 years (i.e. 2 cycles of 3 years' duration, typically)
Matching shares	
Performance Shares	
Share Options	Embedded value at 5 th September 2011

Embedded value as 05/09/11



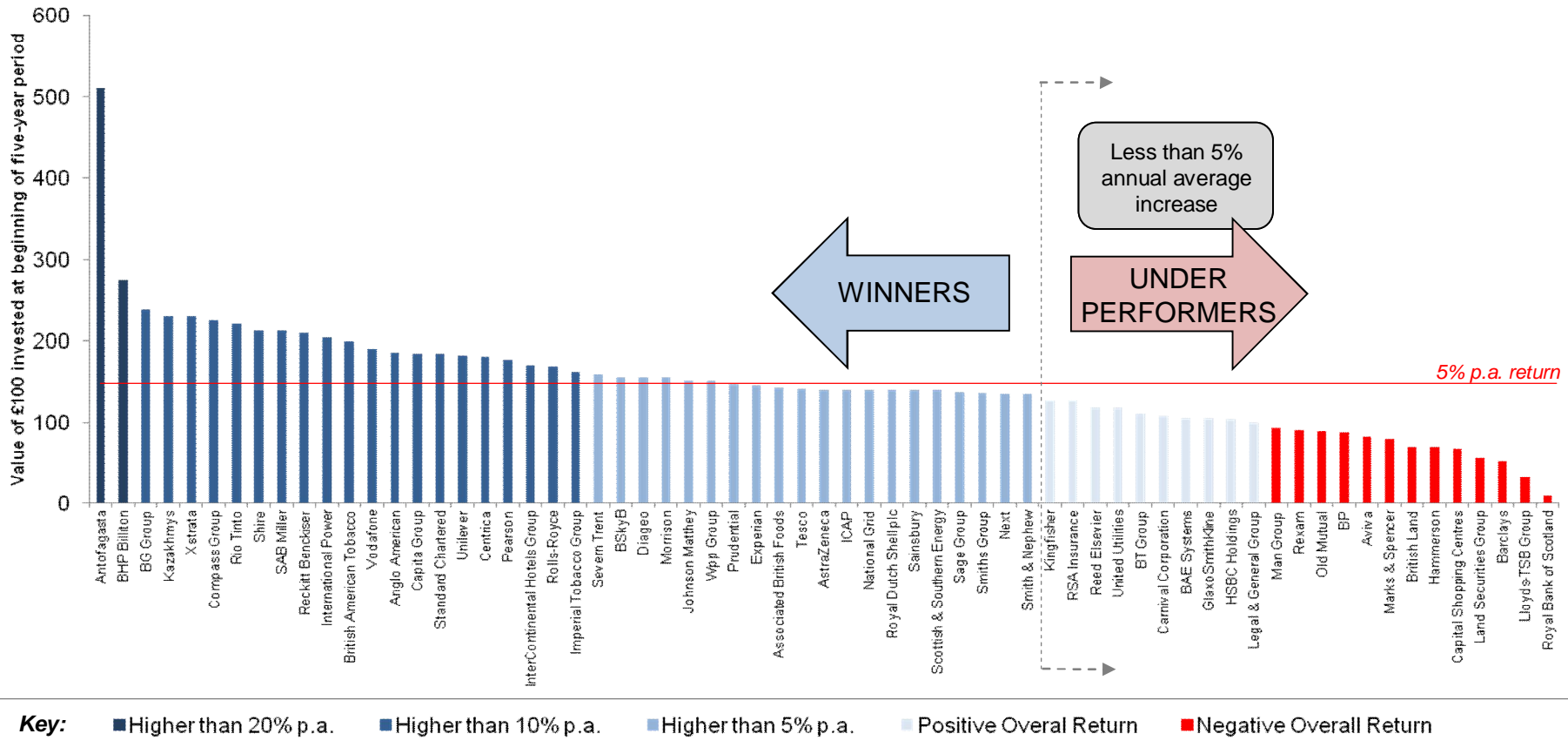
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OUR RESEARCH

FTSE 100 'Survivors' (2006 - 2011)

We ranked the “survivors” by TSR performance to determine the “Winners” and “Under-performers”

