Career Shares as Long Term Incentives

Brian G M Main
(University of Edinburgh Business School)

Rolf Thiess
(University of Edinburgh Business School)

and

Vicky Wright
(Towers Watson)

December 2010

Career Shares as Long Term Incentives

Brian G M Main[*], Rolf Thiess[*] and Vicky Wright[#]

[*]University of Edinburgh Business School, Edinburgh, UK EH8 9JY

[#]Towers Watson, London, UK SW1H 9LL

Abstract

Manuscript Type: Technical

Purpose: A technical exploration of the empirical ramifications of adopting the Career Shares approach to long term incentives (Bebchuk and Fried, 2009; Bhagat and Romano, 2009) that has emerged from the discussion of the structure of incentive pay in the light of the recent financial crisis (FSA, 2009; G-20/FSB, 2009; Walker Report, 2009).

Approach: This paper simulates the impact of such a design of long term incentives in the context of those FTSE350 CEOs whose careers terminated between 1993 and 2008.

Findings: Career Shares automatically introduce a 'settling-up' effect and a 'claw-back' effect to adjust for later periods of poor performance.

Research limitations: Comprehensive coverage and comparability across companies is gained by assuming equal treatment in terms of design of incentive plan.

Practical implications: Some consideration would have to be given to mid-career wealth release for long serving successful CEOs.

Social implications: Remuneration/Compensation committees would need to adjust the overall remuneration package in the light of tax and risk bearing consequences that would follow.

Originality: This represents the first attempt to confront an interesting and promising theoretical idea (Career Shares) with empirical data that reflects the actual careers followed by a group of CEOs.

KEYWORDS:

Corporate Governance; Claw-back; Long Term Incentives; CEO Career.

Introduction

The role of incentive pay has emerged as among the chief suspects in most analyses of the causes of the recent financial crisis. Criticism has focused less on the size of the rewards at stake and more on the short time horizon between recorded performance and payout. In response to this perception, the G-20 encouraged the cross-national adoption of remuneration standards in the financial sector as laid out by the Financial Services Authority (FSA, 2009) and the Financial Stability Board (FSB, 2009). These added to the momentum already given in some countries to the reform of remuneration in this area (e.g., by the Walker Review, 2009, in the UK). In all of this, the essential thrust is towards deferring the majority of bonus payments, using significant vesting periods for incentive pay, and ensuring greater provision for clawback in the event of disappointing completed performance. Although aimed specifically at the financial sector, it is widely expected that these influences will affect executive remuneration practice more widely.

In the USA, in addition to signing up to the G20-backed reforms, efforts were made to contain the level of incentive payments in those companies covered by the Troubled Asset Relief Program (TARP) by limiting incentives to one-third of the annual remuneration received by executives (US Treasury, 2009). This limit could be exceeded if the incentive was in the form of Restricted Shares not vesting until after all outstanding TARP obligations had been met. One of the innovations emerging from this experience was the separation of vesting and transferability – a feature similar to what will be described below in terms of Career Shares vesting and being able to be cashed in (Murphy, 2010). The overall thrust of reform is towards deferred payments with deferral involving periods of significant length.

Reflecting these policy initiatives, two academic contributors to the debate have offered a new perspective on incentive pay by suggesting that incentive alignment could be improved by moving from a typical three-year vesting period towards a significantly longer arrangement. Bhagat & Romano (2009) recommend that long term incentive awards should not vest until two to four years after the last day in office (retirement or other exit from the firm). Bebchuk & Fried (2009) suggest that it would be sufficient to have a pre-agreed extension period after vesting before the executive is permitted to cash-out the majority of the award (whether options or Restricted Shares) – the authors allude to a period of 10 years after vesting. Both papers point to a range of companies that have used similar practices in the past (Boeing, Citigroup, Exxon Mobil, Goldman Sachs, Merrill Lynch).

Such delayed vesting or delayed cash-out arrangements not only ensure that executives build and ever increasing stake in their company as their time in post lengthens, but also guarantee an automatic 'claw back' effect, as subsequent poor performance reduces the value of earlier incentive awards before they can be cashed out, or realised. The automatic or programmed nature of this approach also makes it difficult for the executive to manipulate the timing of the exercise of options and/or the release of corporate news so as to advantage themselves (Bebchuk et al., 2009; Lie, 2005; Lomax, 2008).

To investigate the empirical scope of such an approach, this paper applies a variant of these proposals (Career Shares) in the context of the actual completed career histories recorded by CEOs in the UK FTSE350 during the period 1993-2008. These actual career histories (start-dates and end-dates) are utilised in conjunction with each company's performance as recorded in the *London Stock Price Database* (LSPD). The following section discusses the theoretical underpinnings of the

approach. There is then a section that introduces the data and explains the calculations made in arriving at the results presented. The results themselves are available in a separate section, and the paper ends with a discussion of the policy ramifications of these results and a brief conclusion.

