Issue 16 2015

CSUITE INSIGHT

GOVERNANCE OUTLOOK

A New Focus on the Governance Committee 6

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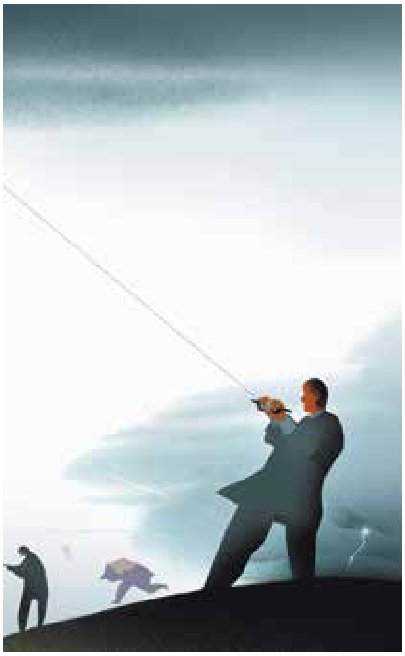

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C-Suite Insight is published by

EQUILAR®
1100 Marshall St.
Redwood City, CA 94063
Phone: (650) 241-6600
www.equilar.com

Send address changes and circulation inquiries to the above address.

Publication Management
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PRINTED IN THE USA EQU-004

David has led Equilar from a pure start-up since its inception in 2000 to one of the most respected and trusted names in the executive compensation industry.

Governance Outlook

The New Year brings with it fresh opportunities for boards of directors and executives amidst a landscape of challenges. As we peer ahead into 2015 and the upcoming proxy season, our latest issue of *C-SUITE Insight* explores a variety of evolving and emerging trends in corporate governance. We included diverse viewpoints of board members, legal counsel, consultants, and a leading journalist to provide a look at major issues.

A series of in-depth interviews by world-class leaders and experts provides insight into topics at the forefront of governance in 2015. Gretchen Morgenson, Pulitzer Prize-winning journalist and assistant business and financial editor at *The New York Times*, shares a compelling perspective on the world's financial markets and corporate governance. Holly Gregory, partner and co-head of Global Corporate Governance and Executive Compensation Group at Sidley Austin LLP, explains the impact of regulation on companies and shares her views on the important governance issues over the next year.

Additionally, Connie Curran, chair of DeVry Education Group, CEO of Best on Board, and board member at Hospira, DePaul University, and University of Wisconsin-Madison, offered insights into successful leadership from her career as an executive, director, educator, and nurse. Dr. Curran passed away on November 10, 2014, prior to the publishing of her interview. While we are saddened by this loss, we are also proud to share her interview with you as we honor her legacy as a business leader.

You will also find thoughts from leading industry experts, TK Kerstetter, The Miles Group, and RR Donnelley. In our "Ask the Experts" feature, leading governance professional discuss what we can expect to see in the coming year. As usual, Seymour Cash takes the last bow with his captivating thoughts on corporate governance.

We are grateful to all our contributors for providing thought leadership and insight. We appreciate the time you have taken to read our latest issue. Don't forget to mark your calendar for our upcoming Executive Compensation Summit in Hollywood, Florida.

Please enjoy, and feel free to contact me with your feedback.

David Chun
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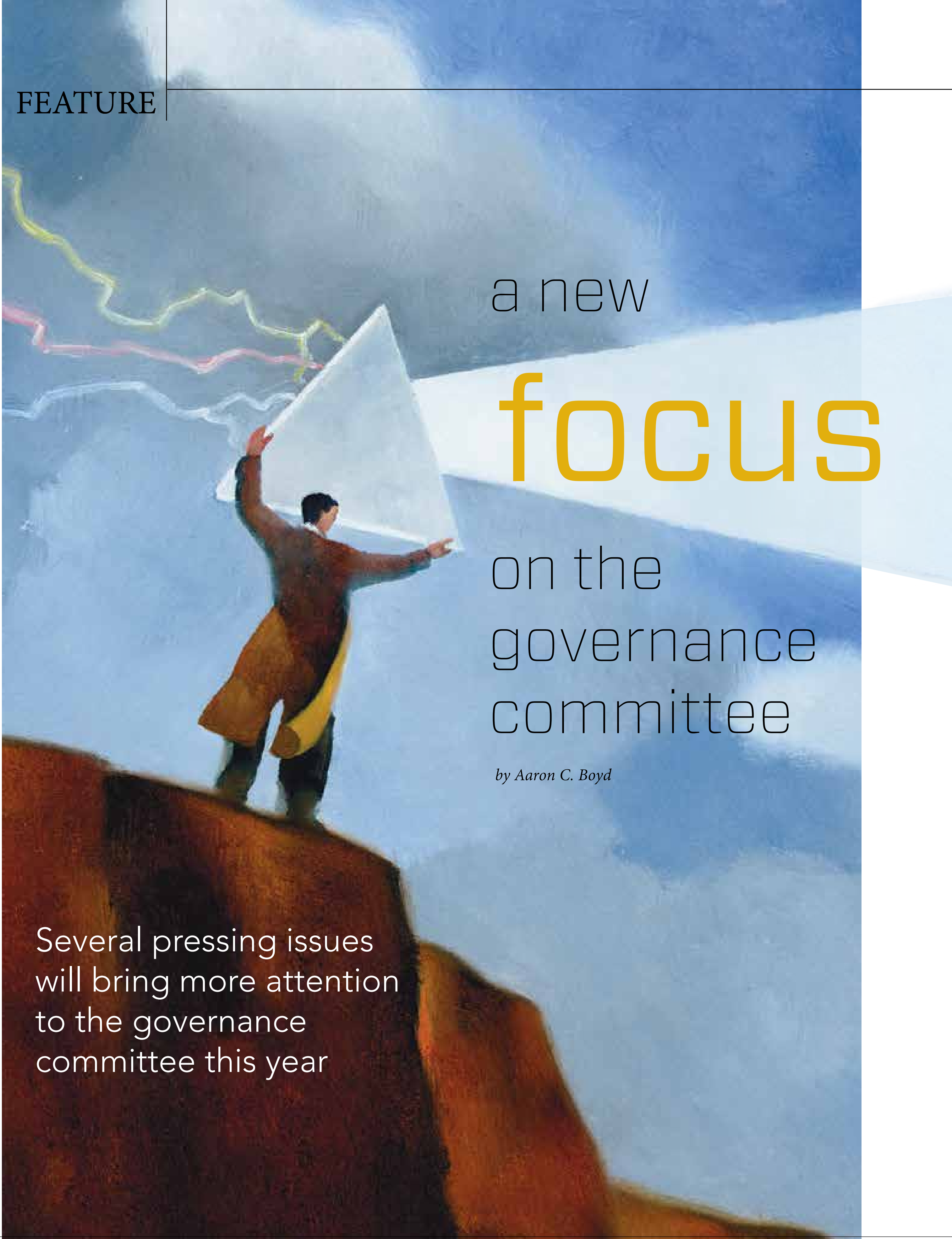
FEATURE



a new focus on the governance committee

by Aaron C. Boyd

Several pressing issues will bring more attention to the governance committee this year

The governance committee, the oft-overlooked, third standing board committee, is seeing a rise in importance as investor focus has shifted toward corporate governance principles and director experience while the level of sophistication and nuance necessary to make decisions has also grown.

New York Stock Exchange listing requirements state the need for companies to have three standing committees: audit, compensation, and governance. The audit committee is typically viewed as the most time-consuming for board members, requiring the most in-depth knowledge of the company, and it is the highest paying among the committees. Its function was thrust into the public concern during the Enron and WorldCom scandals. The implementation of the Sarbanes-Oxley legislation led to a large increase in oversight and the complexity of that oversight required by the audit committee. Recently, the compensation committee has seen a similar rise in its profile due to the collapse of major institutions, an economic downturn, and the subsequent passage of the Dodd-Frank legislation. Compensation jumped to the top of public and political concern, causing committee members to see a rise in both time and sophistication required by the subject matter. With growing concern over the make-up of a board and the call for stronger, more effective policies concerning corporate behavior, the stage is set for the relatively under-the-radar governance committee to take its turn in the spotlight in a new age of corporate governance.

WHY THE LOW PROFILE?

One reason for the low profile of the governance committee may be the vagueness of the term itself and a lack of clarity about its role. Perhaps the clearest description of the governance committee comes from Section 303A.04 of the New York Stock Exchange Listed Company Manual. The manual describes the role of the governance committee in 435 words which includes commentary and disclosure requirements. The two requirements for the committee are that it must be composed entirely of independent directors and it must have a written charter. The compensation committee receives 1,041 words. Meanwhile, the audit committee needed 2,163 to explain its requirements. The lack of specificity around the role of the governance committee allows it to vary from company to company, with some using it for a large number of tasks and others limiting it to only those laid out in the manual.

The Listed Company Manual states that "the committee's purpose and responsibilities—which, at a minimum, must be to: identify individuals qualified to become board members, consistent with criteria approved by the board, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders, develop and recommend to the board a set of corporate governance guidelines applicable to the corporation, and oversee the evaluation of the board and management." A typical governance committee is responsible for the broadest range of topics among the three standing committees. These topics can include reviewing policies on political spending, positions on corporate social responsibilities, and conflicts of interests. The committee is responsible for succession planning as well as setting pay for the board and its committees. These tasks have historically been deemed important, but the shifting landscape in expectations for companies in these areas is creating a need for a stronger, more active governance committee.

THE INCREASING IMPORTANCE OF GOVERNANCE

One of the key functions for the committee is to oversee the company's governance principles. Several key topics have received a significant amount of attention in the past few years, causing the committee to review these policies more closely thanks to a combination of newly passed legislation, regulatory action, and attention from the public.

Part of the 848-page Dodd-Frank legislation contains language requiring listed companies to adopt a specific set of clawback guidelines. These guidelines require companies to recover compensation paid to executives due to accounting misstatements dating back multiple years. According to an Equilar report published in 2013, the prevalence of disclosed clawback policies among Fortune 100 companies rose from 17.6% in 2006 to 89.4% in 2013. In fact, over half of the companies with policies either adopted or amended their policies beginning in 2009, the year Dodd-Frank was proposed. While still awaiting rules from the SEC, many governance committees took steps to prepare for compliance with the legislation when it was finalized. Those committees undertook discussion with a myriad of interested parties, including shareholders and legal experts, to set the framework for policies that would align with the pending regulation.

Another topic that has risen in importance is the political expenditure on donations and lobbying by a company and its employees. Shareholders' interest in the political activity of companies was spurred by the ruling on the Citizens United v. Federal Election Commission case by the Supreme Court. It essentially allowed for unlimited spending on political contributions by companies because of the protection of free speech afforded corporations. A recent Equilar report found that political spending was the most popular proposal put forth in 2014 among shareholder proposals categorized as focusing on a social or environmental issue and voted on at annual meetings. In fact, among the S&P 1500, from 2013 to 2014, the number of proposals on this topic increased from 73 to 86. With mid-term elections just passed, and a looming presidential election, the pressure on companies to establish strong policies around disclosure of political spending and lobbying will only increase.

The wake of the financial crisis coincided with and partially spurred on regulatory crackdowns on insider trading. Cases like those of Angelo Mozilo and Raj Rajaratnam brought with them renewed concerns about individuals profiting from insider knowledge at the expense of shareholders. According to an article by *Agenda* magazine, the SEC has adopted a new broken-windows style of enforcement on insider trading which has resulted in 34 individuals and companies being caught filing information late. Despite the use of 10b5-1 plans by many companies, the need for corporations to be proactive about violations, even seemingly minor infractions, must be driven from the committee level down. According to the article, "the SEC has made clear that directors themselves will be held accountable for any mistakes." The increased accountability of companies and directors in corporate governance will surely require a more concerted effort by the committee and the company to ensure compliance.

MAINTAINING THE RIGHT BOARD

Perhaps the most important role of the governance committee is to ensure that the right people serve on the board. Companies are facing increasing scrutiny over the individuals that serve on the board. Concerns about over-boarding, being over-tenured, a lack of diversity in gender and skill-set, and lacking independence are all issues being brought to the forefront.

Amy Seidel, a Partner at the law firm Faegre Baker Daniel, observes that "a debate is raging over whether long tenured directors become less effective and cease to be 'independent' or whether their experience enhances their contributions to the board." Recently, investor groups like ISS and State Street established policies stating that directors with tenure deemed too long will receive an "Against" vote due to concerns about the individuals' independence status. In June of 2014, State Street Global Advisors updated its voting policies to include voting against directors with "excessive" tenure. Proxy advisor ISS labels directors with tenure of more than nine years as a potential governance risk as a part of its standard evaluation of companies each year. These policy shifts by key organizations are the start of what will likely be a number of policy changes by investors around the topic of board renewal leading to greater numbers of fresh-faced directors.

