Replacement List for Short-term Remuneration Provisions

	STOP...	INSTEAD...
Do No Harm	Creating large one-off moments of financial reward	Set vesting and mandatory hold periods to smooth payouts via rolling distributions
	Accelerating vesting schedules upon an executive's departure	Maintain preestablished vesting schedules
	Assuming companies and individuals have the same time value of money and risk appetite	Measure and adjust for how executives' time value of money and risk appetites diverge from those of the company
Choose Your Own Path	Relying on peer groups to determine the remuneration structure, as opposed to pay levels	Design pay structures that are derived from the firm's unique strategy and circumstances
	Trying to be all things to all market participants (e.g., tacking on miscellaneous or broadly demanded provisions)	Establish remuneration structures that best suit the company, its purpose, and its strategy
Check Blind Spots	Trying to motivate executives exclusively through their remuneration	Integrate monetary incentives and executives' individual intrinsic motivations into a comprehensive package
	Avoiding risk by hiring or continuing to retain an executive to satisfy the market	Accept the risk of hiring the right executive to execute the long-term strategy
	Overemphasizing the objective of remuneration as "attract and retain"	Focus pay on enhancing alignment; alignment driven by extrinsic and intrinsic motivation will help attract and retain talent

Remuneration Conversation Guide for Companies and Their Investors

Board directors and investors need to clarify goals for using longer-term remuneration design and anticipate unintended consequences before taking action. To facilitate these discussions, FCLTGlobal has created this Remuneration Conversation Guide for corporate boards to use, including in engagements with their investors. We have provided illustrative answers to these questions, but they are not intended to be exhaustive or comprehensive.

PATHWAY EXPECTATIONS

How long is the firm's business cycle?

Implication for executive remuneration: Firms can use longer time horizons of pay more easily when they have longer business cycles.

- Less than 2 years
- 2–4 years
- 5–7 years
- Longer than 7 years

What is the firm's growth expectation during the next business cycle?

Implication for executive remuneration: Higher-growth firms will have more of an opportunity to pay in instruments like stock or options. Lower-growth firms will have the inverse.

- Exponential
- Linear
- Little to none

How wide is the firm's range of potential outcomes relative to expectations?

Implication for executive remuneration: Paying for performance depends on stable, reliable, and valid metrics. Such metrics are more feasible when the firm's pathway is more certain.

- Our prospects are quite uncertain.
- We manage the firm within a range of certainty that we can largely control.
- Our prospects are quite certain.

LEADERSHIP EXPECTATIONS

To what extent is the firm led by founders relative to professional managers?

Implication for executive remuneration: Concerns about the alignment of interests between investors and managers is greater when executives have no personal, "lives and legacies" connection to the firm, and firms very often seek alignment by linking pay to performance, using stock or options as instruments of pay, preferring longer time horizons of pay, and requiring larger levels of holding in the firm's stock.

- Our founder is our CEO.
- A member of our founder's family is our CEO.
- A small number of investors hold a significant portion of our shares, and our CEO is their representative in executive management of the firm.
- Our shares are widely held, and our CEO has only business connections with the board.

What is the firm's ability to pay executives now?

Implication for executive remuneration: Firms may choose to pay in variable instruments like stocks and options for strategic reasons, or they may do so because they are at points in their lifecycles at which they have no other choice.

- We have sufficient cash that we can freely choose the portion of variable remuneration that we offer in cash versus shares or options.
- Our cash position can allow us to pay a limited portion of variable remuneration in cash.
- Our cash position can allow us to pay cash for base salary, but we have to pay any variable remuneration in shares or options.
- We do not have sufficient cash to pay cash for any portion of remuneration, so the variable-incentive plan paid in stocks or options is the entirety of our remuneration.

What is the firm's willingness to pay executives over time?

Implication for executive remuneration: Firms are more able to pay variably, in terms of both linking pay to performance and remunerating in stocks or options, to the extent that they are willing to vary the amount that they pay, including increasing pay to compensate executives for whatever level of risk that they take. Firms also are more able to require larger holding levels to the extent that they are willing to grant those holdings to executives.