Incentive pay and career performance

The use of pay-for-performance for executives was originally seen as a remedy for the principal-agent problem (Jensen & Meckling, 1976) that arises when the professional management of a company lacks both an adequate ownership stake in the company and effective direct supervision (i.e., in most widely held public companies). Delivering part of executive pay in the form of equity instruments (shares or options), which do not vest to the executive (pass into ownership) until a time some years in the future, creates a beneficial alignment of interest between the executives and the owners.

Initial analysis of the arrangements in place for CEOs in the USA (Jensen & Murphy, 1990) produced estimates of the pay-performance connection that were seen as empirically too modest to support this as a realistic view of executive pay – leading the authors to suggest that CEOs were paid more like bureaucrats (according to the size of their company) than anything else. But the shareholder-value movement of the 1980s and various tax considerations (Murphy, 2002) caused companies to adopt a more aggressive use of executive share options, Restricted Shares, and Performance Shares, enabling later studies to demonstrate that the predicted pay-performance effect was empirically significant (Hall & Liebman, 1998; Hall & Murphy, 2000).

Bebchuk & Grinstein (2005) report that the performance related component of

executive pay in the USA grew from 37% in 1993 to 57% by 2003. Conyon et al. (2009) report that much of the USA-UK difference in the level of CEO pay can be explained by the higher amounts of equity pay used in the USA. But even in the UK the use of incentive pay in the board room has increased markedly. Following what was interpreted as critical comment in the Greenbury Report (1995) concerning the use of executive share option schemes, companies moved to adopt Performance Share plans. Booker & Wright (2006) report their adoption in 52% of FTSE100 companies by 1999, rising to 84% by 2005. Some of these companies replaced their option schemes with Performance Share plans, others utilised both. Gregory-Smith (2009) reports that in 2005 incentive pay accounted for over 50% of median executive remuneration in his sample of FSTE350 boards.

Statistical studies of the effectiveness of boards in linking the pay of their executives to company performance continue to record mixed results. Meta studies based on the large numbers of papers in the area (Tosi et al., 2000; Rost & Osterloh, 2009) fail to find a significant connection. Given the aggressive expansion of the use of equity-linked CEO pay, these results appear surprising and have recently been challenged by Clementi & Cooley (2009), Core & Guay (2010), and Nyberg et al. (2010) who emphasise the importance of including all of the CEO's equity in the firm (prior unvested grants as well as current grants) and of getting the timing right between the realisation of the share and option gains on the one hand, and performance over the period covered by such grants on the other.

While there may remain a number of critics who doubt the efficacy with which share-based rewards are administered in the boardroom, seeing the process as being hostage to managerial power (Bebchuk & Fried, 2004), the overwhelming importance of this component of pay suggests that the career vesting proposals

discussed here (Bebchuk and Fried, 2009; Bhagat and Romano, 2009) have a key role to play in the design of executive pay. The extension of vesting, or more precisely cashing-in restrictions on incentive shares clearly suggests the following hypothesis:

> *Hypothesis 1: Career vesting of incentive share awards will enhance the ex-post reward of more successful CEOs and reduce the reward of less successful CEOs.*

Chart 1(i) reveals the logic of Career Shares in schematic form. Outstanding performance throughout a career results in 'reward', as shares are cashed out at an appreciated price. Poor early performance followed by further later career disappointment results in an effect we label 'holding their feet to the fire' as any shares that vested early in the career are required to be held through further periods of disappointing performance rather than being free to be cashed in, as would be the case with Restricted Shares. The bottom left diagonal entry reveals a 'settling-up' effect as shares that may have been worth a lot after an early period of good performance see their value fall owing to subsequent poor performance. The reverse effect is seen in the top right box where a 'forgiveness' effect is achieved, whereby shares that vested early at a poor price see their value recover as the share price rebounds owing to superior performance later in the career.

Insert Chart 1 about here

The second part of Chart 1 records similar effects, but this time contrasting the overall performance during the career with the outcome in the period immediately after retirement or exit from the company. It is here that problems of ill considered succession or imperfect strategy can manifest. The results are similar to

those discussed above, but here we label the effect 'clawback' to emphasise the post-career aspect of the adjustment wherein what was initially a high reward is revised downwards in the light of subsequent disappointment. This leads to Hypothesis 2:

> *Hypothesis 2: By extending the cashing-in restriction of Career Shares to cover a period subsequent to the exit of the CEO from the company, an automatic clawback of reward can be effected that reflects any disappointing outcome experienced.*