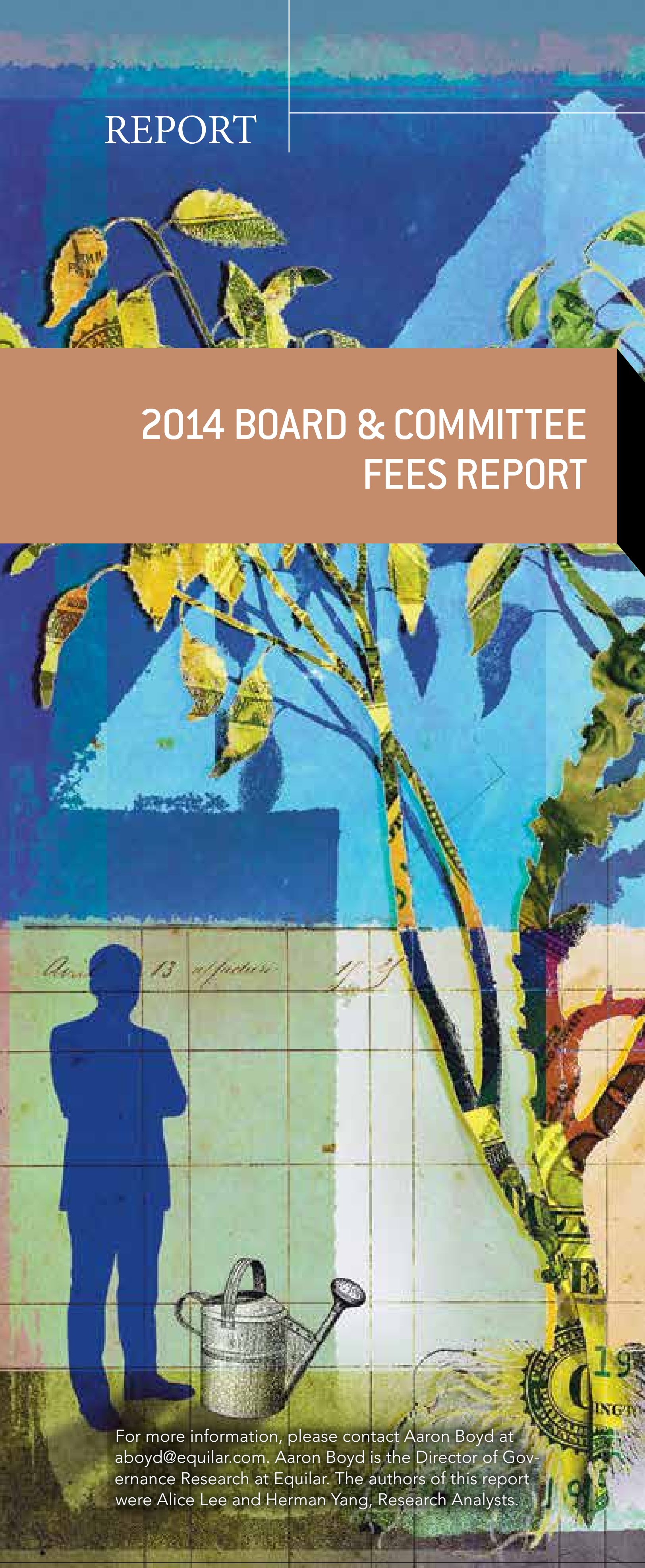
Higher turnover on boards leads to the need for the governance committee to more frequently seek out new members. Besides just the characteristic of being new, there is a growing voice asking companies to add more diversity to their ranks. In Europe, the push for more gender balance on boards has led some countries to adopt equality laws and quotas. Norway passed a law in 2003 requiring every public company to have a board of which at least 40 percent of the directors are female. The European Commission has pushed to increase the number of women serving on public company boards. Although no legislation has yet to be passed in the United States, a number of organizations have pushed to raise the number of women on boards, including The Thirty Percent Coalition, a group of individuals and organizations committed to achieving gender diversity in the boardroom.

A group of directors with a diverse set of skills and perspectives is viewed as a valuable asset. Rich Fields, a Principal at Tapestry Networks, predicts that this will be one of the hot topics of the year as "industry experience, global expertise, and gender diversity will be of particular interest." Companies face changing customer-bases, evolving technologies, increasingly complex risk factors, and a wealth of data to analyze everything from consumer behavior to employee efficiency. The complex finance system and rules create needs among boards to have members with a solid foundation to understand the implications and risks of company behavior. It is the governance committee's job to make sure it has the right individuals to meet the charge of serving as effective supervisors of management.

MOVING GOVERNANCE FORWARD

As was mentioned earlier, the need for sophisticated committee members has grown, requiring new directors with certain skills. Companies now must have a "financial expert" on the board, and some in the compensation world have argued the need for a "compensation expert" to serve on its respective committee along with its independent compensation consultant. This leads to the question, should there be a "governance expert" on the board? Principles like insider trading and clawbacks present a myriad of complicated issues that a company must work through to create effective policy. While it might be a stretch to designate a governance expert, having board members who understand the nuances of these issues may help companies as they attempt to deal effectively with situations that can cause major problems or sidestep troublesome scenarios.

Without impending legislation focused on making large changes in how companies are governed, we may see only incremental growth in the sophistication and importance of the governance committee. What is certain is that governance by companies is increasingly a topic of focus and a large amount of work still remains as boards are shaped to fit the demands of the future. C



2014 BOARD & COMMITTEE FEES REPORT

For more information, please contact Aaron Boyd at aboyd@equilar.com. Aaron Boyd is the Director of Governance Research at Equilar. The authors of this report were Alice Lee and Herman Yang, Research Analysts.

Over the last five years, boards have taken on an even more critical role in corporate America. The 2008 financial crisis and the resulting economic uncertainty required many companies to reexamine the role of the board. With respect to the growing importance placed on directors, this report is intended to provide insight into how S&P 1500 directors are compensated both at the board and committee levels.

EXECUTIVE SUMMARY

For many executives, serving on a board of directors is viewed as the pinnacle of one's career. Individuals invited to join boards, particularly for public companies, have made their marks in the corporate world and are often recognized as industry luminaries and thought leaders. Given the responsibilities and fiduciary duties of board members today, companies make significant investments in recruiting and securing top talent to serve on their boards. It follows that directors should be compensated accordingly for their expertise and time as well as the risks, both personal and financial, that they assume by accepting a board position.

Due to exchange listing standards, publicly traded companies' boards of directors are required to have certain standing committees, such as the audit committee and the compensation committee. For independent board members serving on one or more committees, this requirement only adds to the members' time commitment and responsibility.

Historically, a board's audit committee had the heaviest workload among committees. However, in the early 2000s and in the wake of the 2008 financial crisis, compensation committees have dealt with a series of regulatory and compliance changes requiring even more time and attention from committee members. This trend is reflected in the increased amount of committee member fees.

It is not surprising that boards establish director compensation programs that account for the differences in responsibilities among board committees. However, there is still a high percentage of companies that do not provide additional compensation for committee service across industries and market capitalization.

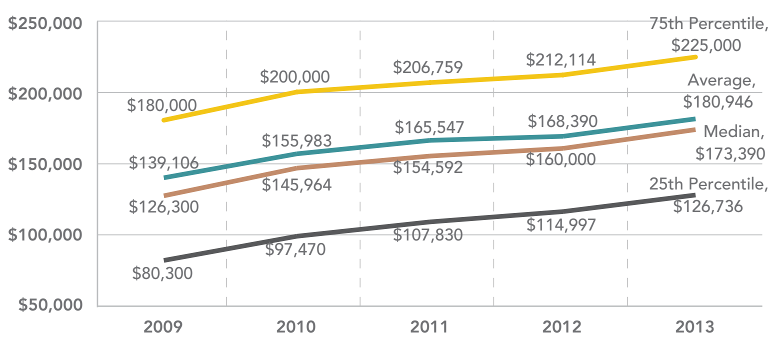
KEY FINDINGS

- **Significant variations in director retainers within the S&P indices.** S&P 500 companies paid the largest median director retainer at $225,000. S&P MidCap 400 companies follow with a median director retainer of $170,000, and the S&P SmallCap 600 median director retainer was $130,000.
- **Board meeting fees fall in prevalence.** The percentage of companies paying board meeting fees has steadily decreased from 54% in 2009 to 35% today. Of the companies that pay meeting fees today, they range from $500 to $25,000 per meeting, with a median fee of $1,800.
- **Prevalence of Compliance/Regulatory and Technology committees rises.** Of the companies studied, there has been a steady increase in the prevalence of Compliance/Regulatory committees, rising from 5.8% in 2009 to 7.3% in 2013. Technology committees have risen in prevalence from 4.7% in 2009 to 6.4% in 2013.
- **Audit and Compensation chair retainers increased in recent years.** Since 2010, the median audit chair retainer has increased by 33% from $15,000 to $20,000, and the median compensation chair retainer has increased by 50% from $10,000 to $15,000. Governance chair retainers have remained at a median of $10,000 since 2010.

METHODOLOGY

For the following analysis, Equilar analyzed data for S&P 1500 companies with the 2013 fiscal year that ended after July 1, 2013 and that filed a proxy as of July 1, 2014. Equilar calculates retainers or meeting fees for board or committee leadership positions with the assumption that those who occupy the leadership positions will receive the same amount as other members of the board or committee if the company does not disclose specific fees for those leadership positions. Companies that lacked disclosure on director compensation were excluded when calculating summary statistics of retainers and meeting fees for non-leadership positions. Equilar employs the Black-Scholes formula, a stock option pricing model commonly used to estimate the grant-date fair value of new-employee stock option awards. Key assumptions used in this formula include the option term length, dividend yield, risk-free rate, and stock price volatility.

Chart 1 **S&P 1500 Director Retainer Summary**



BOARD RETAINER ANALYSIS

Across the S&P 1500, the median director retainer has experienced an upward trend for the last five years. Specifically, it increased by 15.6% from $126,300 to $145,964 in 2010, and thereafter, the median retainer saw a gradual increase for the next few years (see Chart 1). Interestingly, the two companies with the lowest retainers in this study are in the financial industry. The retainers for these banking institutions are $5,000 and $8,400. The less-prevalent companies, such as Berkshire Hathaway, elect not to provide director retainers and instead opt for meeting fees and committee fees. Notably, the two companies with the highest retainers are in the S&P 500 and in the healthcare industry. These companies pay their directors total retainers of $1,147,060 and $1,811,626, and the majority of these retainers are paid in equity.

- Among S&P 1500 boards, 38% are paying retainers of $200,000 or more, compared to just 18.4% five years ago.
- Conversely, the percentage of companies with director retainers less than $75,000 has decreased from 21.5% in 2009 to 7.8% in 2013.

Historically, companies have utilized equity approximately twice as often as the cash component of retainers. The cash and stock components have remained staples of director retainers while options have decreased in prevalence, with only 16.4% of companies granting options, down from 30.6% in 2009. More companies are using units, up 10.0% from 33.4% in 2009. This increase in use of stock and units complements the increase in the median value of stock and units granted to directors.

- Since 2009, the median stock component experienced the largest increase of 66.7%, rising from $60,000 to $100,000 today.
- The median value of units also increased 37.5% from $80,000 to $110,000.
- The median value of options increased by 51% from 2009 to 2011 but experienced a 17.5% decrease from 2011 to 2013. This option value decrease coincides with the decrease in the prevalence of options granted.

S&P INDICES

An analysis by S&P index indicated that S&P 500 companies paid the largest director retainers with a median of $225,000. S&P MidCap 400 companies follow with a median director retainer of $170,000, and the S&P SmallCap 600 median director retainer was $130,000.

Chart 2 **S&P 1500 Median Director Component Breakdown**

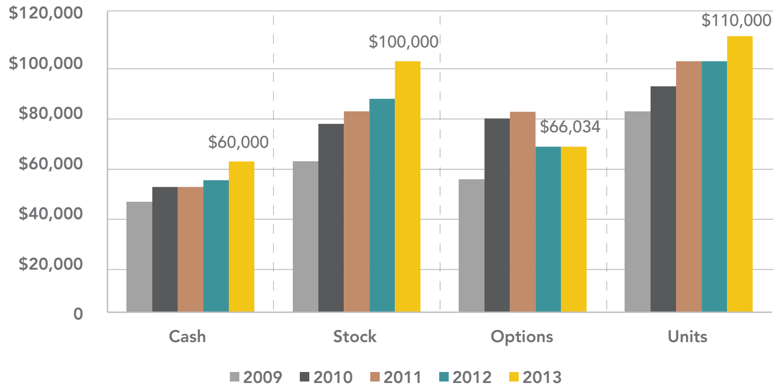


Chart 3 **Median Director Retainer by S&P Index**

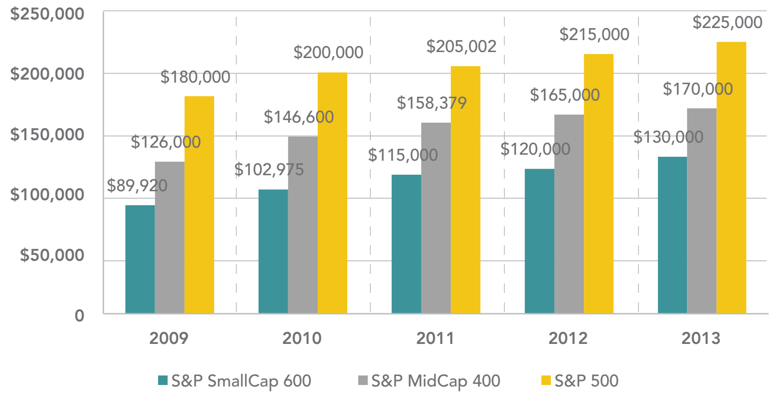


Chart 4 **S&P 1500 Median Director Retainer by Industry**

Table 1

PERCENTAGE OF COMPANIES UTILIZING EACH COMPONENT BY INDUSTRY				
INDUSTRY	CASH	STOCK	OPTIONS	UNITS
Basic Materials	99.26%	56.30%	6.67%	42.96%
Consumer Goods	97.76%	48.51%	16.42%	43.28%
Financial	94.66%	57.25%	10.69%	29.77%
Healthcare	100.00%	40.35%	40.35%	50.88%
Industrial Goods	98.44%	50.78%	21.09%	45.31%
Services	94.60%	48.20%	16.19%	42.81%
Technology	97.60%	33.65%	18.75%	57.21%
Utilities	98.39%	53.23%	1.61%	43.55%

NOTE: Excludes retainers disclosed as $0.

- The largest increase in median retainer is within small-cap companies, with a 44.6% increase from $89,920 in 2009 to $130,000 in 2013.
- For mid-cap issuers, the median retainer increased from $126,000 in 2009 to $170,000 in 2013, or 34.9%.
- Though the S&P 500 has the highest median retainer, it experienced the smallest increase of 25% from 2009 to 2013, increasing from $180,000 to $225,000, respectively.

INDUSTRY ANALYSIS

Director retainers have increased above 2009 levels across all industries in the S&P 1500 (see Chart 4). The industries with the largest increases include the utilities and industrial goods sectors, increasing by 52.4% and 50.0%, respectively. The industries with the smallest gains include the technology and services sectors, with increases of 33.7% and 20.3%, respectively.

As expected, most companies in each industry use a cash component in their director retainers. More than 50% of companies in each of the basic materials, financial, industrial goods, and utilities industries use stock as part of their director retainers.

- The percentage of companies that grant options varies among industries, with healthcare leading at 40.4% while only 1.6% of companies in the utilities sector have options as part of their director retainers.
- More than 40% of companies in all industries grant stock units as part of their director retainers, except for the financial sector at 30%.