FTSE 100 'Survivors' Five Year TSR

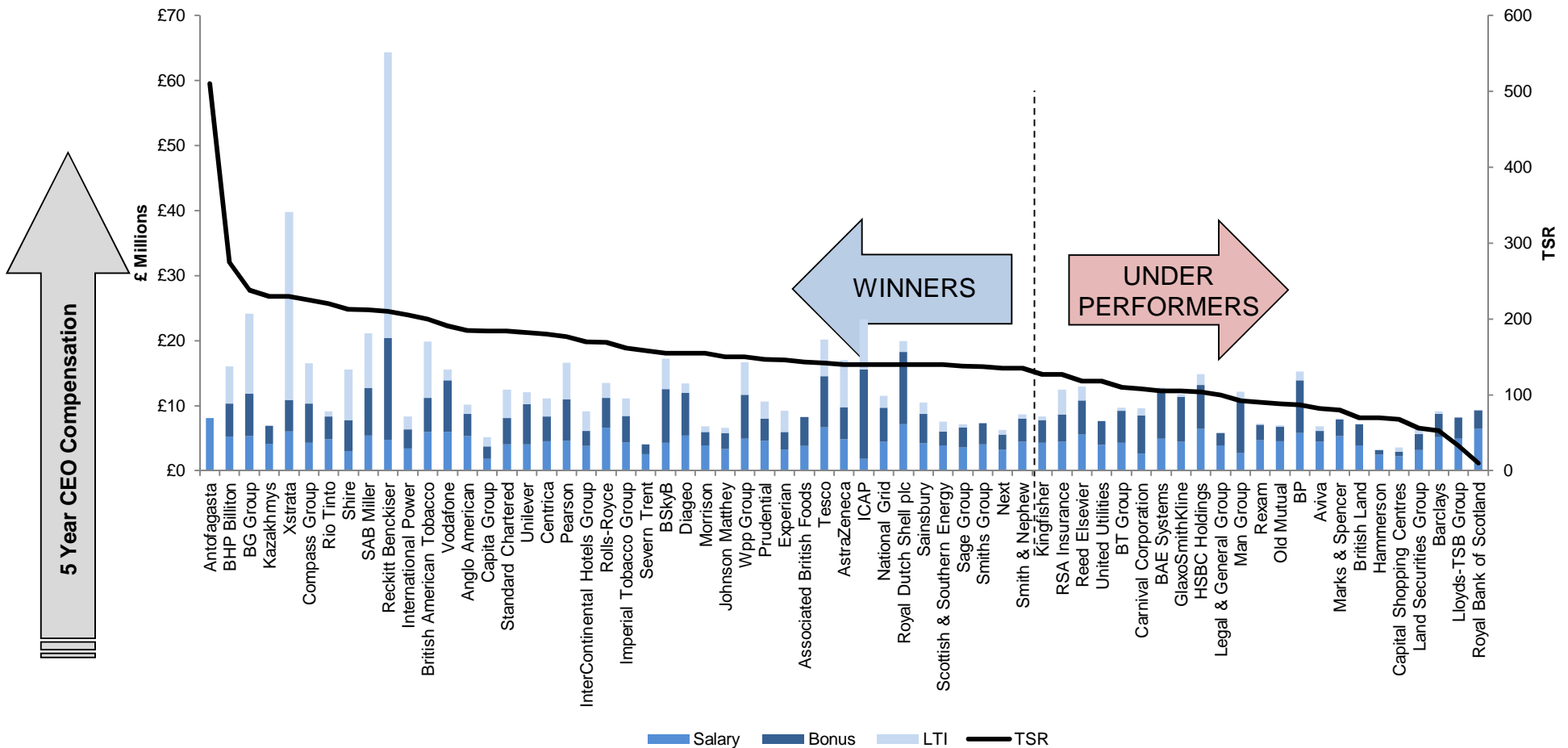


Note: We collected data for each company for the 5 years up to their most recently reported financial year end. For many, this was actually Dec 31st 2010, not 2011

Is CEO Pay Linked To Performance?