To keep the focus on the question of career-length vesting, only grants of shares will be considered in the following calculations. The relative role of shares versus options in the recent financial crisis is still being debated, but early evidence seems to suggest that the distinction between shares and options played little or no role in engendering excessive risk taking (De Young, 2009; Fahlenbrach & Stultz, 2009; Suntheim, 2010). In the basic Career Shares approach, no additional performance condition would be imposed other than remaining in employment. As a variant here, however, career vesting will be assessed in the context of a relative performance hurdle (total shareholder return, TSR), an arrangement that has become common for Performance Shares in the UK. This variant (requiring vested shares not to be cashed in until the end of the career, or later) will be labelled Career Shares_Plus. In each of the variants, it is hypothesised that the pay-performance connection will be enhanced:

> *Hypothesis 3: Career vesting of incentive share awards produces a pay-performance relationship that is stronger than conventional three-year vesting patterns in either Restricted Shares or Performance Shares.*

Details on data and estimation are given in the following section.

Data preparation and calculation

The sample comprises all CEO careers ending between 1993 and 2008 at companies that were in the FTSE350 during that period. Even if the company subsequently drops out of the index, it is still maintained in the sample. All CEO departures from these companies are recorded, and the original start-date of that CEO is identified. Interim CEOs are ignored, as are any careers lasting less than 6 months. In the resulting 1,448 CEO careers, the typical length is remarkably brief, with an overall median of 4.1 years and mean of 5.4 years. At all times, however, there are long serving CEOs observed in this sample – the longest completed career observed is 34 years long, but in no year does the maximum tenure of an exiting CEO fall below 16 years.

The London Share Price Database (LSPD) is used to identify the performance of the company over the duration of each CEO career (and potentially for up to 4 years following the exit of the CEO, if the company maintains a listing for that length of time). To investigate the scope for pay incentives (and long term incentives, in particular), the rewards resulting from each CEO's career performance are computed. To facilitate comparability, the incentive scheme in question is assumed to take the form of an annual award of Restricted Shares and to follow the same pattern in all companies. In each year, it is assumed that the CEO is awarded £100k worth of equity (at £2008), with a normal vesting period of three years.

Restricted Shares are assumed to vest and, under the conventional approach, be cashed in at the prevailing share price at the end of the three-year life of each tranche. To add an alternative context, however, it is also possible to subject such vesting to a relative performance condition ('Performance Shares' as opposed to simply 'Restricted Shares'). The condition used here is that the company's total shareholder return (TSR) over the period should at least match the median of the

FTSE All-Share over the corresponding period for any vesting to take place. Vesting starts at 30% for median performance and rises to 100% for upper quartile performance (again in terms of the FTSE All-Share constituents), with pro-rata vesting for positions between. This arrangement is representative of many currently in place at FTSE companies.

Vesting is computed by reference to the total shareholder return of the company over the appropriate period, as found in the LSPD. This implicitly assumes that the executive is awarded dividends arising from unvested shares (a now common practice – lest the CEO allow such considerations to influence dividend policy). For Restricted and Performance Shares, it is also assumed that, on exit from the CEO position (for whatever reason), all outstanding unvested shares vest pro-rata to the period served. Thus, exiting one year into the life of a recently granted three-year tranche would result in the quantum of shares at stake being reduced to one-third and, where performance conditions were in force, the company's performance would be gauged relative to the FTSE All-Share over the year just completed (but with the same conditions relating to median performance etc.).

It is then relatively straight forward to compute the difference in outcome between the standard three-year vesting and the 'career + n-months' vesting of Career Shares (where 'n' is the number of months post exit during which the cashing in of incentive shares is prohibited). The remaining challenge is to make the resulting numbers comparable by reducing each to the equivalent measure of worth in £2008. The first issue to confront is that the two approaches to vesting (every three years versus career vesting) result in executive reward being realised at different times. Under the conventional approach vesting leads to realised gains on an annual basis

throughout the CEO career. In the second approach, all shares (no matter when granted) are cashed-out at the end of a 'career + n-month' period.

This timing issue is dealt with by compounding the gains realised in the first approach at a rate representing the opportunity cost of the funds. The rate used is the return realised by the FTSE All-share index over the corresponding period. This is taken to represent the opportunity costs of funds, and is used to compute the present value of realised gains under conventional vesting, computed through to the 'career + n-month' cash-out date allowed for Career Shares under the Bhagat & Romano (2009) proposal.

Findings

For each CEO, there are several distinct possible arrangements of long term incentive explored here. The focal arrangement will be labelled Career Shares and, as described above, involves the CEO receiving an annual award of unvested shares which cannot be cashed in until, variously, the end of the CEO's career or some 12, 24, or 48 months after that termination. This is contrasted with a similar annual award of Restricted Shares (with a three-year vesting period). A further comparison pair is created by considering the Career Shares approach in the context of Performance Shares. This results in with what we label Career Shares_Plus, where the shares that would vest, subject to the performance hurdle, at the end of each three-year vesting period are held until the 'career plus n-month' cashing out point. This can be contrasted with the more traditional award of Performance Shares (again with a three-year vesting period).