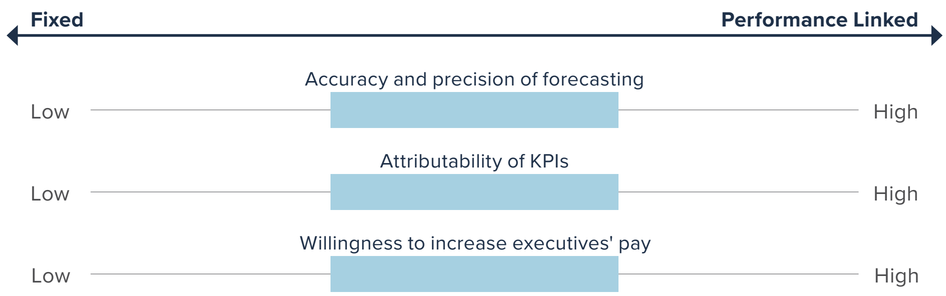
- We are willing to leave executives' potential pay entirely uncapped.
- We have a relative cap on executive remuneration (e.g., CEO to C-suite, CEO to median worker, CEO to revenue).
- We have a real cap ($, €, £, ¥) on executive remuneration.

Key Decisions for Designing Long-term Executive Remuneration

VARIABILITY OF PAY

1. Performance Linking of Pay

- **Accuracy and precision of forecasting:** Accurate and precise forecasts offer a valid and reliable benchmark for assessing executives' skill and are less likely to reward executives for volatility and luck.
- **Attributability of KPIs:** A presupposition of paying for performance is that the person being paid can meaningfully influence the performance being rewarded.
- **Willingness to increase executives' pay:** Variable pay on average will be higher than fixed pay because the risk of missing performance targets increases discounting by executives.



2. Instrument of Pay

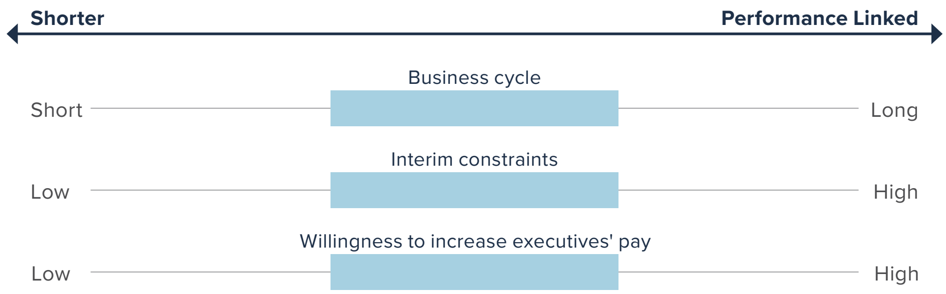
- **Risk tolerance of firm:** The goal in choosing instruments of pay is to align the risk and behavioral effects of the pay instrument with the forecast path of the firm and risk profile of the corporate strategy.
- **Firm's tolerance of dilution:** Paying in stocks or options creates dilution, which firms can accept or offset.
- **Willingness to increase executives' pay:** Higher-risk instruments are discounted more by the executives who bear the risk. Using riskier instruments will increase executive remuneration.

FCLTGLOBAL

OWNERSHIP OF PAY

3. Time Horizon of Pay

- **Business cycle:** Remuneration directors can set the executive pay horizon to match the company's business and investment cycle.
- **Interim constraints on interim performance:** An inability to tolerate interim volatility across financial and nonfinancial metrics can require greater focus on the short-term.
- **Willingness to increase executives' pay:** Delayed pay will be higher because it increases discounting by executives.



4. Holding of Pay

- **Ability to engender ownership mindset:** The level at which the firm requires an executive to co-invest is a measure of the extent to which that executive is a principal, not just an agent, but requiring higher holding levels can inflate pay.