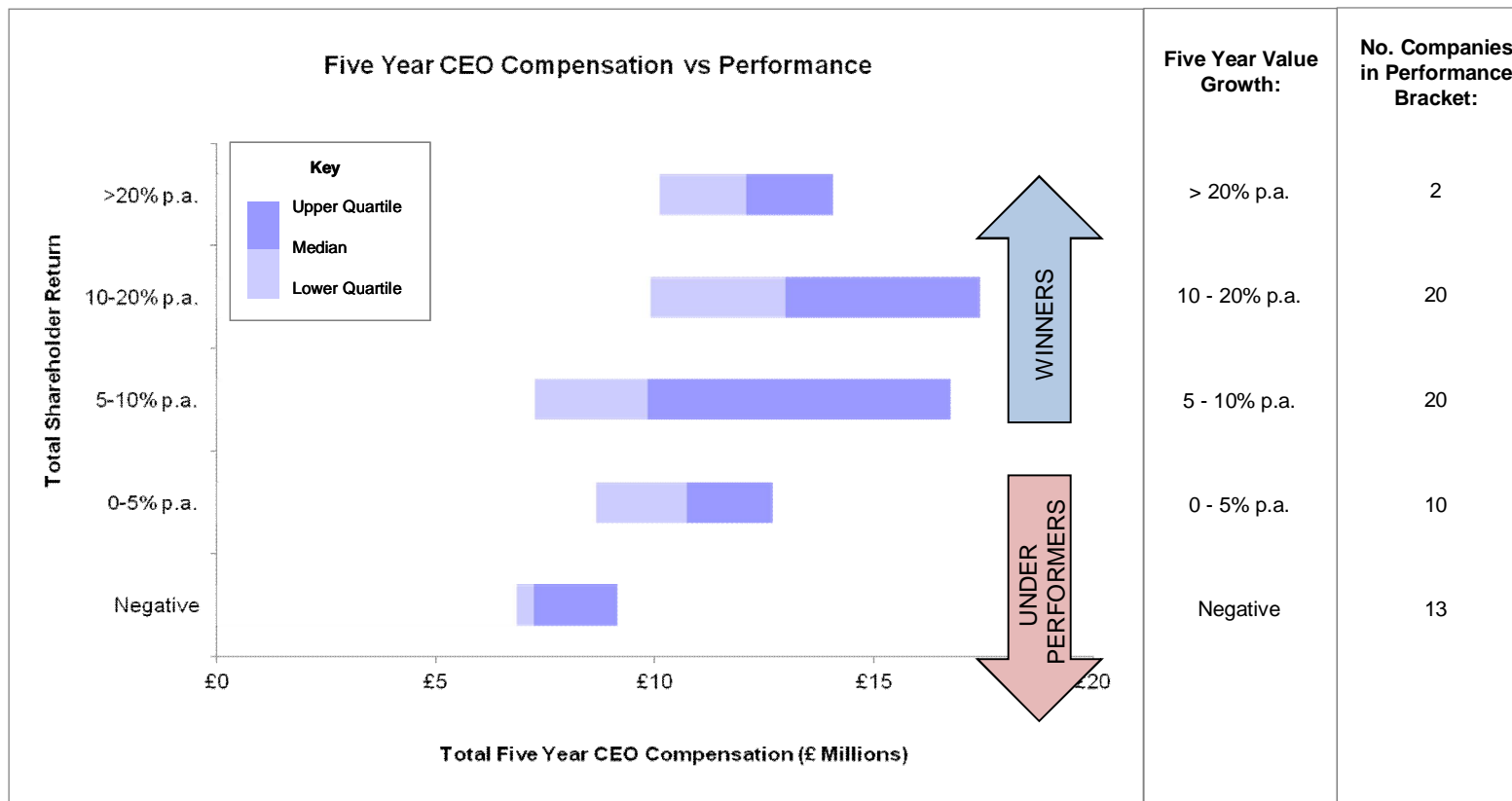
The highest performers clearly do not pay the most, and vice versa

FTSE 100 'Survivors' five Year Cumulative Pay Package



Is CEO Pay Linked To Performance?