Table 1 reports the difference between rewarding with Restricted Shares and with Career Shares. To aid comparability, the comparison is restricted to CEOs with roughly the same length of tenure in the job (between three and six years on completion of CEO career; 447 CEOs in total). The table divides CEOs by whether or not performance in their first year in office was above median FTSE350 TSR. Their final year in office is assessed in a similar way. This results in four groupings of CEOs.

The impact of the settling up effect is clear, with CEOs who start out well but end up badly receiving on average £112,944 less under Career Shares than under Restricted Shares. Similarly by holding their feet to the fire Career Shares reduce the average payout to consistently poorly performing CEOs by £59,064, as shares that might otherwise have been cashed out are required to be held through what is a further period of disappointing performance. This compares with the predictions of Chart 1(i). Both the forgiving effect (+£45,451) and the reward effect (+£48,137) demonstrate how Career Shares maintain an incentive to perform through to the end of the career. The analysis of variance F-statistics show that the final-months effect is the statistically significant driver of the outcome.

Insert Table 1 about here

The same exercise can be repeated in terms of Performance Shares and Career Shares_Plus. The results are displayed in Table 2. The overall conclusions remain unchanged, although the size of the impact of the Career Shares_Plus aspect of long

term incentive design is more muted as the overall reward is reduced in magnitude owing to the performance conditions imposed.

Insert Table 2 about here

To examine the empirical impact of the post-career restriction on cashing out company shares, Table 3 examines the impact of such a restriction on the valuation of Career Shares. The restriction period here is two years. The Table divides CEOs by those who out-performed the FTSE during their career and whose companies went on to out-perform the FTSE in the 24 months following their exit from the company. The clawback effect imposed on those CEOs whose good career performance is let down by a post exit period of underperformance can be seen to average -£198,316. This outweighs the upper left cell average result of £91,845 (holding their feet to the fire), as the stakes here were already low, given that these CEOs had already recorded a disappointing career. In the right hand column, the forgiveness effect can also be seen (£195,980), as strong post-exit performance restores the fortunes of those who otherwise might have taken little away. We will discuss below whether this effect is always merited.

Insert Table 3 about here

Finally, Figure 1 uses the results from the entire sample to plot (where the firms survived long enough) the impact of the post-exit restriction period on the value of realised reward. The data are examined post exit at +12-months, +24-months, and +48-months respectively. Figure 1 splits firms by whether they have realised a

positive TSR from the CEO's exit to the point of observation, and reports the percentage impact that the delayed cashing in period has had on the value of their holdings. The power of the clawback effect is apparent (with continuing underperformance resulting in mounting loss of reward – reaching a median -42% for companies recording a negative return at the end of four years), but the result is enforced by the rising value of the successful firms (where the median reward rises by +24%, through +37% to +58% by the end of the fourth year). There is both a carrot and a stick in this incentive effect.

In a final examination of the workings of Career Shares, Table 4 reports the observed pay-performance sensitivities from a series of simple regressions of the logarithm of reward from long term incentives on the observed total shareholder return over the period (the career, or the career plus the extended restriction period). In all cases, the coefficients are statistically significant and the Career Shares version produces a stronger pay-performance relationship. More importantly, however, the difference between the coefficients is always statistically significant as measured by a Chi-squared test set in a seemingly unrelated regressions framework (Cameron & Trivedi, 2009, p156). The conclusion form these results is that the Career Shares aspect of long term incentives consistently improves the strength of the pay-performance relationship. This is true whether the context is that of Restricted Shares or Performance Shares.

Insert Table 4 about here

Discussion

The results above demonstrate that the restriction on cashing-out of equity-based remuneration can have a quantitatively significant impact on the final reward enjoyed from a CEO's career. The arrangement ensures certain features that are generally seen as desirable in an incentive scheme. These include a 'settling up' effect whereby the value of rewards vesting on the strength of early promising performance is reduced to reflect any subsequent reversal in fortunes of the company. There is also a 'holding their feet to the fire' aspect whereby the inhibition against cashing out early rewards ensures that continuing poor performance has a compounding effect on those early rewards. On the other hand, the 'forgiveness' effect means that a disappointing early period can always be compensated for through subsequent outstanding results. The potential of early incentives remains in force throughout the career. Finally, those who perform well continuously throughout their career will receive a fulsome reward at career's end.

Extending the inhibition on cashing out of share awards through to a period after exit from the firm further enforces these results and also ensures that a subsequent failure in performance, owing to a poorly arranged succession or to a strategy that goes off the rails, will lead to a clawback of reward.