BOARD MEETING FEES

As the prevalence of meeting fees continues to decrease, the amount paid for attending meetings has

Chart 5 **S&P 1500 Percentage of Companies with Board Meeting Fees**

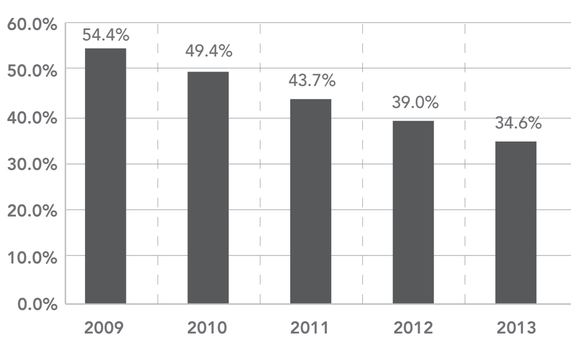


Chart 6 **S&P 1500 Median Board Meeting Fees**

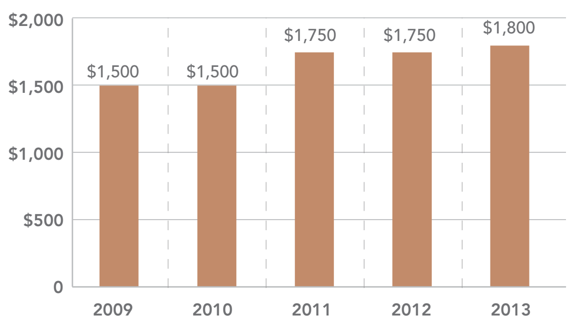
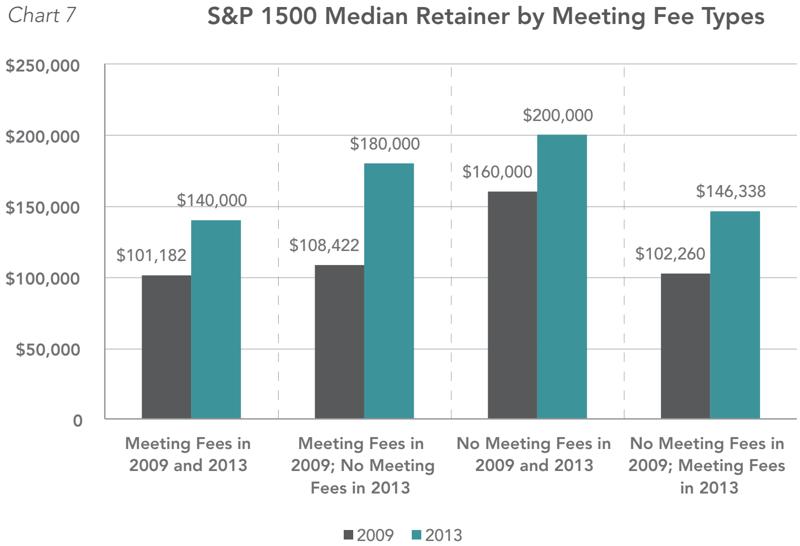


Chart 7



gone up since 2009. Currently, 34.6% of companies award meeting fees, a change from 2009 when a majority of firms, 54.4% paid directors for attending meetings. Despite the drop in the number of companies that pay for meeting attendance, the fee associated with those meetings has risen to a median of $1,800, a 20% increase from the $1,500 in 2009 and 2010.

- Among the companies that pay meeting fees, the fees range from $500 to $25,000 per meeting, with a median fee of $1,800. This is a 2.9% increase from the median fee of $1,750 in 2012.

Further analysis of meeting fees indicates that changes in prevalence may have an effect on retainer values. In a breakdown of companies that either pay meeting fees now or did pay them in 2009 and companies that had no meeting fees during the same period, the data highlights that a significant change in median retainers occurred when companies started using meeting fees or stopped paying meeting fees.

- The median retainer increased from $108,422 to $180,000 for companies that had meeting fees in 2009 and no meeting fees by 2013, a 66.0% increase.
- For the companies that had no meeting fees in 2009 and used meeting fees by 2013, the median retainer increased 43.1% from $102,260 to $146,338.
- Conversely, for companies that had meeting fees in 2009 and kept them in place through 2013 and companies that have never had meeting fees, the increase in the median retainer was 38.4% and 25.0%, respectively.

BOARD COMMITTEE PREVALENCE

Table 2 highlights the board committees found in the S&P 1500 for the past five years, from 2009 to 2013, sorted by prevalence in

Table 2

BOARD COMMITTEE PREVALENCE (COUNT)					
COMMITTEE	2013	2012	2011	2010	2009
Audit	100.00% (1323)	100.00% (1480)	100.00% (1470)	100.00% (1452)	100.00% (1442)
Compensation	100.00% (1323)	100.00% (1480)	100.00% (1470)	100.00% (1452)	99.93% (1441)
Governance	93.20% (1233)	92.77% (1373)	92.18% (1355)	92.08% (1337)	91.47% (1319)
Executive	30.84% (408)	29.26% (433)	29.32% (431)	30.17% (438)	30.86% (445)
Finance	24.72% (327)	24.12% (357)	24.63% (362)	25.28% (367)	24.76% (357)
Strategy	13.91% (184)	12.50% (185)	12.38% (182)	12.74% (185)	11.72% (169)
Compliance / Regulatory	7.26% (96)	6.55% (97)	6.87% (101)	6.68% (97)	5.83% (84)
Technology	6.35% (84)	5.88% (87)	5.37% (79)	5.03% (73)	4.65% (67)

2013. As expected, all publicly traded companies have two required committees, audit and compensation. The next most prevalent committee is the governance committee, which is typically the third standing committee of a board of directors. The next three most prevalent committees, aside from the three standing committees, are executive, finance, and strategy committees.

COMMITTEE RETAINERS

Overall, all committee chair retainers have increased for the past four years. The audit and compensation committee grew at a faster pace than the governance committee, increasing the gap between the chairs of the committees from $7,000 in 2009 to $10,000 in 2013. Meanwhile, median member retainers remained relatively stable over the same time frame.

- In the S&P 1500, the audit and compensation committee chair median retainers remained the same from 2009 until 2012, when the audit chair retainer saw a 20% increase from $15,000 to $18,000 and the compensation committee chair saw a 25% increase from $10,000 to $12,500.
- The median governance committee chair retainer has remained unchanged at $10,000 since 2010, while the audit and compensation committee chair retainers increased in both 2012 and 2013.
- The median governance committee member retainer was the only committee retainer that did not observe an increase in 2010 while the audit and compensation member retainers have increased by 23% and 17%, respectively.
- Median audit and compensation committee member retainers have remained unchanged at $10,000 and $7,500, respectively, since 2011.

Chart 8 **S&P 1500 Median Chair Retainer by Committee**

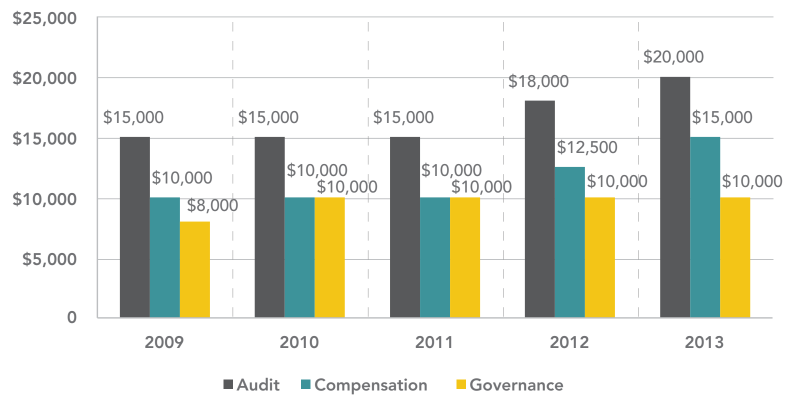
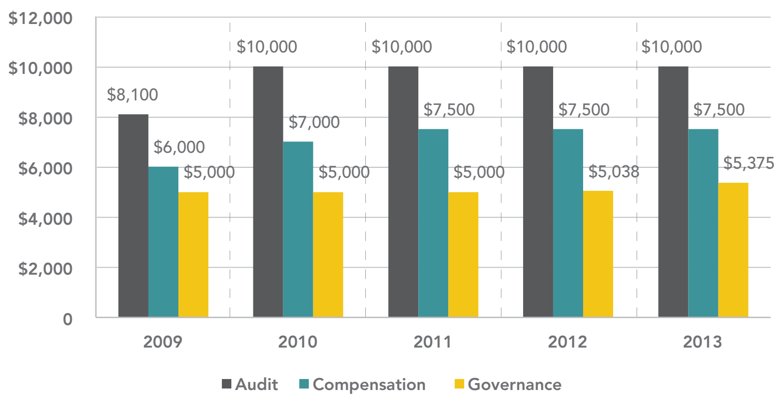


Chart 9 **S&P 1500 Median Member Retainer by Committee**



REPORT

2015 COMPENSATION & GOVERNANCE OUTLOOK REPORT

For more information, please contact Aaron Boyd at aboyd@equilar.com. Aaron Boyd is the Director of Governance Research at Equilar. The authors of this report were Alice Lee and Herman Yang, Research Analysts.

Each year, Equilar highlights critical topics that will affect those dealing with compensation and governance issues in the upcoming year. The Compensation & Governance Outlook Report aims to cover an assortment of relevant and developing trends in the fields of executive and director compensation, equity trends, and corporate governance.

There were a number of noteworthy stories in 2014, including an intensifying climate around shareholder activism, high-profile initial public offerings, increased shareholder engagement efforts, and a strengthening market that led to a further resurgence in M&A activity.

Developments such as these will continue to shape the corporate landscape well into 2015 and beyond. Continuing discussions with shareholders will drive more changes as companies ensure their compensation efforts are communicated through a variety of mediums and methods. Concerns around fairness in a number of areas, including pay equity, will only increase the focus on board decisions and processes. Topics featured prominently in this year's report include board diversity, shareholder engagement initiatives, Say on Pay responses, and pay for performance disclosures. The topics covered are organized into one of three categories: Disclosure & Governance, Executive Pay, and Board of Directors.

Disclosure & Governance

DISCLOSURE ENHANCEMENTS IN PEER GROUP SELECTION

When selecting peers, companies aim to provide justification to shareholders for why certain companies were included in the comparator group. While explanations vary, companies often reference the peers' industry classifications, financial metrics (such as market capitalization or revenue), or competition for talent. It is important for companies to communicate through disclosure that the selected companies are in fact appropriate for benchmarking purposes and have not been "cherry-picked," or selected with the intent of increasing compensation for executives through the inclusion of aspirational peers. The peer companies will often operate in similar industries and, where possible, have similar cost structures or business models. The stronger the fit in these key areas, the more robust and informative the ensuing compensation and performance data will be for the company. Many companies have moved beyond the traditional peer group disclosure of listing the peer companies and selection criteria used. Instead, these companies are opting to provide context around the selection of peers through additional charts and tables.

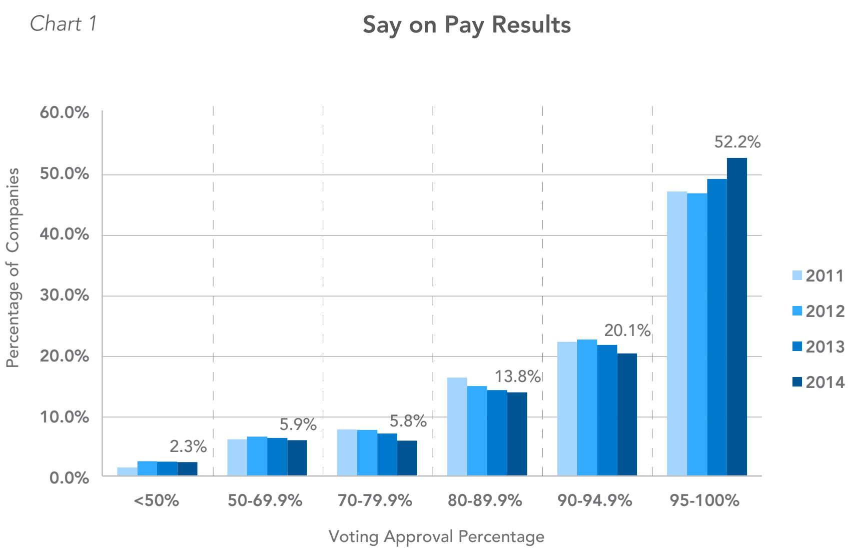
SAY ON PAY VOTES PROMPT SIGNIFICANT RESPONSES

As has been the case since the implementation of Say on Pay, approval rates remained high across the Russell 3000 index with 97.7% of companies passing in 2014. Of companies holding annual meetings through November 15 of this year, only 67 received less than majority support. For the first time, more than half of the Russell 3000 companies received greater than 95.0% support.

KEY FINDINGS

- **Peer group disclosures continue to evolve.** Many companies have moved beyond the traditional peer group disclosure of listing the peer companies, instead opting to provide additional financial and industry context regarding the selection of peers through charts and tables.
- **Shareholder engagement and company outreach are becoming standard.** Disclosure of shareholder engagement has increased in frequency over the past six years among S&P 100 companies. In 2014, 65 companies disclosed some form of engagement with shareholders in the proxy statement, up from only seven companies in 2008.
- **Alignment between pay and performance is becoming increasingly visual.** In addition to the increased use of the phrase throughout the CD&A, companies are also demonstrating "pay for performance" alignment through innovative graphs and tables.
- **Pay ratio disclosures are already beginning to emerge**. While the SEC has yet to finalize rules on the CEO pay ratio disclosure it proposed last year, a handful of companies have begun including similar ratios within proxy statements.
- **Companies are finding new ways to communicate director qualifications.** Several leading companies have included director skills matrices that provide a comprehensive overview of both the skills the company seeks and the representation of those skills by each board nominee.

Chart 1



The majority of companies that failed their 2013 Say on Pay vote made efforts to address the issues raised by shareholders. More than 85% of companies who failed in 2013 included disclosure about their efforts to alter their compensation strategy in their 2014 proxy. Half of these companies reached out to proxy advisory firms, such as ISS and Glass Lewis. With so few companies receiving less than majority support, public scrutiny and shareholder pressure can become focused on them.

Table 1

RUSSELL 3000 SAY ON PAY FAILURES	
2014	67
2013	78
2012	65
2011	46

Companies that failed their Say on Pay in 2013 faced pressure to engage their shareholders and proxy advisors alike and make changes in order to avoid a repeated failing vote. The companies that disclosed a consultation with proxy advisory firms attained an increase in approval rate, with an average change of 32.8 percentage points.

SHAREHOLDER ENGAGEMENT AND OUTREACH EFFORTS

Shareholder engagement can take a number of forms, including distributing written materials, hosting virtual meetings or webcasts, and even convening in-person meetings. Disclosure of shareholder engagement has increased in frequency over the past six years among S&P 100 companies. In 2014, 65 companies disclosed some form of engagement with shareholders in the proxy statement, up from only seven companies in 2008.

