

Share-Based Reward

Introduction

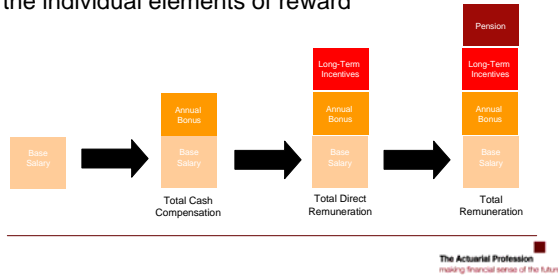
- Pensions actuary (qualified at Bacon & Woodrow)
- Moved into industry as International Pensions Manager for Unilever and then joined Standard Chartered Bank (SCB) as Group Pensions Manager
- Expanded the role at SCB to become Group Head of Reward
 - Bringing pensions into the reward picture
 - Much more focus on technical aspects of share plans
- Now Group Director of Performance and Reward for Cable & Wireless

What do we mean by executives?

- Dictionary definition:
 - “an executive is a senior manager of an organization, company or corporation”
- Institutional Investors’ focus remains fixed on the board members
- This has resulted in 2 effects
 - 1) Either received a premium for serving on the board
 - 2) Or keep key member off the board to allow the flexibility to pay maximum rewards

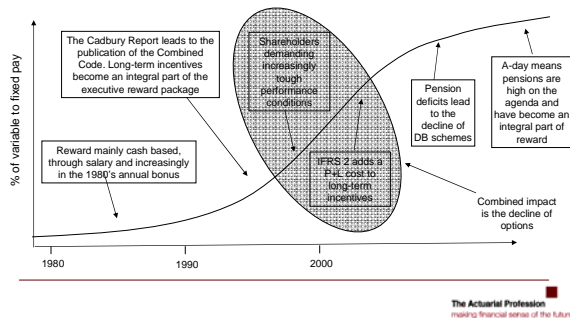
What do we mean by reward?

- Is the focus on the total compensation package or the individual elements of reward



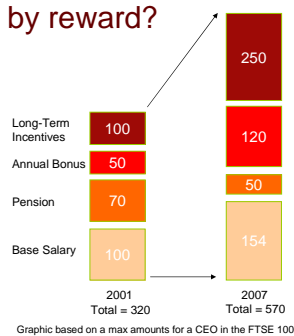
What do we mean by reward?

- How the make-up of reward has developed over time

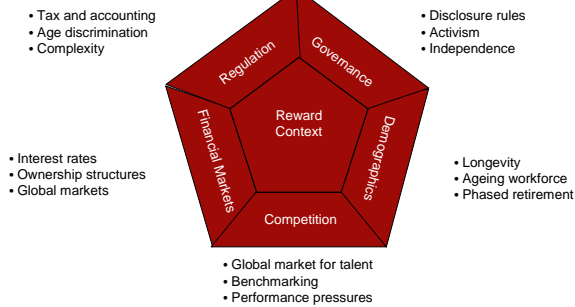


What do we mean by reward?

- The balance may have changed but one clear trend is the increase in quantum



Broad Trends



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What are the influences?

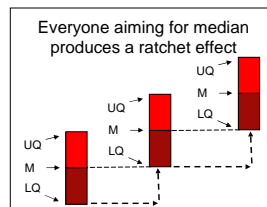
- Disclosure guidelines
- Newspapers
- Tax accounting rules
- Shareholders
-
-
-
- Finally - Reward as management tool for improving performance



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Dealing with Senior Executives

- All by definition are:
 - High-achievers
 - Above average performers
- This means that everyone has to be at least median performance and resulting pay for achievement also needs to be well above average
- Also difficulty of performance management at this level:
 - Who can give difficult messages
 - Certain levels considered free of development needs



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Why are long-term incentives important?

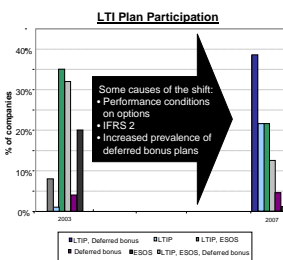
- Business initiatives require executives to have a long-term focus
- Management interests need to be aligned with shareholders who look for returns over the longer term
- Retention of executives is key – but does it work?

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Delivery Mechanisms

Two types – whole shares and options

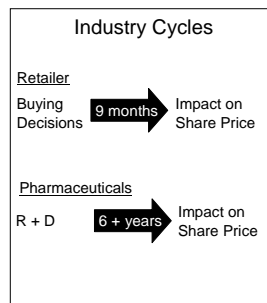
- Over the last few years there has been a movement away from the use of share options with an accompanying increase in the use of shares
- Most common combination of plans in the FTSE 100 is a PSP with a DAB
- But companies with high growth opportunities use options to provide executives with leverage



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Definition of “long-term”

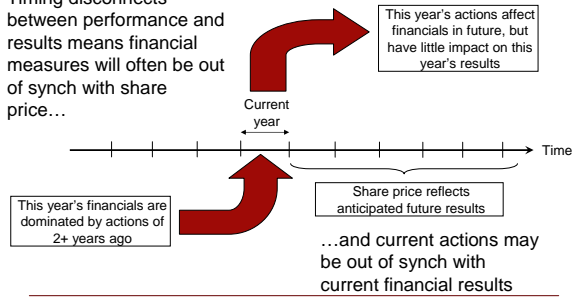
- Remarkable conformity...why?
- 3 years is the shortest “long-term” acceptable to investors
- This ignores the distinct differences in industry cycles, which result in different timing disconnects
- In Continental Europe there are “medium term” (3 years) and “long-term” plans – but 3 years remains the most common



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Definition of “long-term”

Timing disconnects between performance and results means financial measures will often be out of synch with share price...