One claim that is made for the Career Shares approach is that it removes the endogeneity of timing of the release of company news and/or the granting of equity related incentives. Yermack (1997) & Lie (2005) both drew attention to suspicious activity around option grant days. Subsequent SEC investigation proved this to be the case and reporting requirements were tightened up (Herron & Lie, 2007; Lomax, 2008). But this may be an overstated claim, as well organised and publicised award

and vesting schemes of any type should be immune from this criticism – it is a matter of governance.

The approach adopted above ignores an important effect illustrated by Booker & Wright (2006) and Main et al. (2008) who demonstrate the significant difference to eventual vesting that a few days can make in the choice of the defining dates for a performance period. This observation reflects the general finding of Acker & Duck (2007) and Dimitrov & Govindaraj (2007), referred to as the 'reference day' effect. The results reported above might have been very different for particular companies had our timing of share performance measurement commenced on a different day of the month. It is less likely, however that the overall results would have been much different taken over a sample of the size used here.

The Career Shares arrangement does satisfy the Core & Guay (2009) critique that the timing of the pay event and the period of performance measurement are frequently mismatched. Save for the extension beyond the end of the CEO career, pay and performance are exactly matched. And, of course, the period immediately following exit from the firm can be viewed as reflecting some aspects of the CEO's performance while in office. This is, of course, the advantage of taking the whole-career perspective offered by Career Shares.

Several further issues regarding the robustness of the Career Shares approach remain and these merit highlighting. First, the reward achieved by a disappointing CEO may be resurrected if a successor CEO quickly turns the company around. The same criticism can, of course, be made regarding any takeover premium enjoyed by a failing company that is subject to acquisition. To the extent that the CEO has some influence in choosing a successor – customary, at least for internal succession – the arrangement provides an effective incentive to choose wisely. On the other hand,

career vesting will raise the stakes as to the timing of voluntary exit from the CEO position (say, into retirement) and this may provoke precipitously early exits or overly delayed departures.

The Career Shares approach works by exposing the CEO to substantially more risk as to the company's performance and this can be expected to require compensation in the form of higher base pay or salary. There may also be tax consequences when Restricted Shares vest and yet must be carried through to the designated period some years after demitting the CEO position. Again the company may well be required to compensate the executive for this liability (albeit with the possibility of claiming this back at the end of the process), or at least allow a partial cashing out of the CEO's incentive shares to meet tax liabilities.

One further issue concerns long serving CEOs who also tend to be among the better performing CEOs - otherwise they would have been long since let go (Gregory-Smith et al., 2009). Long service CEOs will therefore tend to benefit disproportionately from career vesting. This is, possibly, no more than it should be, but remuneration committees will be required to explain significantly larger cashing-out events than are currently observed and for these individuals some early release of accumulated wealth may be appropriate.

Career vesting introduces increasing amounts of risk into the CEO's wealth prospects. Whether caught by a cyclical downturn or by long term sectoral decline, the CEO is exposed to an unwelcome increase in uncertainty. Companies may be required to compensate for this in the form of higher base salary. For longer serving CEOs, boards may need to be aware that decision making in later career may be influenced by such large amounts of accumulated wealth at risk in the company's shares. Thus, while the final payout to underperforming CEOs may be reduced in

such arrangements, those more successful and longer serving CEOs will see their final payout increase considerably. While much of this will be compensation not only for performance but also for the extra risk born, shareholders may look askance at such enlarged payouts. Although four years may be empirically too long a period to fairly add to the CEO's career-vesting arrangements (owing to the vagaries of the business cycle), two years may be a reasonable extension.

While the Career Shares approach has much to commend it, there remain a considerable number of complications that await early adopters. But the over all contribution of the three hypotheses examined above: the career balancing of reward and performance; the potential for post-career clawback and adjustment; and the overall strengthening of the pay performance relationship – represents a very powerful contribution. It is an incentive arrangement with which most shareholders will be able to identify and which all will find transparent.

References:

Acker, D. & Duck, N. W. (2006), "Reference-day risk and the use of monthly returns data: a warning note". *Journal of Accounting, Auditing and Finance*, Vol. 22, pp.527-557.

Association of British Insurers. (1994), *Long term remuneration for senior executives*. London: ABI (May).

Bebchuk, L. A. & Fried, J. M. (2004), *Pay without performance. The unfilled promise of executive compensation.* Cambridge, Mass.: Harvard University Press.

Bebchuk, L. A. & Fried, J. M. (2009), *Paying for long-term performance*. Harvard: John M Ohlin Center for Law, Economics and Business, Discussion Paper No. 658 (December).

Bebchuk, L. A., Grinstein, Y. & Peyer, U. M. (2009), *Lucky CEOs and lucky directors.* Harvard law School and National Bureau of Economic Research Working Paper (May).