Companies failing a Say on Pay vote or those that exhibit poor performance will often disclose shareholder engagement undertaken to address any shareholder concerns. The effective communication of any adjustments made to align company policies and programs with the interests of shareholders is critically important. Of the companies that failed their 2013 Say on Pay vote, 20 disclosed shareholder outreach as a response. On average, the voting results of the 2014 Say on Pay of those companies increased by 22.6%.

While shareholder engagement is a tool that can help companies that are experiencing issues concerning the alignment of pay and performance, it is no longer used solely by companies as a reactionary measure. In addition to generating goodwill, proactive engagement with shareholders allows boards to assess any potential disconnects between parties prior to the annual meeting. An increasing number of companies are recognizing that disclosure of shareholder engagement is generally perceived to be good corporate governance practice and are proactively engaging with shareholders as a result.

Table 2

Response	Companies	Average 2013 Approval	Average 2014 Approval	Average Change
Consulted with Proxy Advisors	24	38.9%	71.7%	32.8%

Table 3

Response	Companies	Average 2013 Approval	Average 2014 Approval	Average Change
Reached Out to Shareholders	20	36.9%	59.5%	22.6%

Executive Pay

EMPHASIZING THE ALIGNMENT BETWEEN PAY AND PERFORMANCE

With the value of their investments derived from the underlying performance of the companies in which they invest, it is no surprise that shareholders pay close attention to how a company's performance aligns with the compensation of its executive team, particularly in the wake of Say on Pay. "Pay for performance" has emerged as one of the key phrases in executive compensation over the last several years. As such, many companies do what they can to assure shareholders that they make this link between pay and performance as strong as possible. This linkage is critical for companies in demonstrating that the long-term interests of shareholders are being considered in the context of compensation decisions. Whether by simply stating within the CD&A that pay for executives is in line with the performance of the company, or by including entire sections and graphs about "pay for performance," companies are committing larger portions of their proxy statements to addressing the alignment.

The phrase "pay for performance" was disclosed in 84 out of the S&P 100 companies' proxies in 2014, up from 60 of the S&P 100 companies in 2009. In addition to the increased use of the phrase, companies are also demonstrating a "pay for performance" philosophy through alternative graphs and tables. By comparing company performance to compensation within a graph, shareholders are able to easily discern a clear relationship, or lack thereof in some cases. The frequency of "pay for performance" graphs has increased from four S&P 100 companies in 2009 to 23 in 2014.

RENEWED FOCUS ON INCENTIVE PLAN METRICS

Incentive plans often have set threshold, target and maximum amounts that pay out depending on the performance of the plans' metrics. In addition, each metric often has its own threshold, target and maximum values that determine percentages of plans' payouts. When setting the metrics for incentive plans, the ability for the targets to be achieved has become a focal point for issuers, shareholders, and proxy advisors. Companies frequently have disclosure regarding the rigor of selected performance metrics that are featured in both the annual and long-term incentive plans. In the event that the metrics are not perceived to be rigorous enough, companies can subject themselves to criticism from shareholders or proxy advisors.

Several companies address rigor in some form within the proxy statement in an effort to combat the possibility of criticism. Increasing targets or changing companies used in performance peer groups are common ways to increase the rigor within incentive plans. For example, United States Steel (X) increased the threshold, target, and maximum relative TSR for its long-term incentive plan.

Including disclosure about the rigor of the performance metrics may only partially satisfy shareholders wishes. Quantitative evidence provides a complete picture that the metrics set were rigorous, but this can be difficult to convey to shareholders. An interesting case involving the rigor of performance metrics is Apple (AAPL). Although Apple received a great deal of attention resulting from mega-grants of equity within its compensation program in recent years, the company also has an annual cash incentive plan which includes specific annual performance metrics. The plan's metrics are net sales and operating income, which have been consistently selected for its plan over the past several years. Despite more than a $6 billion decrease from actual operating income in Fiscal 2012, the maximum payout was paid out in fiscal 2013 with an operating income of $48,999 (millions). This was the third consecutive year that Apple was able to achieve a maximum payout through its annual incentive plan. The rigor of the performance metrics in Apple's annual incentive plan would presumably be an area of concern for shareholders, yet Apple's Say on Pay vote percentage increased from 59.7% in Fiscal 2012 to 95.7% in Fiscal 2013.

THE PAY RATIO AND INTERNAL PAY EQUITY CONSIDERATIONS

Under current SEC rules, companies are required to provide extensive information about the compensation of their CEO and other named executive, or Section 16, officers. Companies have not, however, been required to disclose the same compensation information for employees outside of the C-suite. Section 953(b) of the Dodd-Frank Act directed the SEC to amend existing rules to require companies to disclose the median of the annual total compensation of all employees of a company along with a ratio of that median to the annual total compensation of the company's CEO. On September 18, 2013, SEC proposed a rule in accordance with the Dodd-Frank mandate that would require companies to begin disclosing this new ratio within company proxies as early as 2016. Among other details included in the proposal, the SEC outlined a summary of the new pay ratio rule, discussion of methodology for identifying the median employee as well as those covered by the rule, and direction as to how total direct compensation should be calculated.

The forthcoming adoption of this CEO-to-median-worker pay ratio by the SEC again brings the discussion about pay equity to the forefront. While the vast majority of companies are awaiting final guidance from the SEC before implementing processes and systems to comply with the pay ratio rule, a small number of companies have already included such a ratio within their proxy statements.

Board of Directors

DIRECTOR QUALIFICATIONS AND SKILL MATRICES

An SEC rule finalized in 2010 required companies to disclose, for each director and nominee, the particular experience, qualifications, and attributes or skills that led the board to conclude the individual should serve as a director of the company. Companies have approached this disclosure requirement in a variety of ways. To facilitate shareholder understanding of director skills and qualifications, many are now frequently opting to clarify directors' skills by providing separate sections to highlight this particular area. Whereas previously, qualifications and skills were listed in director bios, disclosure methods have evolved in the way by which director qualifications are presented. A number of companies now disclose qualifications in their director bios in a separate section labeled "Qualifications" or "Skills." This cleaner approach allows shareholders to more easily identity relevant skill sets of each director. Rather than reading through large paragraphs, their eye is drawn to a separate section.

TACKLING THE ISSUE OF BOARD REFRESHMENT

While the issue of gender diversity on corporate boards has rightfully gained greater attention in recent years, another equally critical issue is beginning to emerge in boardrooms. Board refreshment and planning for director succession are key tasks that are starting to be examined more closely in the context of optimal board performance. The argument against long-tenured directors is that service beyond a certain number of years may compromise a director's independence from management and his or her ability to be objective. A multitude of long-tenured directors at one company may indicate a lack of refreshment of the skills and perspectives required by the board. At the same time, many long-tenured directors offer invaluable experience and intimate knowledge of a company's operations within a particular industry that would not be easily replaced.

Earlier this year, State Street Global Advisors unveiled its new policy around its evaluation of director tenure. The State Street policy is more nuanced than a strict limit on tenure in that it considers average board tenure, the pervasiveness of very long-tenured non-executive directors, and whether the company has a classified board structure. Although ISS does not currently use director tenure as a key factor in its recommendations for director elections, it does weigh director tenure in its Governance QuickScore. ISS examines whether a company has "excessive" director tenure (measured at more than 9 years) as a governance factor within its QuickScore rating. Glass Lewis, on the other hand, explicitly states within its voting guidelines that director age and term limits typically are not in shareholders' best interests. The renewed focus on board refreshment and succession planning appears poised to stay, and as such, many companies are finding ways to highlight the issue within the proxy.

STAND ING UP to Scrutiny

Protecting the board through superior proxy disclosure

Each year, several hundred clients request our assistance in evolving their proxy statements from their traditional compliance focus into more visually inviting and comprehensible communication pieces. Motivation for this transformation varies from company to company. The most frequent drivers of change include:

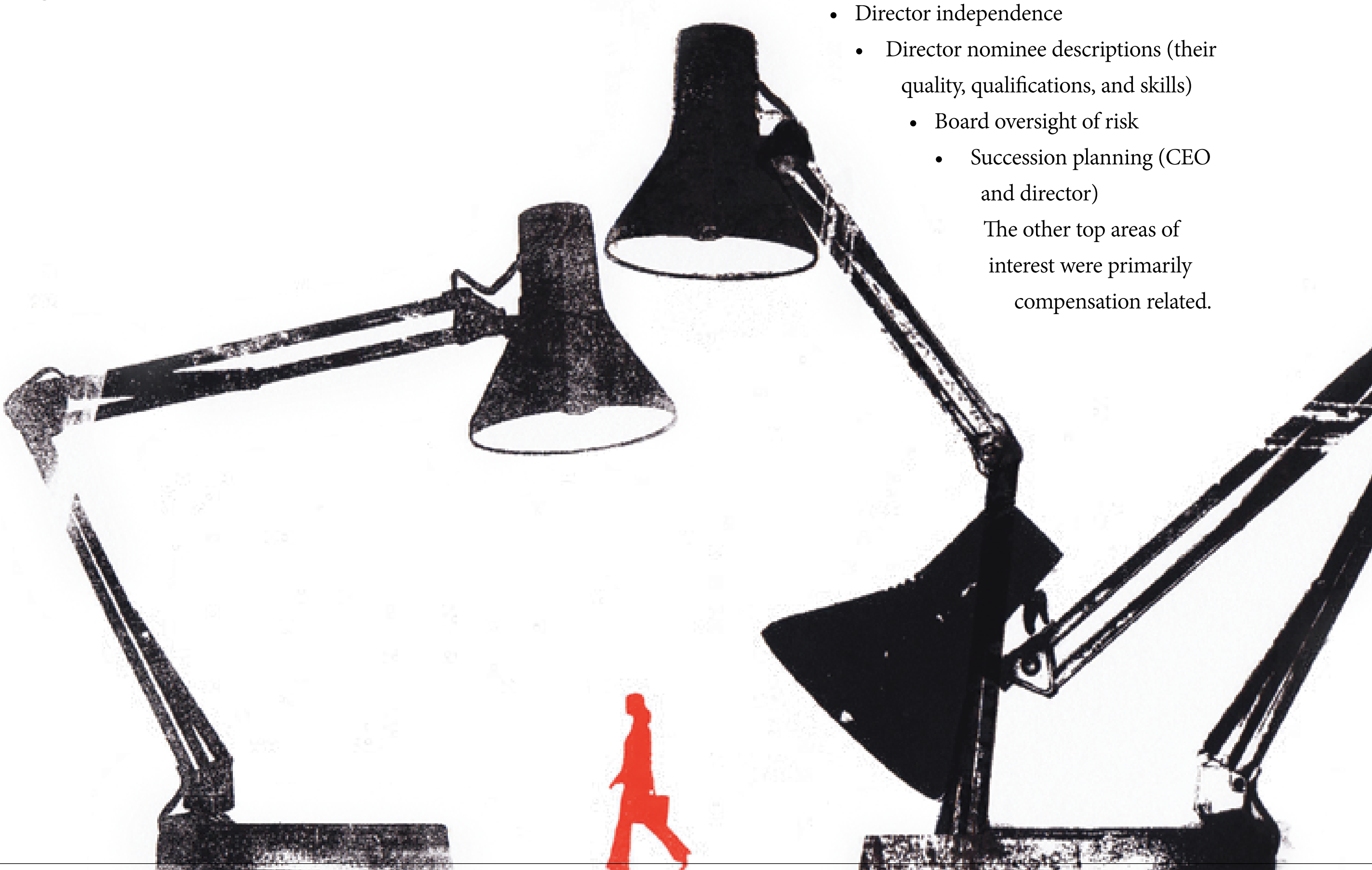
- To effectively portray their board and the directors' independence, skills and qualifications (driven by current high levels of investor activism and increasing focus on long-tenured directors),
- To clearly communicate their compensation programs (driven by Say on Pay votes), and
- The recognition that if a companies' peers have elevated the quality of their proxy disclosures and appear to be making conscious efforts to better meet investor informational needs—other companies risk being perceived as relative laggards if they don't similarly enhance their disclosures to meet these escalating investor proxy statement expectations.

INVESTOR INTEREST IN BOARD COMPETENCIES IS VERY HIGH

When we surveyed institutional investors this past year, asking them which proxy statement subject matter areas they were most interested in, they listed the following as among the top nine out of 20 topics (including both SEC requirements and optional ones):

- Director independence
- Director nominee descriptions (their quality, qualifications, and skills)
- Board oversight of risk
- Succession planning (CEO and director)

The other top areas of interest were primarily compensation related.



WHY COMPANIES ARE BEEFING UP THEIR BOARD DISCLOSURES

Boards operate primarily away from the public's eye, and for good reason. This means that director quality, independence, and engagement are relatively invisible to most outside parties. While direct engagement between board members, investors, and other stakeholders can build appreciation for director quality and independence, in the U.S. the majority of company/investor engagement is still conducted by senior management. This lack of a direct line of sight into the boardroom causes proxy advisors, investors, and others to rely on more easily observed metrics, so they focus on directors' biographical history/life experience, disclosed skills, and qualifications, age, tenure, other board seats held, and ethnic and gender diversity.

RECORD LEVELS OF ACTIVISM Activist investors increasingly are viewed as a distinct asset class, generating superior returns and attracting greater levels of capital. This is true of current firms raising more money and new firms joining this class.

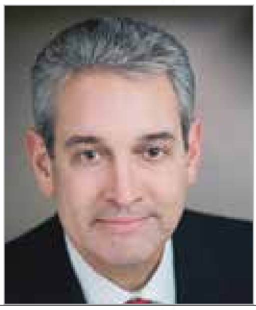
Size apparently no longer deters activists as it once did, with numerous large-cap companies being targeted this past year. What's more, investors owning less than 1% have succeeded in forcing changes at certain companies because of the expectation—or fact—that other, larger mainstream investors would support their campaigns.

INCREASING FOCUS ON LONG-TENURED DIRECTORS As part of its Governance QuickScore rating system, influential proxy advisor ISS views tenure of more than nine years as excessive and potentially compromising a director's independence. If tenure alone becomes an even greater focus in evaluating director effectiveness, companies could risk losing the service of some of their best and most seasoned directors.

IN THIS ENVIRONMENT, HOW ARE COMPANIES TELLING THEIR BEST BOARD STORY?

If attacked by activists, companies will respond in many ways, including telling their best board story. Why wait when you can do it proactively?