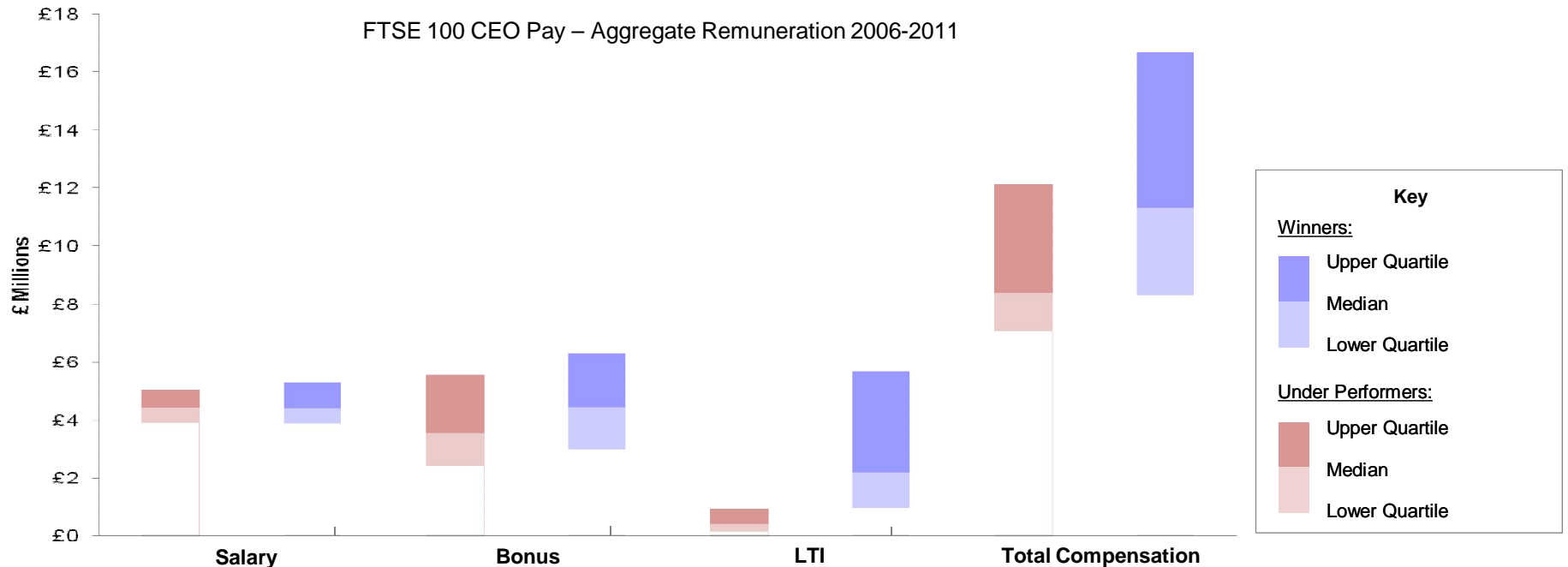
Some “Under-performing” companies are paying more for their CEO’s than the “Winners”



Are “Winners” Paid More?

We compared the pay packages of the “Winners” and “Under-Performers”

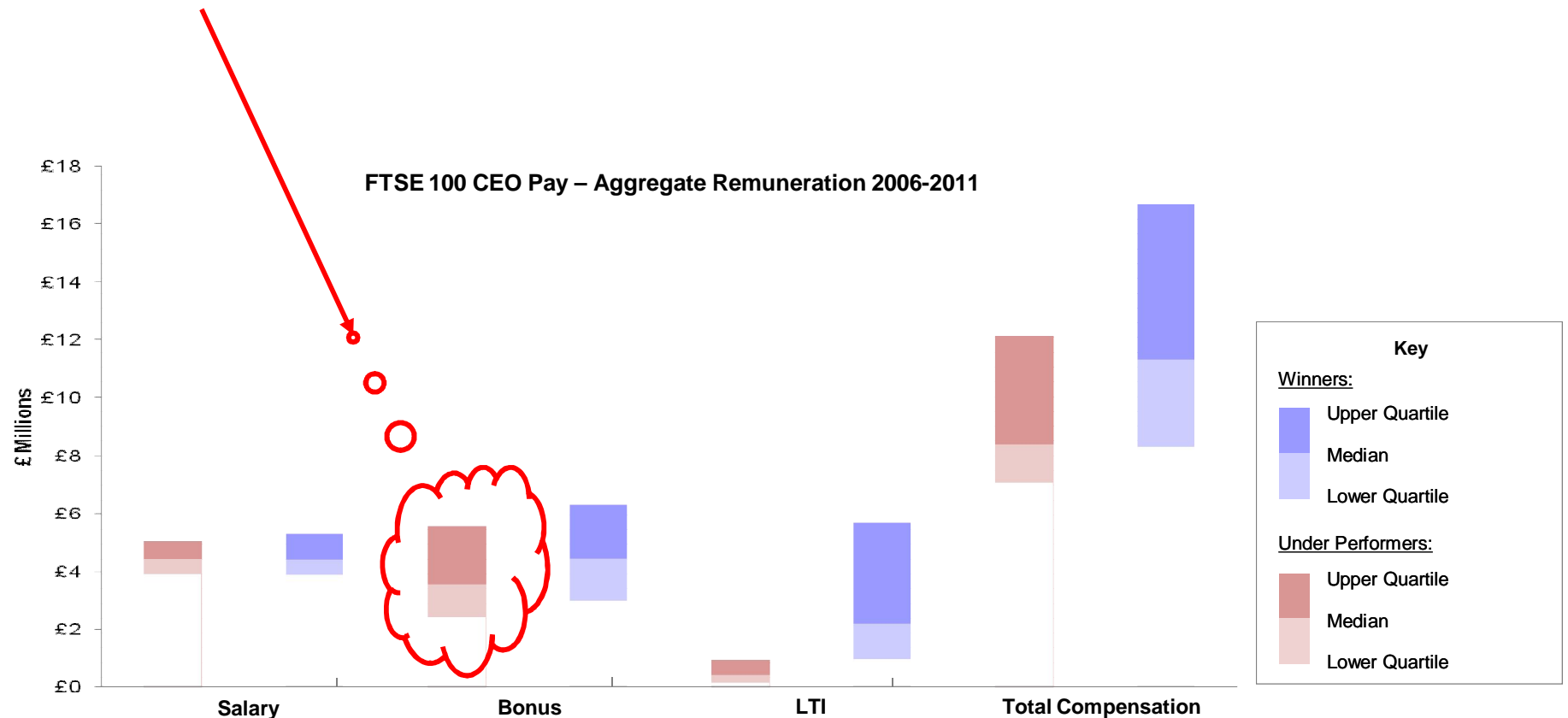
- Salary levels are very similar in both groups
- Under-performers are paid far more than one would expect.....but their long-term incentives are (as one would expect) near valueless
- Because bonus fills the void, Total Compensation of both good and bad performers is similar
- As a result Total Compensation does not reflect performance