Bebchuk, L. A. & Grinstein, Y. (2005), "The growth of executive pay". *Oxford Review of Economic Policy*, Vol. 21, pp.208-303.

Bhagat, S. & Romano, R. (2009), "Reforming executive compensation: Simplicity, transparency and committing to the long-term". Yale: John Ohlin Center for Studies in Law, Economics, and Public Policy, Research Paper No. 393.

Booker, R. C. & Wright, V. (2006), "Relative shareholder return – the best measure of executive performance?" *What if? Perspective*. London: Watson Wyatt (June).

Cameron, Colin A. and Trivedi, Pravin K. (2009), *Microeconomics using Stata*. College Sation, Texas: Stata Press.

Clementi, G. L. & Cooley, T. F. (2009), "Executive compensation: Facts". National Bureau of Economic Research, working paper 15426.

Conyon, M. J., Core, J. E. & Guay, W. R. (2009), "Are US CEOs paid more than UK CEOs? Inferences from risk-adjusted pay". University of Pennsylvania, Wharton Working Paper (November).

Conyon, M.J & Florou, A. (2004), "The pattern of investment surrounding CEO retirements: UK evidence". *The British Accounting Review*, Vol. 38, pp.299-319.

Core, J. E, Guay, Wayne R. (2010), *Is pay too high and are incentives too low? A wealth-based contracting framework*. The Wharton School, University of Pennsylvania Working Paper (January 28, 2010)

De Young, , R., Peng, E. Y. & Yan, M. (2010), "Executive compensation and business policy choices at U.S. commercial banks". Kansas City: Federal Reserve

Bank of Kansas City Research Working Papers.

Dimitrov, V. & Govindaraj, S. (2007), "Reference-day risk: observations and extension". *Journal of Accounting, Auditing and Finance*, Vol. 22, pp.559-572.

Edmans, A. & Gabaix, X. (2009), "Is CEO pay really inefficient? A survey of new optimal contracting theories". *European Financial Management*, Vol. 15, pp.486-496.

Fahlenbrach, R. & Stulz, R. M. (2009), "Bank CEO incentives and the Credit Crisis". Fisher College of Business Studies Working Paper Series, Dice Center WP 2009-13 (July).

Financial Reporting Council (2009), *Review of the combined code: Final report*. London: Financial Reporting Council.

Financial Reporting Council (1998), *The combined code on corporate governance*. London: Financial Reporting Council .

Financial Services Authority, FSA. (2009), *Reforming remuneration practices in financial services. Feedback on CP09/10 and final rules*. FSA: CP09/15.

Financial Stability Board, FSB. (2009), *Financial stability forum - FSF principles for sound compensation practices*. Bank for International Settlements in Basel, Switzerland, (September).

Greenbury, R. (1995), *Directors' remuneration. Report of a study group chaired by Sir Richard Greenbury*. London: Gee Publishing Ltd.

Gregory-Smith, I. (2009), "Chief executive pay and non-executive director pay in the UK: Optimal contracting vs. rent extraction". Nottingham University NUBS Research Paper Series No. 2009-02.

Gregory-Smith, I., Thompson, S. & Wright P. W. (2009), "Fired or retired? A Competing Risks Analysis of Chief Executive Turnover". *Economic Journal*, Vol. 119, pp.463-481.

Hall, B. J. & Liebman, J. B. (1998), "Are CEOs really paid like bureaucrats?" *Quarterly Journal of Economics*, Vol. 113, pp.653-691.

Hall, B. J. & Murphy, K. J. (2000), "Optimal exercise prices for executive stock options". *American Economic Review*, Vol. 90, pp.209-214.

Heron, R. A. & Lie, E. (2007), "Does backdating explain the stock price pattern around executive stock option grants?" *Journal of Financial Economics*, Vol. 83, pp.271–295.

Jensen, M. C, & Meckling, W. H. (1976), "Theory of the firm: managerial behavior, agency costs and ownership structure". *Journal of Financial Economics*, Vol. 3, pp.305-360.

Jensen, M. C. & Murphy K. J. (1990), "Performance pay and top-management incentives". *Journal of Political Economy*, Vol. 98, pp.225-264.

Lie, E. (2005), "On the timing of CEO stock option awards". *Management Science*, Vol. 51, pp.802-812.

Lomax, S. (2008), "Backdating stock options: the latest corporate storm". *Business & Economic Review*, (January/March), pp. 15-18.

Main, B. G M, Berry, G., Neate, J. & Wright, V. (2008), "The potential for backdating executive share options in the UK. The length of a footprint – does it matter?" University of Edinburgh Business School, Centre for Financial Markets Research Working Paper 08.01.

Murphy, Kevin J. (2010), "Executive pay restrictions for TARP recipients: An assessment". Evidence presented to United States Congressional Oversight Panel, October 21, 2010. University of Southern California Marshall School of Business, Working Paper FBE 23-10.