- With respect to director nominee disclosures, the trend is toward shortening the biographical histories and beefing up the skills and qualifications disclosure.
- Particularly for long-tenured directors, longer bios aren't the answer—more specific descriptions of directors' unique skills and qualifications are.
- Many companies are using a bullet format to highlight key information such as age, diversity, tenure, independence, and other board seats held.
- Shading, call-out boxes and other visual devices can further draw the reader's eye to qualifications.
- Director photos in the proxy may help to humanize directors. In other cases, these same photos may highlight lack of gender and ethnic diversity, so the desirability of including photos varies from company to company.
- Each year, in a visually inviting effort to reinforce board competencies, we are seeing more companies include within the proxy a version of its board skills matrix. This will not inoculate a particular board from potential activist threats, but at least could signal that, should an activist seek board seats, the company is not a sitting duck on key issues such as already having several directors with industry experience. As with the issue of including director photos, there are pros and cons to this approach, so it should be a company-specific decision.
- Some companies are highlighting the impact of recent board refreshment on the average age, tenure, and diversity of the board, including through before-and-after graphical images of the impact of these changes. Certain parties are always going to press for more or faster change, so it makes sense to remind them of the actions you have taken.
- Consider including a letter from the independent board Chair (or Lead Independent Director), explaining his or her perspective about the company and their oversight role.
- Are your disclosures about board risk oversight, succession planning, and other key issues what could be perceived as boilerplate? Or are they more thoughtful and company-specific, and likely to build investor confidence that the board is effectively carrying out such key duties?
- Take a look at the proxy disclosures not just of governance leaders, but also of your peers. Ask yourself how your disclosures stack up to theirs. Are you falling behind the ever-escalating floor of company disclosures and rising investor disclosure expectations? If so, consider what steps you might take to reverse this trend. C



Ronald Schneider is the Director of Corporate Governance Services at RR Donnelley. Over the past three decades, Ron has advised public companies of all sizes, industries, and stages of growth facing investor activism, as well as challenging and sensitive proxy solicitations involving corporate governance, compensation, and control issues.

To read more of Ronald Schneider and RR Donnelley's proxy analysis, visit ***csuiteinsight.com/author/rschneider***.

FEATURE

Weathering the Storm

Boards need a strong plan if they want to stay out of the rain in 2015

One of the exercises that all businesses go through at the close of a year is to thoughtfully plan for next year. The same should be true for the board of directors. I've stood on my soapbox several times to express the need for boards to operate like a business, meaning they should develop or reaffirm their mission and establish goals for the upcoming year. It's just logical to go through that exercise, and, especially now, there are a couple of issues that make it critically important that the board have a plan for 2015. So I thought I'd take a look at two of those key issues and discuss why every board should have them on their planning agenda.

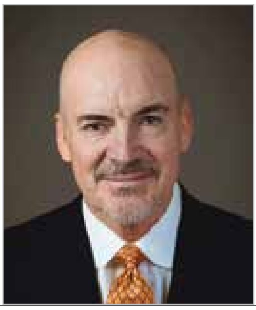
CYBER AND BIG DATA RISK

I would bet that just about everyone who regularly reads the paper or watches the nightly news, especially investors, understands that

U.S. companies are under attack. Why do I say that? Just look at the facts. Federal officials have reported that more than 500 million U.S. financial records have been stolen over the past 12 months—and that's just the cases they know about! And here's one even scarier thing about this ever-growing risk: In many cases, companies don't even know they have been hacked. A recent study by Verizon reported that 80% of hacked companies didn't know they were violated until informed by outside sources, such as customers or vendors. A list of the recently hacked reads like a "Who's Who" of brand names: Target, Home Depot, and JPMorgan Chase, just to name a few.

From a board's perspective, a lack of awareness is only half the problem. Directors are the corporate overseers who have the responsibility to ensure (to the best of their ability) that processes and procedures are in place to mitigate all types of risks and protect the investors. In today's world, where cyber risk is changing and evolving every day, one of the challenges for directors is that most of them never had to deal with cyber risk when they were busy getting their leadership experience. Therefore, the combination of increased breaches as well as unprepared state of many companies and boards magnifies the concern and need for planning at the board level.

At a minimum—and I emphasize *minimum*—boards should have a crisis plan in place that has been tested on what should happen if their company undergoes a breach. It can be a standalone plan or a part of the organization's larger crisis management plan, but one way or another, if the board hasn't ensured that a response plan is in place, they shouldn't look for sympathy when shareholders come gunning for directors' seats during annual elections. Target Corp.'s board, for example, narrowly survived the recent headhunting movement led by Institutional Shareholder Services (ISS) following its widely publicized data breach, but only because the board demonstrated sound governance in other aspects of its practices, and because Target shareholders were ultimately convinced that throwing out two-thirds of the directors would not be a good move for the company or themselves. Other companies would be wise to learn from the these mistakes, or else we will see less and less tolerance from angry investors—which makes a great segue to my next key issue that should warrant attention in 2015.



TK Kerstetter is the former chairman of NYSE Governance Services – Corporate Board Member and is a second generation pioneer of governance thought leadership and board education.

SHAREHOLDER ACTIVISM CONTINUES TO GROW

There are many ways to describe the current state of shareholder activism, but let's just say, as a group, they are "feeling their oats" these days. New regulations out of the SEC and as a result of Dodd-Frank have given investors a bigger voice than ever, and we've seen signs that they aren't afraid to use it. As a result, all the chatter in the last few years about knowing who your shareholders are and communicating with them on a regular basis has become very important. Therefore, it is another critical issue that should be on every board's planning agenda.

Boards of directors should proactively go through the process of evaluating their companies as if they were an active outside shareholder. They should identify issues where certain external optics may not look good and find ways to communicate or explain the real story behind a company's or board's actions. Now I'm not advocating that you do this in a vacuum, but rather, the board should involve the entire team, including the corporate secretary and the investor relations officer. The recent tale of Darden Restaurants versus investor Starboard Value & friends, where the activist shareholder was successful in replacing the entire board, is certainly not unprecedented, particularly with the way the board represented the shareholders in some M&A transactions, and should be viewed as a serious shot across the bow. Furthermore, it's not just the bad performers or the companies that ignore shareholders' wishes that are getting targeted. We've seen good performers, such as Apple and Microsoft, in the crosshairs of infamous activists as well. As hedge funds and activist investors produce higher and higher returns, the money will continue to flow into their coffers, and their messages will grow more and more powerful.

My take is that 2015 will be a challenging year for boards, but particularly for boards that fly by the seat of their pants versus running their boards as a business. So this is a call for "all hands on deck." There are storm clouds forming, and everyone should be prepared if you want to weather the storm. C

*For additional cybersecurity insight and more from TK Kerstetter, visit **csuiteinsight.com/author/tkkerstetter**.*

Juggling Act

Managing relationships with the 3 key stakeholders CEOs should pay attention to in 2015

"Stakeholder overload" is a reality that will continue to challenge CEOs in the coming year. New chief executives can feel particularly overwhelmed by how their relationships with internal and external stakeholders change once they reach the top spot, but even veteran CEOs admit struggling with the shifting expectations of groups above, below, and outside.

The sheer pace of market changes—from new product cycles to technology disruptions to global geo-political swings—has turned the CEO role into a juggling act. Having to develop the corporate strategy, and then bring all stakeholders (inside and outside the company) along on the "journey," and then assemble the talent to execute it all requires a constant re-focus and prioritization.

It is in this context that CEOs must create an intentional strategy for managing key stakeholders, and leveraging these relationships to propel the company into growth. Three groups in particular will need additional focus on the part of the CEO in the coming year to ensure that these stakeholders are vested in the success of both the CEO and the future of the company:

NEW BOARD MEMBERS

We are moving out of the era of the "CEO's board," where the CEO carefully orchestrated everything behind the scenes. New directors are entering, and expecting, more transparent boardrooms, and CEOs and directors have more of a blank canvas to work with as far as establishing a working relationship with each other. This demands that CEOs start fresh in determining how best to engage with a new member of the board who may come in.

Meeting a new director for the first time—who may not yet be expert with the company or even the industry—presents a real opportunity for a CEO, good or bad. In striving to gain an ally in the director, some CEOs react in an overly transactional way. They answer questions too quickly, provide too much of an information dump, and respond with more speed than thought. This can happen with new CEOs in their initial interactions with the board, but we see it with veteran CEOs, too, in engaging with new directors or board chairs.

On the other hand, if a CEO approaches new directors in a way that is less reactive and more strategic, the relationship can start off in a high-functioning, meaningful way. This is a case where time is a friend, not an enemy. New directors will have a lot of questions, but they are not looking at the CEO to "prove" that they know the role. These incoming directors are building their own knowledge base and forming a perception of the CEO to last for the long haul. This is the time for the CEO to talk less, not more, and be alert for where the new director is coming from in his/her questions. Then, going forward, the CEO can continue the dialogue by investing in a one-on-one relationship with the new director—an investment that must be continually maintained over time.

YOUR "ANCHOR" TALENT

A key talent management tool drilled into every leader is spotting and cultivating his/her high-potential talent. There is no doubt these high-potential executives are essential to the growth of an organization: These folks are your future, and companies must allow them to stretch and prove worthy of the organizational investment. The problem is that many leaders overrate high-potential executives as contributors to success, and underrate their "anchors."

Anchor executives are high-performing and have a mastery of their role, but for certain reasons are unlikely to rise to the top of an organization (they may have different personal or career aspirations other than the top spot, or they may have a very narrow area of expertise). They are deeply valuable because of their experiences, technical knowledge, and mastery of a role. High-potential executives take from an organization, as they are in deep learning mode—they have less capacity to engage with others on their team. But anchors are already at the contributing stage: They are delivering results and are able to hit the ground running.

As a CEO looks ahead, it's tempting to focus on the emerging shining stars and future leaders of the company. But a high-performance organization is dependent on teams that are structured around both high-potential and anchor executives. The presence of these anchors allows high-potential colleagues to develop and transition more effectively into higher leadership roles, providing balance and not putting the stake of the company on riskier ground with less tested executives.

INVESTOR COMMUNITY—ESPECIALLY THE BUY SIDE

The importance of effectively managing relationships with the analyst community in the coming year cannot be overstated. As CEOs think about their role in shaping their company's future, successfully managing investor/analyst communications can be a powerful lever to their company's success. Like a board, the analyst community needs to be brought on a journey, and it's the CEO's job to engage them. This starts with doing the hard work on the strategy so it is simple and easily understood—and also connected to the decisions and actions the company is taking.

It is important to move beyond the transactional, one-way information sharing and develop true engagement. The CEO who talks about all the great new products and plans for the company but never bothers to figure out what the analysts want to hear about is not protecting his/her share price. What are they measuring—and, most important, what are they measuring that your company may not be? It's essential to bring analysts and investors on your journey as a company, to walk them through the story of the company's vision, but it's just as important to find out where they are coming from.

* * *

As CEOs consider thoughtfully how they will approach their many different constituencies in the coming year, the underlying factors to keep top of mind are value and engagement. Internal and external stakeholders crave engagement and dialogue—and CEOs must be able to cultivate this for high-functioning relationships. At the same time, the CEO job demands a ruthless prioritization, requiring a keen sense of where true value can be captured as far as executive performance and creating valuable investor relationships. C

Stephen Miles is the founder and Chief Executive Officer of The Miles Group, an executive consulting firm specializing in talent strategies.

Taylor Griffin is a partner and Chief Operating Officer of The Miles Group.

*More insight from The Miles Group, including an interview with Stephen Miles and Taylor Griffin, is available at **csuiteinsight.com**.*

What will be a hot topic in corporate governance in 2015?

ASK THE EXPERTS

Amy C. Seidel
Faegre Baker Daniels
Partner

One of the hottest governance topics going in 2015 is director tenure. This issue emerged last year when certain institutional investors and proxy advisory firms announced policies focused on director tenure. As we head into 2015, companies and investors will consider questions like "How long is too long?" and "Is the focus on director tenure just another way to encourage refreshment and diversity in the boardroom?"

WHAT HAPPENED IN 2014?

- CII announced its view that long tenure can impair independence.
- ISS included director tenure into its Governance QuickScore rating system, whereby long tenured directors (more than nine years, according to ISS) may negatively impact the company's score.
- State Street announced a policy focused onboard refreshment, indicating that it may engage with companies if the average director tenure is above the market average.

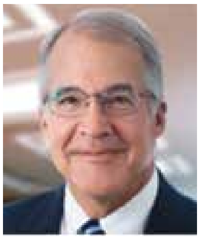
WHAT DOES THIS MEAN FOR COMPANIES IN 2015 AND BEYOND?

In order to avoid scrutiny for director tenure concerns, companies should consider the following:

- Break down the tenure of directors. For example, identifying the number of directors serving less than three, three to six, six to nine, and more than nine years may help the board visualize the mix of tenures.
- Employ a rigorous director evaluation process. If shareholders had confidence that all director evaluations were honest and constructive, they likely wouldn't care about tenure. Their real concern is whether each director is holding his or her own weight and making meaningful contributions, and is able to bring diverse perspectives and independent viewpoints to the boardroom.

Refresh the board with relevant experience for the company's evolving business. Businesses change over time—they may expand into new geographies or product lines, or face new risks. Ensure that the board includes members with experience relevant to the company's evolving business who bring diverse viewpoints that identify with the company's diverse constituents.

Greg Lau
RSR Partners
Managing Director - Board of Directors Practice



My morning routine typically begins with *The Wall Street Journal*. And, frankly, I cannot remember the last time an activist investor headline was missing from my breakfast table. But whether you prefer coffee or tea, I think we can all agree that activist investing will be one of this year's hottest corporate governance topics.

As such, it is high time for boards of directors to take a hard look at how—or even if—they are equipped to go into discussions with an activist. More than 20% of the Fortune 500 has already been targeted. How so? Typically, these activists use direct letters to the board or 14a-8 proposals to incite other shareholders around campaigns aimed at gaining board seats and promoting alternative value maximization strategies.

Now, initiatives to improve shareholder value are indeed a good thing. In the first eight months of last year, activist investors returned an average of 5.9%, according to research outfit HFR, compared with a 3.9% gain for hedge funds generally. In fact, Bill Ackman, head of Pershing Square Capital Management, wrote his investors last August, saying, "The popularity of activism as a strategy has increased due to the potential it offers for substantial returns."