Total Compensation Is Not Linked To Performance

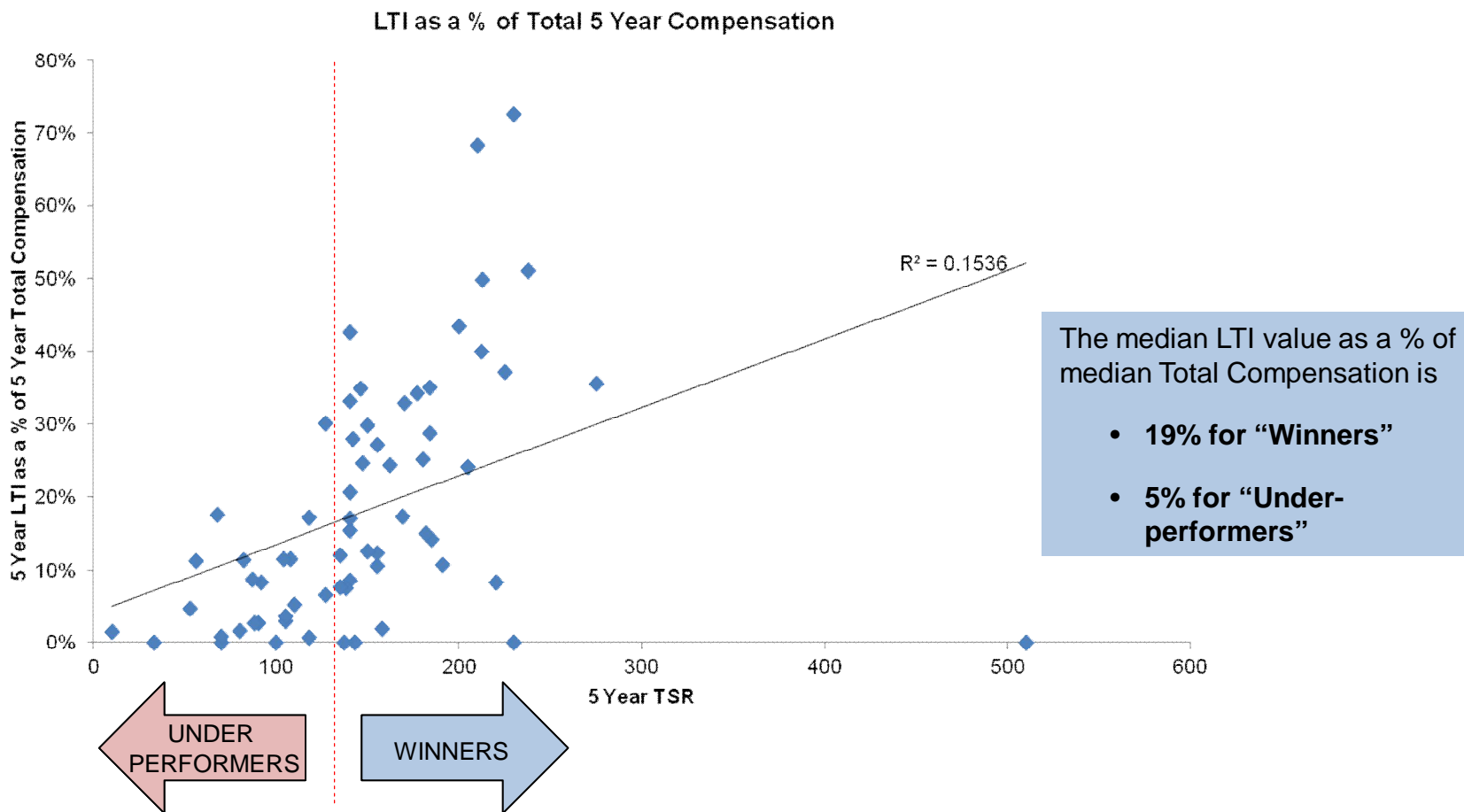
So, bonuses paid to “Under-Performers” means Total Compensation is not linked to performance