Murphy, K. J. (2009), "Compensation structure and systematic risk". Evidence presented to United States House of Representatives Committee on Financial Services, June 11, 2009. University of Southern California Marshall School of Business, Working Paper FBE 34-09.

Murphy, K. (2002), "Explaining executive compensation: Managerial power vs. perceived cost of stock options". *University of Chicago Law Review*, Vol. 69, pp.847-869.

Nyberg, A., Fulmer, I., Smithey, G. B., & Carpenter, M. A. (2010), "Agency theory revisited: CEO returns and shareholder interest alignment". *Academy of Management Journal*, Vol. 53, pp.1029-1049.

Rost, K. & Osterloh, M. (2009), "Management fashion pay-for-performance for CEOs". *Schmalenbach Business Review*, Vol. 61, pp.119-149.

Securities & Exchange Commission. (2006), *Executive compensation and related person disclosure*. Washington, D.C.: Securities & Exchange Commission.

Securities & Exchange Commission. (1993), Securities Act release no. 6962 and no. 7009. Washington, D.C.: Securities & Exchange Commission.

Suntheim, F. (2010), *Managerial compensation in the financial service industry*. Milan, Italy: University of Bucconi Department of Finance Working Paper.

Tosi, H. L., Werner, S., Katz, J. P. & Gomez-Mejia, L. R. (2000), "How much does performance matter? A meta-analysis of CEO pay studies". *Journal of Management*, Vol. 26, pp.301-339.

U.S. Treasury Department. (2009), *Interim final rule for TARP standards for compensation and corporate governance*. *Part 30*. Washington, D.C.: U.S. Treasury Department

Walker Review. (2009). *A review of corporate governance in UK banks and other financial industry entities*. London: Financial Services Authority.

Yermack, D. (1997), "Good timing: CEO stock option awards and company news announcements". *Journal of Finance*, Vol. 52, pp.449-476.

Chart 1
Career Shares in operation

i) Career holding requirement

	Late career: under-perform	**Late career: out-perform**
Early career: under-perform	Hold their feet to the fire	Forgiveness
Early career: out-perform	Settling-up Reward	

ii) Post Career holding period requirement

	Post career: under-perform	**Post career: out-perform**
Balance of career: under-perform	Hold their feet to the fire/ Claw-back	Forgiveness
Balance of career: out-perform	Claw-back Reward	

Table 1
Impact of Career Shares versus Restricted Shares for CEOs with careers between 3 and 6 years in length

Outperform	s FTSE median over final 12 months		
Outperforms FTSE median over initial 12 months	No (under-perform)	Yes (out-perform)	ALL
No (under-perform)	-£59,064	£45,451	-£6,356
Yes (out-perform)	-£112,994	£48,137	-£37,300
ALL	-£85,911 £46,696 -£21,239		

F(2,444) = 33.85 [0.00]; initial 12 months effect F(1,445) = 2.57 [0.11]; final 12 months effect F(1,445) = 64.15 [0.00];
Averages: Restricted Shares = £548,127; Career Shares = £526,887
For CEOs with a career lasting between 3 and 6 years.

Table 2
Impact of Career Shares_Plus versus Performance Shares for CEOs with careers between 3 and 6 years in length

Outperform	s FTSE median over final 12 months		
Outperforms FTSE median over initial 12 months	No (under-perform)	Yes (out-perform)	ALL
No (under-perform)	-£30,824	£16,526	-£6,945
Yes (out-perform)	-£96,504 £33,166 -£35,589		
ALL	-£63,521 £24,236 -£20,722		

F(2,444) = 17.19 [0.00]; initial 12 months effect F(1,444) = 2.70 [0.10]; final 12 months effect F(1,444) = 31.00 [0.00];
Averages: Career Shares_Plus = £331,635; Performance Shares = £352,358
For CEOs with a career lasting between 3 and 6 years.

Table 3
Average outcome of Career Shares – with 24 month post-career restriction

Outperform	s FTSE median over post-career 24 months		
Outperforms FTSE median over career	No (under-perform)	Yes (out-perform)	ALL
No (under-perform)	-£91,845	£195,980	£ 37,383
Yes (out-perform)	-£198,316	£390,813	£54,168
ALL -£141,949		£283,655	£45,130

F(2,270) = 47.61 [0.00]; Career effect F(1,270) = 0.34 [0.56]; Post career effect F(1,270) = 95.08 [0.00].
For CEOs with a career lasting between 3 and 6 years and whose companies are still publicly traded 2 years after the exit the firm.