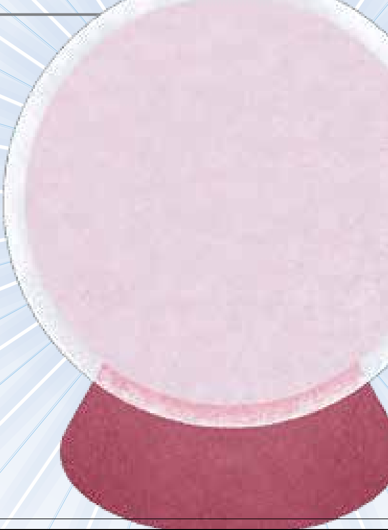
But typical goals of increasing value and separating disparate business units are not activists' only aims. As the upcoming presidential election heats up, it is worth noting that, as The Conference Board's Matteo Tonello and Melissa Aguilar point out in their report Proxy Voting Analytics, "Political spending and lobbying activities, a topic virtually absent from voting ballots until a few years ago, became the most frequently submitted shareholder proposal type of 2014."

These proposals will continue to gain momentum. According to The Conference Board, during last year's proxy season, activist hedge funds submitted 39 proposals at Russell 3000 companies, up from 24 proposals in 2013. These proposals, however, only represented 5.2% of the total. But let's not forget just how powerful these activists can be. Recall last fall when Starboard Value took on Darden Restaurants, convincing shareholders to replace the entire board with its 12-director slate. And Starboard wasn't even Darden's largest shareholder.

So just as boards have been beefing up their benches to handle cybersecurity's ever-evolving challenges, it is important that directors seriously consider adding to their ranks colleagues with the savvy necessary to navigate this new age of activist investing. And if that colleague is already on the board, it is imperative that he or she has the right financial, operating, and communications skill set.

With more than 35 years of corporate governance experience, Greg Lau has deep expertise working closely with chairmen, chief executive officers, and nominating and governance committees on board composition. At RSR Partners, Lau advises the boards of some of the nation's leading companies on succession planning and director recruiting and also provides compensation and corporate governance consulting. Lau previously served as executive director of global compensation and corporate governance for General Motors, during which he was secretary of the directors and Corporate Governance Committee of GM's board. He is a member of the board of the National Association of Corporate Directors (NACD) and is a NACD Board Leadership Fellow. He also serves as a trustee of the Committee for Economic Development (CED).

Amy C. Seidel is a Partner at Faegre Baker Daniels LLP where she is the head of the firm's Public Companies and Securities practice area. Her practice involves advising public companies on SEC reporting requirements, stock exchange listing standards, executive compensation issues, disclosure issues, shareholder activism, and general corporate governance matters. She also has experience in many areas of corporate representation, including public and private securities offerings, mergers and acquisitions, and general corporate counseling.



Expert responses are the personal opinions of each expert and may not reflect the opinions of their firms.

Tapestry Networks

Rich Fields
Tapestry Networks
Principal

Board composition will be a hot topic in 2015. The number of desired experiential, demographic, and personal attributes for most boards has grown substantially. Board composition questions are very company-specific, but industry experience, global expertise, and gender diversity will be of particular interest at many companies.

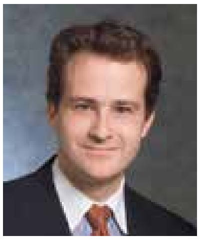
- Shareholder activists have demanded boards bring on more members with industry experience, asserting that industry veterans are better equipped to monitor senior management and the company's competitors. Expect companies to seek this experience in the absence of activist pressure.
- According to Egon Zehnder, international revenue is now 37% of total revenue at S&P 500 companies, up 5.5% since 2008. More than 70% of S&P 500 companies report some international revenue. Foreign nationals and those with significant international work experience—especially in Asia and the Middle East—will be in high demand.
- Broad social and political pressure to improve gender diversity will energize efforts to increase the percentage of board seats held by women (roughly 17%) and the number of companies with three or more women on the board (roughly 23%).

Average board size has remained stable, meaning that boards must create space for directors with new ideas and capabilities. Mandatory retirement ages have historically been one route to refreshment, but they continue to trend older (typically 72-75) and are often rendered toothless by exceptions. Major investors are unlikely to hold US companies to tenure-related independence standards like those found in the UK and France, but I think that investors will pay more attention to individual director and aggregate board tenure.

Rich Fields is a Principal at Tapestry Networks. He leads many of the firm's corporate governance initiatives and leadership networks, engaging with directors of the largest U.S. public companies on topics such as compensation, independent board leadership, audit policy, and board composition. Fields was instrumental in the creation of the Shareholder-Director Exchange and SDX™ Protocol, a practical framework that helps companies and shareholders determine when shareholder-director engagement is appropriate and how to make such engagements more effective. Earlier in his career, Fields was a litigator at Ropes & Gray, where he advised boards on government enforcement and internal investigation matters. He is also the immediate past president and chairman of the board of the Boys & Girls Clubs of Middlesex County.

SULLIVAN & CROMWELL

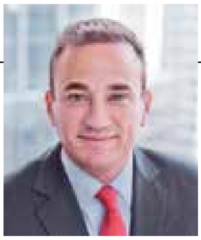
Glen T. Schleyer
Sullivan & Cromwell
Partner



I know that we and others have said this in the past, but there's a good chance that 2015 will be the year that proxy access really starts to gain some traction. This will be the fourth year that shareholders will be permitted under SEC proxy rules to submit proxy access proposals—that is, to propose that companies allow qualifying shareholders to include their own nominees in company proxy statements. In 2012 and 2013, many of these proposals were deemed excludable by the SEC because of drafting errors, and most of those that came to a vote got low support levels. But in 2014, shareholder proponents seemed to have hit upon a successful form of proposal—seeking to give the right to holders of 3% of shares for a 3-year period. This proposal passed most of the time it came to a vote, sometimes by wide margins. We expect to see some private ordering play out in this area in 2015 and beyond, as more companies respond to shareholder proposals by putting forward their own proxy access proposals, with conditions and limitations that the company finds acceptable. In the past few years, we've seen special meeting rights and written consent rights develop in this way, particularly at larger companies. Though proxy access has been a slow grower to date, it seems poised for expansion, and companies should be prepared.

Glen T. Schleyer, a partner in Sullivan & Cromwell's Corporate & Finance Group, advises numerous corporate clients on ongoing public company matters, including SEC reporting, executive compensation, corporate governance, regulatory compliance, and managing shareholder relations and shareholder proposals, as well as a variety of registered and unregistered securities offerings.

Daniel Laddin
CAPartners
Founding Partner



Seamus O'Toole
Semler Brossy
Principal

CAP Compensation Advisory Partners

As scrutiny of executive compensation and corporate governance increases, one of the most significant challenges facing Boards is "going against the grain." Pressure from organizations like Institutional Shareholder Services (ISS) and Glass Lewis has influenced policies on executive compensation to the point where there is increased homogenization of practices, which may not be in the best interest of shareholders. For example:

- Relative Total Shareholder Return has become one of the most prevalent metrics in long-term incentives. However, this has come at the cost of driving line-of-sight and linking equity payouts to successful execution of a company's strategy. While outperforming peer stock performance over the long-term is critical, it may not always be the best metric for incentives, particularly if not balanced with operational or financial indicators of success.
- Stock options have become significantly de-emphasized, in no small part due to ISS's view that they have limited performance linkage. That being said, few vehicles can reward for long-term value creation as well as options. In fact, one could argue that few incentives today provide for a focus of greater than three years versus the 10-year life of options.
- Limitations of the Board to exercise its judgment related to incentive payouts. Shareholder advisory groups never complain when a Board chooses to reduce an award, but what if a Committee has strong reasons to increase a payout? Many Committees feel their hands are tied as upside adjustments are frowned upon, even when they may be warranted.

These are just a few examples where outside pressure is influencing executive compensation, and not always for the better. What is most important is to do what is in the best interest of driving value. If that decision includes something that may be "going against the grain," then the most important thing is for a Board to have a compelling reason for making that decision and communicating it through the CD&A and one-on-one discussions with shareholders.

Dan Laddin is a founding partner of Compensation Advisory Partners LLC (CAP) in New York. He works with Boards and management consulting in all areas of executive compensation, including annual and long-term incentive design, performance measurement, target-setting, regulatory/compliance as well as outside director compensation programs. He has over 15 years of experience working with both private and public companies across industries with a focus in consumer products/services, media, and manufacturing.

SEMLER BROSSY

Now is the time for Boards to take a fresh look at their goal setting approach. At the time this was written, the SEC had not provided final rules on the CEO Pay Ratio or clawback requirements. While these topics will be hot in 2015 if final rules are provided, I view goal setting as potentially a more complicated and pressing issue for many Boards.

Increasingly shareholders and their advisors are scrutinizing the difficulty of goals used in pay programs. The recent acquisition of Incentive Lab by ISS suggests this trend is likely to accelerate and become more analytical. External assessments of goal-setting rigor will play a larger role in Say on Pay votes going forward.

There is uncertainty around exactly what frameworks will be used by shareholder advisory groups to assess goals. But given the contextual nature of goal setting, it is likely they will have limitations. As a result, Boards will face significant pressure to provide expanded disclosure on the topic.

Boards will benefit from proactively scrutinizing their approach before others apply the lens. First, Boards should take a fresh look at their process to ensure it is comprehensive and that the right information is available to guide decisions. Second, Boards should review their disclosure to identify opportunities to provide a fuller picture of the calibration process as well as the Board's analysis of the difficulty of the goals. Boards that don't act now risk being caught flat footed in the future.

Seamus O'Toole, a principal with Semler Brossy Consulting Group, has served as a trusted advisor on compensation and incentive design issues for both public and private companies for over 12 years. Working with companies of all sizes and across industries including technology, financial services, utilities, and retail, he helps clients execute their strategy through appropriate performance measurement and incentive design, including annual and long-term programs. Prior to joining Semler Brossy, O'Toole founded and ran a technology consulting boutique focused on data and process management and customized application development. O'Toole can be reached at sotoole@semlerbrossy.com.

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INTERVIEW WITH CONNIE CURRAN

DeVry | Education Group

Editor's Note: On November 10, 2014, Dr. Connie Curran passed away. In October, she granted this interview to *C-SUITE Insight*. Dr. Curran was an accomplished member and leader of the business community and her contributions and opinions will be missed. We appreciate Dr. Curran's generous and thoughtful participation in this interview for our magazine. We honor her memory and offer condolences to her family and friends.

Dr. Connie Curran was the CEO of Best on Board, a national organization focused on educating and certifying healthcare trustees. She was the founding executive director of C-Change, a national organization focused on the eradication of cancer. C-Change participants included the heads of federal and state governmental agencies, for-profit corporations, the motion picture industry, and nonprofit groups whose missions relate to cancer. There were approximately 150 C-Change participants. Former President George H.W. Bush and Barbara Bush served as co-chairs, with Senator Dianne Feinstein serving as vice chair.

Dr. Curran was the founder, president, and chief executive officer of CurranCare, LLC from 1995 to 2000. CurranCare was a national management and consulting services organization that delivered dynamic leadership to the healthcare industry. Cardinal Health acquired CurranCare and she served as President of Cardinal Health Consulting Services providing leadership to approximately 200 consultants.

Dr. Curran held a variety of executive positions in academic and academic healthcare organizations; she was the Chief Nursing Officer of Montefiore Medical Center in the Bronx, Vice President of the American Hospital Association, and Dean at the Medical College of Wisconsin.

Dr. Curran was also one of the most prolific scholars in the field with more than 200 publications and several research programs to her credit. She served as the director of two of the most comprehensive national studies on staff recruitment, retention, and labor market participation. More recently she co-authored books on hospital-physician integration, hospital redesign, and on optimized home care integration. She served as the editor of Nursing Economics for 18 years. Her most recent book, "Claiming the Corner Office: Executive Leadership Lessons for Nurses," was published in 2013.

She was a graduate of the Harvard Business School program for company owners and presidents. Dr. Curran served on numerous corporate, privately held, and non-profit boards. She was Chairman of the Board of DeVry, Inc. She served on the board of directors for Hospira, Inc., DePaul University, Chicago Lurie Children's Hospital, the University of Wisconsin Foundation, and was the former chairman of the board of Silver Cross Hospital.

C-Suite Insight: You began your career as a registered nurse and subsequently went on to become dean of the School of Nursing at the Medical College of Wisconsin, hold professorships at highly regarded universities, author influential publications, become a successful entrepreneur, and serve on many public and private boards. In your wide array of experiences, what were some of the most valuable?

Curran: The most valuable experiences have been the insights I've gained from others throughout my varied career. I learned at a very early age the value of active listening and taking the time to learn about the needs, concerns, and interests of others. My dad would say that "we have two ears and one mouth for a reason, listen twice as much as you speak." That has held true as a nurse when working with patients, as a dean when working with professors and students, as an entrepreneur, and certainly as a board member.

CSI: How have those experiences shaped your career?

Curran: I have a personal mission around contributing to the quantity and quality of life of patients and caregivers. That mission enabled me to try many new things. Caring for patients, teaching students, developing innovative education programs, creating companies, and participating in governance. A broad personal mission facilitates creativity and professional growth. I have always been involved in a variety of activities and organizations. Whether I was taking classes, teaching classes, or writing, I saw it as an opportunity to improve the quantity and quality of life. DeVry has medical schools, a veterinarian medical school, allied health programs, and 18,000 nursing students. We make an enormous impact on the quantity and quality of life in the USA, Brazil, and around the world. I feel very fortunate to be in an organization like DeVry that is closely aligned with my mission and values.

CSI: Throughout your journey, you have maintained a voice in the healthcare industry. You work to educate healthcare trustees and frequently write and speak about the power of a nurse's skillset in executive positions. In what ways do you bring this passion into the boardroom?

Curran: The passion I bring to board service comes from a focus on accepting only those roles that allow me to align my personal mission and values with the organization, taking the time and making the effort to understand the organization and its constituents, and being an active and engaged board member.

CSI: How do you see governance and leadership evolving as a result of this focus?

Curran: I see governance and leadership evolving from an increased awareness of the importance of understanding varied constituents. In an environment that is increasingly diverse and increasingly global, these audiences are many and varied. It is still the case that many boards are comprised primarily of older white men. I see this changing as more organizations become aware of the value that a variety of voices can bring. There is strength and brilliance in diversity.

"THERE IS **STRENGTH AND BRILLIANCE** IN DIVERSITY."

CSI: Most recently, you were named chair of the board of DeVry. Do you think your unique experience as an educator and leader within this realm gives DeVry an advantage in continuing the vision of education, especially in the healthcare field?

Curran: DeVry has a diverse and dedicated board with varied expertise. We have great financial experts, former CEOs, a former university president, and even a founder. My unique experience combined with the unique experiences of my fellow board members give DeVry an advantage.