- We will focus on why this happens – lower performing companies paid big bonus...
- Who are these companies, and why do they pay so much?



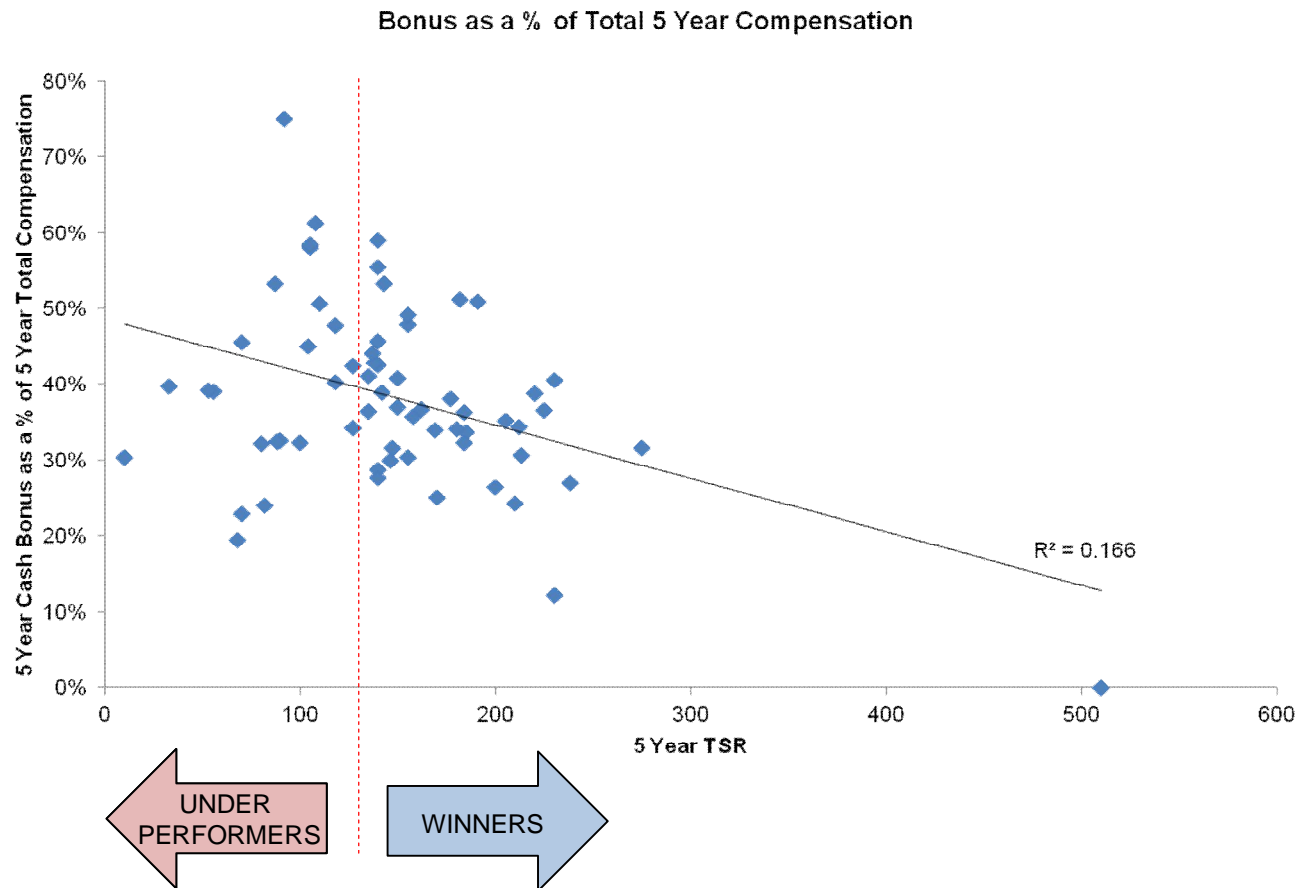
But, LTI's Are Tied To Performance

Despite much recent press about how LTI's are not working, there is a good correlation between LTI and TSR performance. Those paid a significant LTI had good performance.



