

MSCI Pay Report Finds Misalignment Between Reported Pay and Shareholder Returns

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A [new MSCI report](#) reviewed 429 large-cap U.S. companies from 2006 to 2015 and found that, on a 10-year cumulative basis, total shareholder returns of those companies whose compensation was below their sector median outperformed those companies where pay exceeded the sector median by 39%. The conclusion was [reported](#) in the *WSJ*. SEC disclosure rules focused on annual pay were criticized for obscuring these trends.

The report aggregates its data to arrive at its conclusions. The underlying data for individual company results are not provided. The largest company in the study was Apple (\$591 billion market capitalization) and the smallest company was PPL Corp. (\$2.4 billion market capitalization). Since average CEO tenure is 6.6 years, only 159 companies in the study had the same CEO throughout the entire 10-year period, meaning that over 800 individual CEOs were included in the analysis. About 17 outlier companies, including Apple, were excluded, leaving a sample set of 429 companies.

Long-term incentive pay accounted for more than 70% of compensation. The report uses both the pay as required to be disclosed in the summary compensation table and a realized pay figure that uses the prior period equity-based award values actually received, which is also found in proxy statements but in a different table. Generally, realized pay exceeded the pay reported every year, especially during 2005 to 2014 and from 2011 onward. In total, the pay reported totaled nearly \$46 billion, but realized pay topped \$59 billion.

Given the pay for performance emphasis in recent years and the focus on appropriate incentives geared toward long-term results, it would be expected that a company that outperformed should have higher realized pay than the summary pay originally reported in the proxy statement, and vice versa. However, the report found the opposite to be true. In several tests, overall companies with the lowest pay disclosed achieved the highest shareholder returns.

Disclosure required under SEC rules was blamed in large part for the misalignment, since the disclosure focuses on annual reporting, which results in an excessive focus on short-term price gains. The report recommends that investors ask companies to disclose a number of additional figures that it believes is necessary to effectively assess CEO pay, including cumulative realized incentive pay totals over a CEO's entire tenure compared to the company's performance, updated annually.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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