Successful boards draw upon the shared contributions of management, executives, and board members whose mission and values align with the organization's and whose passion and perspectives can lead to stimulating discussion that drives insights, innovation, and success.

The fact that I was a tenured full professor and a dean gives me a real world understanding of higher education. I understand the importance of expert and engaged faculty who strive to give students a high-quality education that results in great career opportunities and personal fulfillment.

CSI: The role of a director is seeing increasingly greater demands on time and responsibility. Many individuals are scaling back the number of boards they sit on because of the extra time commitment. Being involved in as many organizations as you are, how have you seen the demands on your time change over the years?

Curran: Yes, the demands have changed, particularly in the nonprofit arena. Years ago, these boards were generally made up of local community leaders and donors. Their presence was often more symbolic than contributory. Today, that is far less the case. This has been driven by necessity—as organizations find themselves in increasingly competitive market environments with increasing regulation and greater risk, they are recognizing the need to ensure that board members come to the table with the right mix of skills, backgrounds, and competencies to serve effectively in these important governance roles.

Corporate boards have also increased their time demands. The average corporate board meets approximately nine times annually. Board preparation often includes understanding international currency, global trends, new and pending regulations, and the operating details to make the correct governance decisions.

CSI: Any keys you can share for dealing with these increased demands?

Curran: In terms of dealing with these increased demands, my advice would be to be selective about those boards you choose to participate on. Your services should be aligned with your own personal mission, values, and passions. This alignment is essential to promote your involvement to invest the required time, energy, and ongoing commitment to the organization and its stakeholders.

CSI: Circling back to the corporate boardroom, what have been the biggest challenges you've faced as a chair of a public company? What have you learned from this role that was different from being a director?

Curran: I believe that minimally corporate governance requires:

- A focus on detail and awareness of the trends affecting the industry.
- The ability to ensure that the company has the right leadership to execute on strategy and deliver on its goals.
- The expertise to maintain the right balance between constituents and the company's management team—protecting the rights and interests of shareholders while also understanding, guiding, and engaging management of the company.

An essential part of my role as chair is to ensure that we successfully address these requirements. The issue of maintaining a balance between constituents, management, shareholders, and regulators is very consuming. As chair of DeVry Group, I have developed both a more global view and a more micro view. I have worked to understand the risks and strengths in each of our subsidiary schools and to meet their board members and executives. We have several campuses in Brazil, and by spending time in Brazil, I was better able to understand how we can help them and how we can learn from Brazil's leaders, students, regulators, and culture.

Being chair requires a great deal more time. I work with each of the committee chairs, spend time with faculty and staff, and work closely with the CEO to align our work with the strategic plan. We have implemented a rigorous board evaluation and development process to create and implement best governance practices.

CSI: Every year brings new challenges for organizations. What specific challenges do you foresee facing any of the organizations you are a part of now?

Curran: DeVry is a diverse, international organization and consequently faces an ever-changing regulatory environment. It's crucial that we keep up with new regulations—state, federal, and international—and maintain our already strong compliance and auditing program. There is also greater competition. DeVry Group is nimble and often first to market with new ideas, academic offerings, and innovative educational approaches, but public sector and independent schools are adopting our approaches and catching up. Many are now online, competing in the same space. We need to maintain our innovation edge and constantly be seeking new ways to increase student access and success, employee satisfaction, and shareholder value.

CSI: As with every proxy season, there are likely to be certain hot-button issues that arise this year. What compensation and governance issues do you see becoming more important in 2015?

Curran: Over the past several years, particularly since the enactment of Dodd-Frank Act in 2010, there has been an increased interest in corporate governance. Since the adoption of the "Say on Pay" provision of Dodd-Frank, executive compensation has been of particular focus. An investor is challenged with understanding the intricacies of a company's philosophy on executive compensation by reading the proxy and is also influenced by firms like ISS and Glass Lewis, which provide guidance on voting but don't always consider the company's particular situation and competitive dynamics.

Other areas of focus recently are the separation of the chairman and CEO roles, declassified boards and clawbacks, to name a few, but I believe that the major area will continue to be executive compensation.

CSI: Do you see anything specific to the healthcare or education industries?

Curran: Both healthcare and education are confronting similar issues related to declining budgets in environments of increasing demand, growing risks, and heightened scrutiny from a variety of sources. Quality and safety are critical areas of focus for any organization, but obviously both healthcare and education are particularly impacted in these areas.

CSI: Any last words of advice for us?

Curran: Corporations must be able to quickly identify both challenges and opportunities—and respond to them nimbly and appropriately. This requires decisive, but informed and calculated, action.

It is essential to keep the lines of communication open with key stakeholders and to be committed to active listening and learning across a variety of diverse audiences. C

"BE SELECTIVE ABOUT THOSE BOARDS YOU CHOOSE TO PARTICIPATE ON. YOUR SERVICES SHOULD BE **ALIGNED WITH YOUR OWN PERSONAL MISSION, VALUES, AND PASSIONS.**"

INTERVIEW WITH **GRETCHEN MORGENSON**

The New York Times

Gretchen Morgenson is assistant business and financial editor and a columnist at *The New York Times*. She has covered the world financial markets for *The Times* since May 1998 and won the Pulitzer Prize in 2002 for her "trenchant and incisive" coverage of Wall Street.

Morgenson began her career in 1976 upon graduation from St. Olaf College in Northfield, Minnesota. She joined *Vogue* magazine as an editorial assistant and began writing the personal finance column for the magazine several years later.

In 1981 she became a stockbroker, a job she held for three years. Morgenson joined *Money* magazine as a staff writer in 1984 and moved to *Forbes* in 1986. In September 1995 she became national press secretary to Steve Forbes when he ran for President of the United States. When Mr. Forbes withdrew from the race in March 1996, she returned to writing and editing at *Forbes*. She was named assistant managing editor at the magazine in September 1997. She joined *The Times* eight months later.

Morgenson is co-author, with Joshua Rosner, of "Reckless Endangerment," a *New York Times* bestseller about the origins of the 2008 financial crisis published in May 2011 by Times Books.

She has won two Gerald Loeb Awards, one in 2009 for her coverage of Wall Street and another in 2002 for excellence in financial commentary. Morgenson has also served on two Pulitzer Prize juries, evaluating investigative reporting entries in 2009 and 2010.

Morgenson lives in New York City with her husband and son.

"DODD-FRANK HAS BEEN **SOMETHING OF A DUD** AS FAR AS GOVERNANCE IS CONCERNED."

C-Suite Insight: **In 2002 you received the Pulitzer Prize for Beat Reporting, and in 2009 *The Nation* named you "The Most Important Financial Journalist of Her Generation." As an aspiring journalist, did you envision yourself pursuing a career in business reporting and reaching this level of success?**

Morgenson: When I was at St. Olaf College in the 1970s studying English, I wanted to become a political reporter. This was the era of Watergate, and naturally, I thought it would be cool to follow in the footsteps of Carl Bernstein and Bob Woodward.

Now, however, I'm grateful that I took another path—business reporting. Covering finance and business is so much cleaner than political reporting because you can rely on reams of public documents that must be filed by public companies. Political reporters often have to rely on the kindness of sources who have an ax to grind, but financial reporters do not.

CSI: **Your career began as an editorial assistant at *Vogue* magazine where you later became a writer and financial columnist. What did you learn from some of your early experiences that helped you in the path of financial journalism?**

Morgenson: Throughout college, I had read *The Wall Street Journal* and was interested in finance. But I never took an economics class. Instead, I went to work as a stockbroker at Dean Witter in NYC in 1981. It was there that I received a rock solid grounding in finance as well as an understanding of the ways of Wall Street. When I left The Street in 1984, I had a grasp of finance and capital markets that was kind of unusual among journalists back then.

Starting out as a secretary at *Vogue* magazine right out of college was not my idea of a path to journalism success. But in that menial job I learned a lot about New York (I had come from the Midwest) and met some fascinating people. There was a lot not to like about the day-to-day—including working with some tyrannical people. But you can learn a great deal from bad experiences. Like how not to manage people!

CSI: **In a recent article for *The New York Times* entitled, "An Open Window for Insider Sales," you wrote about a study out of the Haas School of Business at the University of California that found that insider trading peaks for companies with revenue recognition issues during the five days between when the SEC begins its Dodd-Frank-mandated review of a company's filings and when the comment letters regarding this review are made public. Insider trading has been a big topic over the years, but despite all the new regulations, it's still a concern. What more do you think needs to be done to level the playing field for investors?**

Morgenson: Yes, insider trading has been a huge topic over the years, and I am still astounded by the numbers of people who think they won't get caught doing it. The SEC and the Justice Department have both been very aggressive bringing cases in this area, and that's fine. I am not among those who believe that insider trading is a victimless crime.

That said, insider traders did not bring about the financial crisis of 2008. And yet cases against key figures in the crisis have not been forthcoming. I wish law enforcers had brought a wider array of cases focusing on the behavior that brought on the crisis. And I wish they had filed cases against individuals rather than corporations. Third wish: that their cases against corporations required top executives or inert directors to pay fines out of their own pockets.

"DIRECTORS AT MANY COMPANIES STILL SEEM TO BE **BEHOLDEN TO THE EXECUTIVES** THEY ARE SUPPOSED TO MONITOR."

"BOARDS ARE ALSO TOO HOMOGENEOUS— WE NEED MORE DIVERSITY ON BOARDS."

CSI: As was mentioned in the previous question, the Dodd-Frank law has changed how companies operate. In your opinion, what impact has the Dodd-Frank law had on corporate governance?

Morgenson: Dodd-Frank hasn't really had a huge impact on corporate governance. Proxy access is a good example—shareholders are still unable to unseat directors easily; expensive proxy fights are still required to remove directors. Moreover, many rules required by Dodd-Frank have not yet been written or implemented. For example, an important rule that would have given regulators more power to claw back executive pay in cases of earnings restatements has not been written. So Dodd-Frank has been something of a dud as far as governance is concerned.

CSI: In your experience as an investigative business writer at *Forbes* magazine and editor/columnist for *The New York Times* as well as many other renowned publications, what do you see as the emerging or changing trends related to corporate governance?

Morgenson: The emerging trends related to corporate governance are the same as they ever were. A big one involves inert institutional shareholders. These are the large mutual fund managers who do nothing to force boards to act in their investors' best interests, who do little to rein in ludicrous executive compensation at companies, and generally refuse to hold executives and directors accountable for their misdeeds or breaches of duty. These failings are unfortunate because directors at many companies still seem to be beholden to the executives they are supposed to monitor.

Even now, corporate boardrooms are exceedingly clubby places, and this creates situations where shareholders can be easily victimized by me-first executives. Boards are also too homogeneous—we need more diversity on boards, and that's been a problem forever.

Executive pay remains a hot issue and one that is, of course, related to passive institutional investors.

Speaking more broadly, in spite of the general view that an ownership society is good for America, we still operate in an environment where the hired help (executives) can run roughshod over the owners (the shareholders). This dynamic is unacceptable, although it shows no sign of change. Entrenched managers have a way of keeping themselves entrenched.

CSI: In response to the recent recession, companies are presented with the challenge of creating more transparency between executives, directors, and shareholders. Clearly, as a business journalist, your career is largely based around providing information to the public. In what ways do you think communication between company leaders and the public can still be improved? Are there particular areas or topics that are harder than others to uncover as a journalist?

Morgenson: In spite of the obvious need for transparency in corporate America, there is less transparency today than there was in the past, I believe. Companies hire phalanxes of spinmeisters to ensure that the truth doesn't get out. Even though this has always been the case, they seem to be more aggressive now than they used to be.

The way companies respond to journalists' questions is an example of how corporations control the dialogue. In the old days, reporters typically interviewed company employees either in person or on the phone, which meant that journalists were free to ask follow-up questions or take the dialogue in a direction that may have been unpredictable. Now, interviews are done via email, which shuts down the potential for pursuing an angle that came up in the interview. Email exchanges are much more proscribed and narrow, and that makes it harder for reporters to get to the bottom of things.

During the years leading up to the financial crisis, I also saw some companies become extremely combative. One example involved Countrywide Financial, the toxic subprime lender whose predatory loans created so many problems for its acquirer, Bank of America. One day in 2007, after a lengthy phone interview with the company's head of servicing, Countrywide officials quickly transcribed the call and posted it on their website.

They had not advised me that they would be taping the call. It didn't matter because I had simply asked questions that any interested journalist would about their operations. But Countrywide clearly was trying to intimidate me or embarrass me or get out in front of my article by secretly taping the interview and posting it online.

I am still amazed at the lengths to which companies will go to hide the truth. They don't seem to understand that (a) people will probably find out sooner or later and (b) it's better to be truthful than evasive.

As a journalist covering Wall Street and corporate America, I've encountered my share of brick walls. But it was when the 2008 financial crisis moved from Wall Street to Washington that I learned how hard it is to get information out of the government. Penetrating the fog machine in D.C. made cracking the Wall Street codes seem like child's play.

CSI: Could you share one of these experiences?

Morgenson: *The Times* was trying to understand how many home loan modifications the United States Treasury's initial program had generated. The Treasury had trumpeted the program as a monumental effort to help Main Street after bailing out Wall Street. But after weeks of trying, we couldn't get a straight answer on the number of loan mods created under the program.

That's because there weren't many, of course. But it was a great example of how much more secretive the government is than Wall Street or corporate America.

CSI: As an investigative journalist, you broke a number of stories regarding financial malfeasances, including a piece on the anti-investor practices on the NASDAQ stock market that led to further investigation by the Justice Department and the SEC. Without scooping yourself, what other areas are you interested in writing about? What do you think is the next area of focus for the DOJ regarding corporate misbehavior?

Morgenson: It's hard to predict where my work will take me. I try to see the big story that is coming around the corner, but that's not always possible. In the meantime, I try to connect the dots to help people understand how certain actions or news events are related, even though they might appear to be completely unconnected. Generally, I am interested in shining the light on the dark corners, whether at public companies or among investment firms or regulators.

As regards your question about the Department of Justice, unfortunately, I don't think it really has an area of focus regarding corporate misbehavior.

"WE STILL OPERATE IN AN ENVIRONMENT WHERE THE HIRED HELP (EXECUTIVES) **CAN RUN ROUGHSHOD** OVER THE OWNERS (THE SHAREHOLDERS)."

CSI: What do you think will be the most important topics of the upcoming year? What do you think the public should be better informed about regarding corporations and investors?