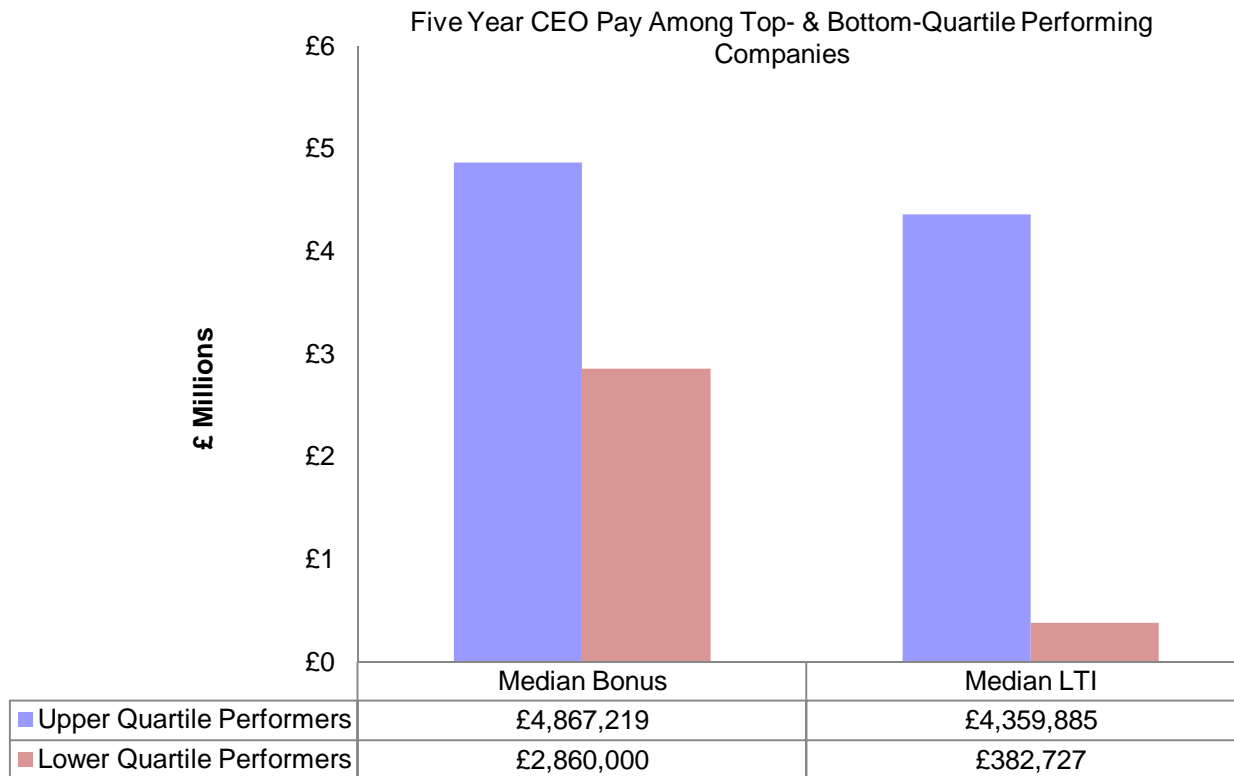
Bonuses Do Not Reflect Performance...

The opposite trend can be seen with Bonuses. Both the “Winners” and “Under-performers” are awarded a similar range of Bonus %