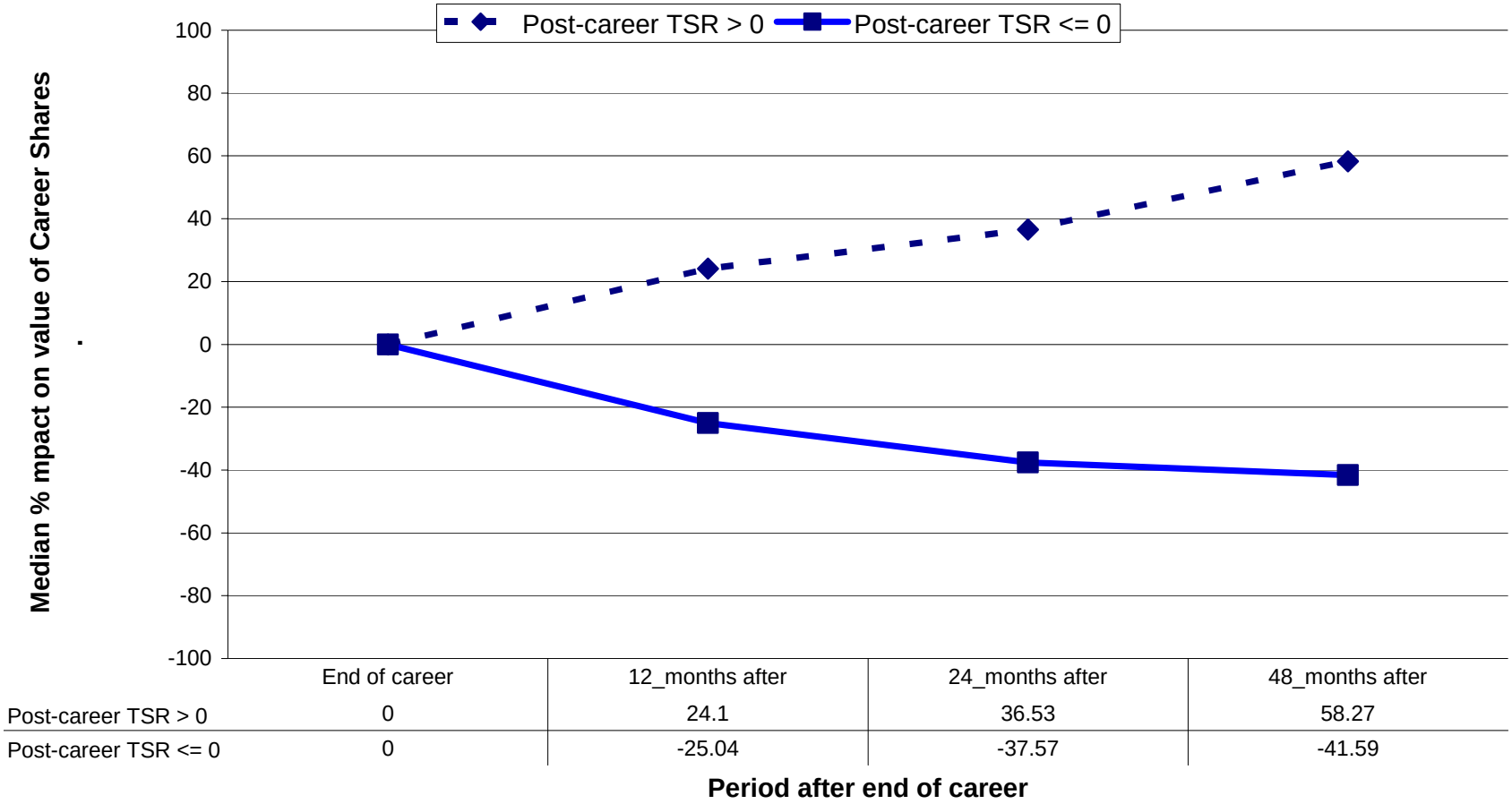
Table 4

Coefficients from simple regression of log-reward against period total shareholder return (TSR)

Post-Career Restriction	Regression Coefficient on TSR				Regression Coefficient on TSR		
Restricted	Shares	Career Shares	chi2(1) [prob.]		Performance Shares	Career Shares_Plus	chi2(1) [prob.]
00_months	0.935***	1.021***	119.47 [0.00]		2.571***	2.632***	44.55 [0.00]
12_months	0.806***	1.024***	398.44 [0.00]		2.167***	2.309***	150.72 [0.00]
24_months	0.744***	1.019***	475.91 [0.00]		1.945***	2.132***	204.59 [0.00]
48_months	0.695***	1.031***	493.31 [0.00]		1.746***	1.975***	220.29 [0.00]

N = 1482; legend: * p<.1; ** p<.05; *** p<.01

Figure 1
Post-career claw-back effect of Career Shares



	End of career	12_months after	24_months after	48_months after
Post-career TSR > 0	0	24.1	36.53	58.27
Post-career TSR <= 0	0	-25.04	-37.57	-41.59