Morgenson: Important topics for the coming year may sound all too familiar: the ongoing problem of too-big-to-fail banks; underfunded pensions; outsized executive pay. Unfortunately, until some real reform takes place in all these areas, they are going to continue to be hot news topics. C

INTERVIEW WITH **HOLLY GREGORY**

Holly J. Gregory is a partner in Sidley's New York office, and is co-head of the firm's global Corporate Governance and Executive Compensation practice. Gregory counsels clients on the full range of governance issues, including fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership structures, special committee investigations, board audits and self-evaluation processes, shareholder initiatives, proxy contests, relationships with shareholders and proxy advisory firms, compliance with legislative, regulatory and listing rule requirements, and governance "best practice."

Gregory played a key role in drafting the OECD Principles of Corporate Governance and has advised the Internal Market Directorate of the European Commission on corporate governance regulation, and the joint OECD/World Bank Global Corporate Governance Forum on governance policy for developing and emerging markets. She also drafted the NACD Key Agreed Principles of Corporate Governance. In addition to her legal practice and policy efforts, she has lectured extensively on governance topics and was recently appointed to a three-year term as Chair of the Corporate Governance Committee of the ABA's Business Law Section.

In addition to her legal practice and policy efforts, she has lectured extensively on governance topics, including at events in Europe and Asia sponsored by the U.S. State Department, International Corporate Governance Network (ICGN), The Conference Board, National Association of Corporate Directors (NACD), Association of Corporate Counsel, Society of Corporate Secretaries & Governance Professionals, and Institutional Shareholder Services (ISS). The author of numerous articles on governance topics, she writes the governance column for *Practical Law: The Journal.*

"COMPANY ENGAGEMENT WITH SHAREHOLDERS HAS PROVEN TO BE AN **EFFECTIVE DEVICE FOR RELEASING TENSIONS WITH SHAREHOLDERS.**"

C-Suite Insight: As co-head of a corporate governance group at a top law firm, you've counseled clients on issues relating to compliance and governance practices. You have also seen firsthand the changes brought forth by Dodd-Frank. What has been the most impactful rule change?

Gregory: For rank-and-file public companies outside the financial services industry, the shareholders' advisory vote on executive compensation has had the most significant impact on governance. That non-binding vote has resulted in much more attention to shareholder engagement and to aspects of compensation plans as companies seek to understand what drives shareholder decisions and strive to construct pay to avoid a growing list of red flags with the proxy advisors who influence institutional shareholder voting.

In turn, company engagement with shareholders has proven to be an effective device for releasing tensions with shareholders in certain situations. Much has been written about shareholder engagement since Say on Pay went into effect in 2011. Engagement efforts are driven by a host of factors including concerns about shareholder votes on Say on Pay and other proposals, and activist efforts. A recent study by the Investor Responsibility Research Center Institute and Institutional Shareholder Services Inc. determined that since Say on Pay was instituted, shareholder engagement efforts have increased by more 50 percent. More than two-thirds of Russell 3000 companies disclosed some form of engagement with their investors.

CSI: What other issues do your clients face from this regulation?

Gregory: Another key provision that has had a significant impact on public companies is the Securities and Exchange Commission's (SEC) whistleblower bounty program. Under this program, a whistleblower can receive significant payment from the SEC for reporting concerns of wrongdoing. The Dodd-Frank Act gave the SEC authority to pay large cash bounties to whistleblowers who provide original information leading to a successful SEC enforcement action. The SEC is required to award such persons between 10 and 30 percent of monetary sanctions, exceeding $1 million received by the SEC, the Department of Justice, or other regulatory agencies in related enforcement actions.

Concerns about increased whistleblower activity as well as the need to avoid any retaliation for such activity has caused greater attention to compliance and reporting systems within companies, including enhanced attention to employee education regarding compliance and ethics, increased focus on professional development and reporting lines of compliance personnel, and more active board oversight of compliance, ethics, and internal reporting systems.

CSI: In general, how has the response to corporate governance changed since the introduction of Dodd-Frank?

Gregory: The Dodd-Frank Act, signed into law in 2010 in reaction to the financial crisis, required rule making by a number of federal agencies including the Securities and Exchange Commission. While many of the provisions targeted the financial services industry, the SEC was instructed to adopt a number of regulations that broadly impact publicly traded companies outside that industry as well. These include shareholder advisory votes on executive compensation (Say on Pay), compensation committee and adviser independence, development and disclosure of incentive and compensation clawback policy, and enhanced whistleblower incentives and protections. Moreover it has impacted the disclosure of board leadership, relationships between pay and performance, and the ratio of median compensation to CEO compensation.

Some rules have yet to be fully adopted, including those on disclosure of pay ratios, pay-for-performance, clawback policies, and hedging by employees and director.

CSI: Relating to Dodd-Frank, an issue on the minds of many is the disclosure of CEO pay ratios. The SEC put off proposing rules for several years, and delayed finalizing the rule for over a year. Could you clarify what this rule would entail for the SEC?

Gregory: The Dodd-Frank Act (§ 953(b)) requires the SEC issue rules mandating companies to disclose the ratio of the median of the annual total compensation of all the company's employees except the CEO to the annual total compensation of the CEO. The SEC has proposed—but not yet adopted—these rules.

CSI: As there is no "standard" for this type of disclosure, what sort of hurdles does the SEC face in setting guidelines for corporate issuers to disclose this information?

Gregory: The challenge for the SEC is to provide workable rules from both a company and investor perspective that can withstand legal challenge. The potential burden on companies and the value of this information to investors must be considered and there are legitimate concerns about both. The SEC is faced with the particular challenge of providing clarity around how a company is to determine the median—or midpoint—for compensation in the range of its employees and to determine who must be included as an "employee," for example, whether to require inclusion of part-time, leased, and foreign employees, and at what point in time.

"THE CHALLENGE FOR THE SEC IS TO **PROVIDE WORKABLE RULES** FROM BOTH A COMPANY AND INVESTOR PERSPECTIVE."

CSI: Corporations have sighted numerous issues with the rule. What have you seen as the most common or biggest problem posed by the pay ratio rule?

Gregory: A number of legitimate concerns have been expressed about the burden that this disclosure will place on companies and whether this information is likely to provide meaningful information to investors. Some investors have argued that the pay ratio data will provide the ability to compare practices among companies, and to look at how a particular company's practices change over time. However, concerns have been voiced about the potential for pay ratio information to provide incomplete and therefore misleading information. The pay ratio will not provide information about the unique conditions that impact the ratio. These include aspects such as business structure, mix of employee skill sets (for example the proportion of highly skilled versus lower skilled workers), geographic mix, reliance on outsourcing, and other industry practices and market and industry conditions.

CSI: In response to calls from the SEC and investors, disclosure in proxies and other SEC documents has seen a change over the last several years from legal, and sometimes opaque language, to clearer and more "plain English" descriptions. What other changes are you seeing in proxy disclosures?

Gregory: As a key disclosure document that must strictly comply with an ever-expanding array of SEC rules, the typical proxy statement can be a dense read even in plain English. In the last several years, companies have explored ways to improve their proxy statements. These include letters from the Board and CEO summarizing key highlights, summaries at the outset of important information related to voting issues, and summaries throughout particularly lengthy sections. They may incorporate the CD&A, user-friendly graphics and charts, director skill matrices, and electronic navigation tools for online readers.

From a content perspective, companies are taking greater efforts to place their governance and compensation decisions in context, and to describe the rationales of decisions that may draw shareholder concern. For example, there is more effort in discussing how a company has engaged with shareholders and responded to a low Say on Pay vote or a high vote on a shareholder proposal that the Board opposed.

While anything to improve readability of proxy statements has value, the sheer amount of information that must be covered may itself be the central problem in the usability of the information.

CSI: You follow events in the international arena, and advise clients on these trends. What do

you see as the major governance developments in foreign markets that may have implications in the United States?

Gregory: Governance practices and rules that develop in Europe and elsewhere can migrate to the U.S. through investor expectations and regulatory approaches. The advisory vote on executive compensation is a good example. Currently in Europe, there are several developments to watch that could migrate to the U.S. in the next decade.

In the UK and other parts of Europe, shareholders have been granted binding Say on Pay. Shareholders have a binding vote on the compensation policy of the company, and if the company does not receive support for the compensation approach, the company must change the approach.

Last year in Switzerland, there was an effort to impose through a constitutional amendment to a cap executive compensation at no more than 12 times worker pay. The electorate rejected the effort, but concerns about pay disparity continue to be voiced in parts of Europe as a potential topic of regulation.

Many parts of Europe have adopted gender quotas for their corporate boards.

CSI: What governance issues do you foresee making their way to the forefront this upcoming year? What do you think will be most important in 2015?

Gregory: Changes in investor power and expectations regarding governance over the past 15 years have influenced, and will continue to influence, governance reform through SEC regulations, listing rules, and voluntary corporate action. As companies begin to prepare for the 2015 proxy season, they should be mindful of the priority items on the wish list of key institutional investors for further governance reform. Efforts to improve the link between executive compensation and performance, eliminate staggered boards and poison pills, and expand shareholder ability to call meetings and act by written consent, are likely to continue. However, the priorities for regulatory and voluntary governance reforms now focus on investor rights in director elections, and the quality of board composition.

Expect public pension funds to continue to press for more meaningful ability to nominate and elect directors. Examples include the imposition of listing rules to require majority voting in director elections, renewed calls for the SEC to adopt proxy access rules through listing rules to prohibit dual class registration (one share/one vote), and through SEC allowance of universal proxy cards that list all director nominees in contested elections.

Board succession and refreshment are on the priority list of institutional investors as areas for voluntary corporate action. This is due to rising concerns about whether board composition is adequately addressing industry sector knowledge needs, low board turnover rates, and slow improvement on board gender diversity.

In terms of shareholder proposals for 2015, the emphasis on expanding shareholder rights will likely continue to focus on eliminating supermajority provisions to amend by-laws, annual election of directors (board declassification), and majority voting in the election of directors. Other expansions may include the ability of shareholders to call special meetings, ability of shareholders to act by written consent, and proxy access.

In the governance area, companies should expect shareholder proposals on the separation of chair and CEO and limiting the tenure of directors.

In the social and environmental areas, companies should expect shareholder proposals on political contributions and lobbying, environmental sustainability and risks, human rights policies and impacts, and board diversity.

On the shareholder activist front, 2015 is likely to continue to be a year of active efforts by hedge fund activists to influence, and at times, take control of companies through efforts to seat directors on the board. The number of actual proxy fights is unlikely to reach the high levels seen in 2008 and 2009, but largely because companies are now more likely to engage in negotiations that result in concessions.

Overall, boards will continue to feel the pressures of expanding shareholder expectations, and will be challenged in considering the range of viewpoints and interests while applying their own objective fiduciary judgment to the issues at hand. C

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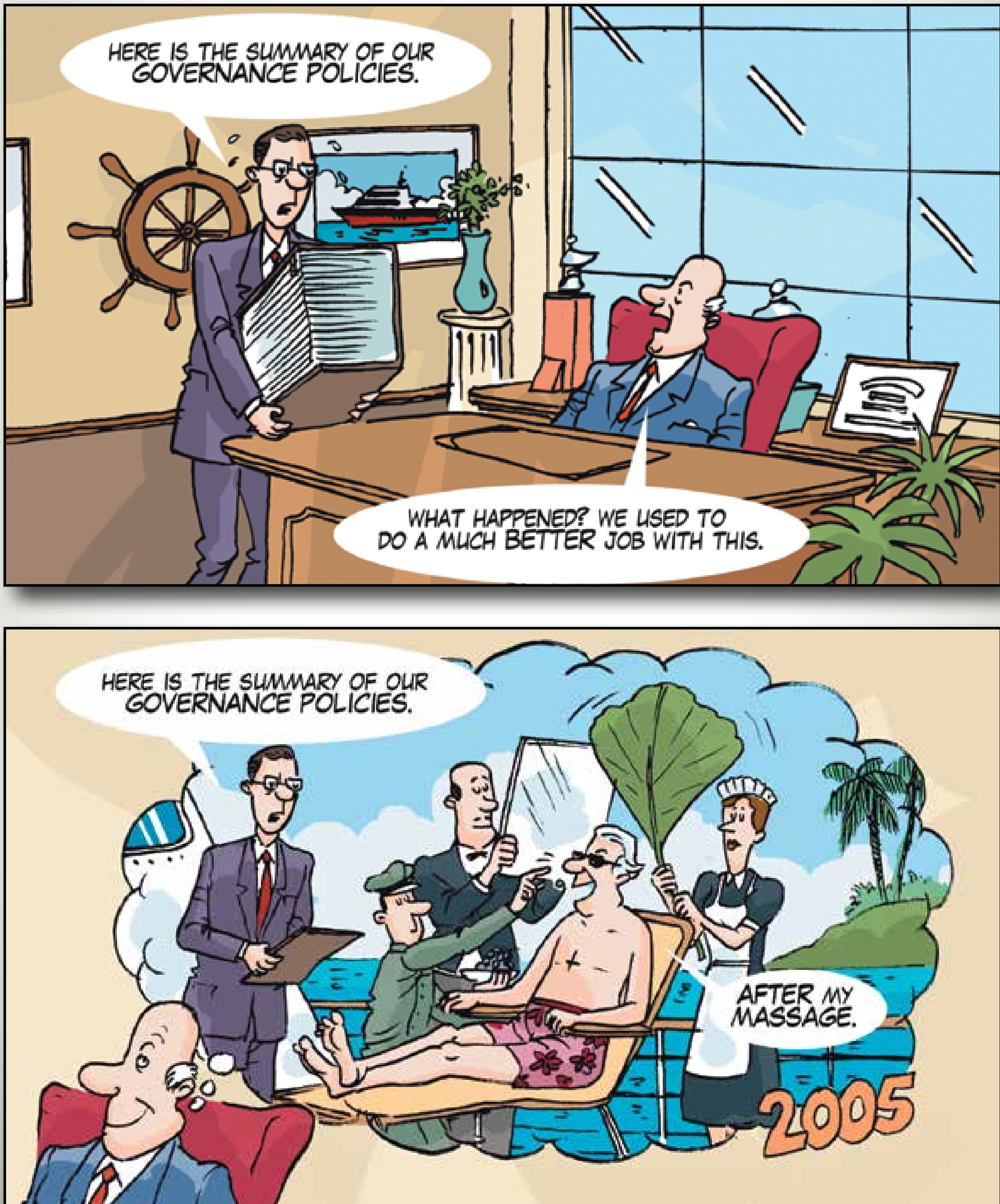

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Issue 16 2015