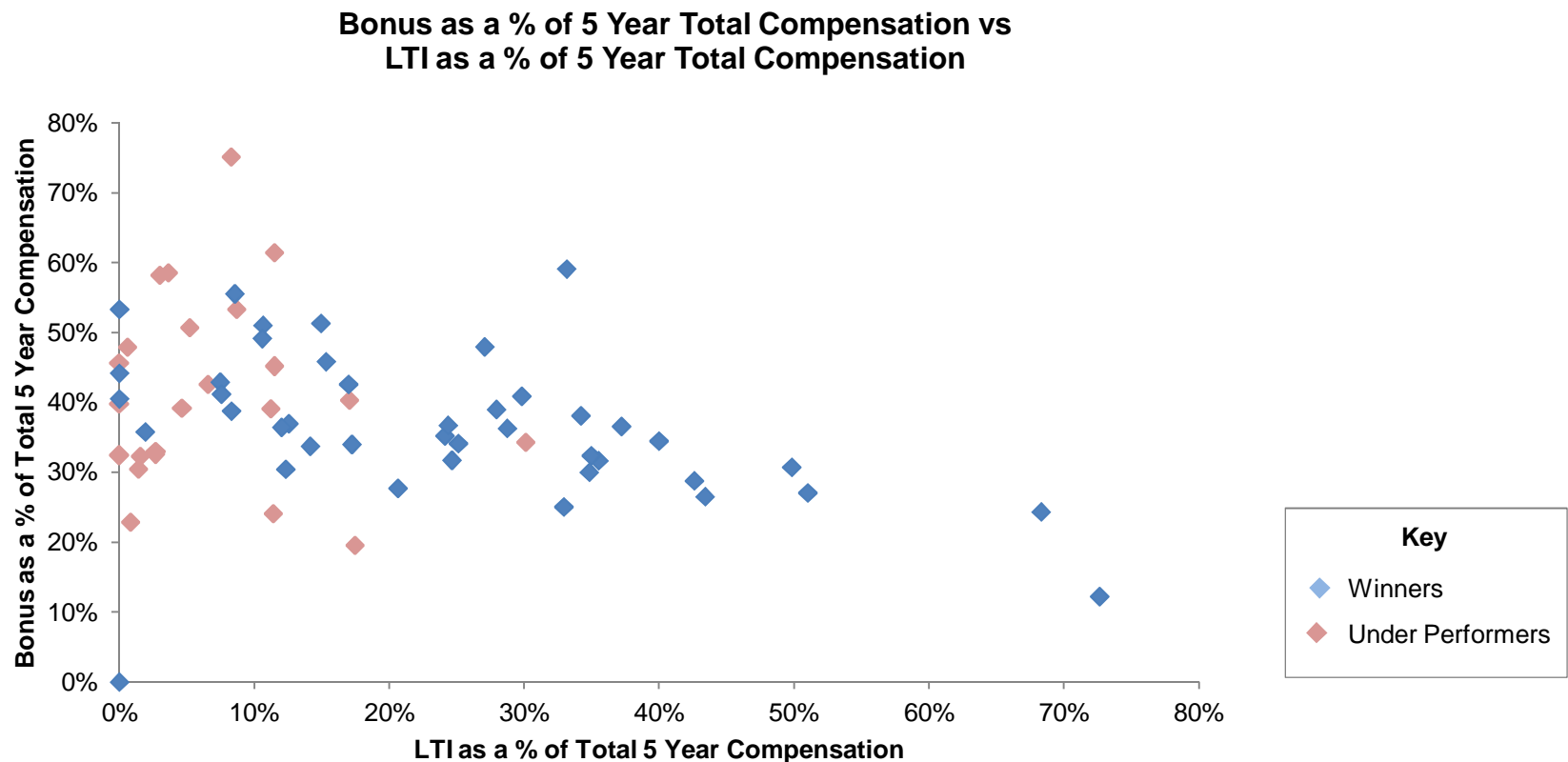
CEO Variable Pay Structure: 2006 - 2011

- Top quartile companies (blue) award significant annual bonus and Long Term Incentives vest in full (as they should) - their performance was good
- Lower quartile companies (red) still award big bonus, but their performance wasn't good enough to trigger the vesting of their Long Term Incentive



Why Are “Under-Performing” Companies Still Paying Out Bonuses?

This shows again that “Under-performers” are paying a significant Bonus vs. LTI. The LTI did not pay out (as expected if performance was low) but a Bonus was still Awarded.



Note: ‘Under Performers’ are those companies which failed to deliver a 5% annual average growth in shareholder value over the five-year period; while ‘Winners’ delivered 5% p.a. or more.

Five Year CEO Compensation – Total Pay

Total Five Year Compensation for CEO's ranges from £10m median to a maximum of £15.6m

	Total 5 Year Compensation		Annual Compensation	
	Median	Upper Quartile	Median	Upper Quartile
Salary	£4,433,500	£5,262,298	£886,700	£1,052,460
Cash Bonus	£4,040,698	£6,185,345	£808,140	£1,237,069
Total Cash Compensation (TCC) (Salary + Cash Bonus)	£8,433,000	£11,182,847	£1,686,600	£2,236,569
Long Term Incentives (LTI)	£1,437,378	£3,194,059	£287,476	£638,812
Total Compensation (TCC +LTI)	£10,164,378	£15,570,481	£2,032,876	£3,114,096