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Design: idealism

- What do you want to achieve?
- Incentivise the right behaviours
- Be highly valued by the recipient
- Low cost to the company
- Payouts highly correlated with performance

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Design: practicality

- What can happen in practice?
- Plans are too complex for individuals to value them highly
- Individuals have poor line of sight to performance conditions
- Payout profiles can be seen as something of a lottery
- But expected costs are high due to commercial performance conditions not having much effect on expected value or because market conditions means costs are not reversible

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Design: Lessons from private equity

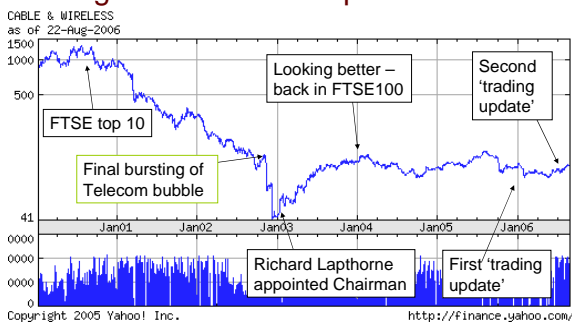
- Line of sight
 - Large quantum linked to clear strategic timeframes
 - One-off plans, rather than rolling
 - Tailored design
 - Targets specific to business
- ➡ Increasing incorporated into quoted companies
e.g. WH Smiths, Sainsbury, ITV and

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.... now for something completely different
(well, a bit anyway)
- long-term incentives at Cable & Wireless

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Background – financial performance



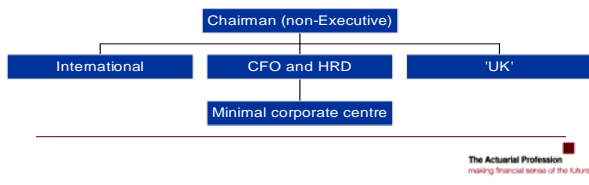
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Background - organisation

2003 - 2004 – keep the business going whilst the mess is cleared up and a strategy developed (CEO, COO over the businesses, multiple functional reports to CEO)

2005 – hands on the problem (2 layers removed in the UK, one layer in International; still multiple functional reports to the CEO)

2006 - ? – two 'companies' within the plc

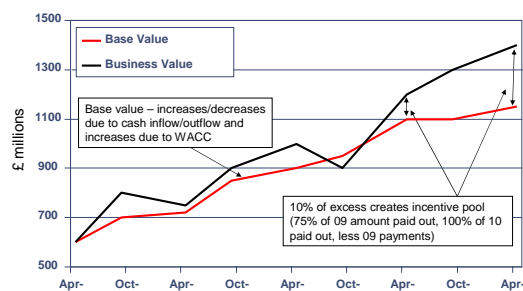


Reward Decisions

- One-off adjustments to base pay
- One-off awards of share plans to corporate executives
- New LTIP for the businesses:
 - Cash-based
 - Driven by 'market' value
 - Incorporates notional balance sheets
 - One-off awards
 - Annual bonus opportunity reduced from 150% to 100% of salary for Heads of Businesses
 - No deferred bonus or other share-based awards

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LTIP illustration



Consultation process – plan amendments

- Individual payments capped at £10m up to April 2007, £20m thereafter (big mistake!)
- Payments restricted if the Remuneration Committee believes there has been incomplete or incorrect disclosure to the market
- For the Heads of the Businesses only, overall Cable & Wireless TSR must be positive to get a payment
- For the Heads of the Businesses only, underlying financial performance of their Business must improve to get a payment

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Where are we now?

- Flying start overall (absolute and relative share-price performance, very strong)
- Majority of upside has been attributed to the UK (unit value £9,720) but International also very healthy (unit value £5,150)
- Behaviours have changed
- Corporate involvement significantly reduced (ongoing technical issues)



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Key lessons

- Link to business strategy and organisation was vital
- The role of the Chairman was key (helped by his non-participation in the plan) and the support of the Remuneration Committee Chair provided considerable comfort
- During the consultation process the main risk was NOT that it would be voted out but that it would be a turkey
- It is not easy to have a complete discussion on Total Pay (several comments that 10% share seemed too high and/or 8% hurdle too low but no real discussion)
- Putting a high figure (£220m) in writing created considerable problems BUT has worked wonders amongst participants!
- IT WAS ALL WORTHWHILE

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